MEMORANDUM TO CLIENTS AS TO WHAT THEY NEED TO KNOW BEFORE FILING A CHAPTER 11 CASE

Filing a Chapter 11 case may be the only alternative to prevent the termination of a company's business when it is in serious financial trouble. Chapter 11 may enable a business to reorganize its financial affairs and to continue its business operation. While operating in a Chapter 11 case, a business may be able to lower its monthly payments for secured debts, terminate unprofitable leases or contracts, pay back taxes over time and emerge from bankruptcy by paying unsecured creditors a significantly lower amount of what is owed.

However, before considering filing a Chapter 11 case a company needs to be aware of its administrative responsibilities in the weeks and months before and after a Chapter 11 case filing. Knowing what to expect, preparing for the necessary information gathering, budgeting and knowing the fiduciary duties under Chapter 11 can make the process less difficult and enable the business to balance those obligations with everyday demands of running the business.

INFORMATION GATHERING

Some of the forms that are required to be filed at, or shortly after, the filing of the bankruptcy case are lists of assets and liabilities, a statement of financial affairs and a list of contracts, and documents providing the company's recent financial history and financial condition at the outset of the case.

In order to streamline the process, the company’s owners and key employees should identify the individuals with the greatest knowledge of the business’ operations and finances to work closely with us and organizing information into a format that can be submitted to the Bankruptcy Court.

Information gathering is critical because the material provided will be scrutinized by the Bankruptcy Court, the company’s creditors and the U.S. Trustee’s Office (a division of the Federal Government charge which monitors bankruptcy filings).

BUDGETING

Management should always maintain periodic budgets of the company’s necessary operating expenses. Once a company files for bankruptcy, a budget containing its ordinary and necessary expenses becomes critical if there are any creditors that have liens on the company’s cash, because the company often needs a secured creditor’s consent to use its cash operate the business. The company’s spending will be subject to heightened scrutiny in Chapter 11 proceedings, and therefore it should take measures to ensure each and every expense is necessary for business operations. For example, although it is quite common for a company to pay for its owners’ personal expenses from business funds, this type of spending must be avoided when the company is in Chapter 11 proceedings.

The company should periodically compare the budget’s predicted expenses to the actual expenses to make sure the budget is being followed, and closely monitor the bookkeeping so that every expense is actually recorded. Proper labeling and recording of expenses will allow you evaluate whether particular expenses are truly necessary for business operations or can be cut.

FIDUCIARY DUTIES

When a Chapter 11 case is filed, the current management team remains in place and the company holds its assets and operates the business for the benefit of creditors and equity interest holders. In particular, directors and management are obligated to preserve the assets of the business and otherwise act consistent with the interest of creditors. The company remains in control of the business operations until the conclusion of the case, unless management fails to fulfill its fiduciary duties in operating the business. The U.S. Trustee's Office and any interested party may seek the appointment of a Chapter 11 trustee if there are grounds to suspect the company's leadership participated in actual fraud, dishonesty or mismanagement. If a Chapter 11 trustee is appointed, current management losses control of the business operations and the trustee takes over. To avoid this situation, the company should understand its fiduciary duties once in Chapter 11 proceedings and follow them to ensure them it maintains control of the business operations throughout the Chapter 11 case.

The owners of a failing business entering Chapter 11 have to find a way to balance the demands of operating their business with the administration of the Chapter 11 case. Information gathering, meetings with bankruptcy counsel and the U.S. Trustee’s Office, any appointed Creditors’ Committee, monitoring operations to ensure Chapter 11 Plan requirements and attending court hearings or take up a significant amount of time especially at the outset of the filing. Delegating administrative and operational responsibilities to key employees can help to alleviate some of the time demand pressures the business owners face while in bankruptcy.