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Using Insolvency Tools While Facing Economic Challenges

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Although economic indicators, including GDP and unemployment numbers, look shockingly similar to, and worse than seen during historic downturns, it should be remembered that today's numbers result from, what some have referred to as, a "self-induced economic coma" and first arose when the economy was fundamentally robustly healthy. Not the usual situation.

Business bankruptcies, receiverships, assignments, insolvencies, and the like, normally result from industry/business-specific issues, economic recessions and depressions or physical catastrophes, natural and man-made. In a sense that is what many businesses face now. Moreover, banks and other creditors, vendors, and landlords are obviously impacted.

That is why it is reasonable to approach these challenges with creative solutions and an expectation that cooperation among the competing interests is in everyone's best interests. If a business was fundamentally sound going into this Covid-19 epoch there are many responses to the new challenges.

The Federal Bankruptcy Code includes two primary tools for business: Chapter 7 for Liquidation Under Supervision of a Trustee and Chapter 11 for Reorganization or Sale of a Business, with the debtor normally remaining in possession. As reported in recent Cullen and Dykman legal alerts, there is now a new Subchapter V provision providing for Small Business Reorganization which should be more efficient and less expensive, assuming the business qualifies. Federal bankruptcy law is especially useful when one needs the power of the Courts to deal with recalcitrant creditors, escaping onerous contracts, and otherwise dealing with contentious issues.

However, State Laws also provide methods to confront insolvency challenges. In some states, it is popular to use the assignment for the benefit of creditors or receiverships approach. Advantages include being able to choose who will perform the "trustee" role. These generally may be less complex and expensive than using federal bankruptcy law.

Outside of statutory solutions, and especially because of shared pain under the current circumstances, voluntary, out of court, workouts and liquidations are possible. These include Forbearance Agreements between creditors and debtors, especially useful with secured debt, and Trust Mortgage Agreements which are modeled on the Bankruptcy Code and use its priorities waterfall in the design of a distribution plan for creditors.

Creditors and small and medium-sized business should take comfort from the fact that there are a variety of useful strategies, plus governmental programs, and a shared spirit of self-preservation which will make the recovery process more quickly and less painful then has been experienced by prior generations confronting economic recessions, panics and even depressions.

Consulting legal and financial advisory services to review options is the next step.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Michael Traison at 312.860.4230

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