

1. What is bankruptcy?

Bankruptcy is a federal, legal process designed to give financially distressed individuals and companies a way to either restructure or “discharge” their debt in order to move forward with a fresh start unhampered by the debt burden.

2. Will filing for bankruptcy allow me to simply walk away from my debt and start over?

It will allow you in certain circumstances to start over, but the extent to which creditors must be paid will differ according to whether relief is under Chapter 7, 11 or 13 of the Bankruptcy Code.

3. If I decide to file for bankruptcy, what are my options?

There are multiple options, depending on the nature of your business, your financial circumstances, degree of debt and your ultimate goal, *i.e.*, closing up shop or remaining a going concern. While all of the options have benefits for small business owners, none comes without drawbacks. There are eligibility requirements for each type of bankruptcy filing that must be satisfied and costs, which may be substantial, depending on the type of filing. For small business owners, Chapter 7 or Chapter 11 is, generally, the avenue of choice. Chapter 13 is an option, but only if you’re filing as an individual (sole proprietor).

4. What is the difference between Chapter 7, Chapter 11 and Chapter 13?

Under a Chapter 7 *business* bankruptcy, the assumption is that you intend to liquidate your company’s assets and shutter your business for good. When a Chapter 7 petition is filed, a trustee is appointed with broad authority to sell off the non-exempt assets to satisfy your creditors. The trustee effectively steps into the shoes of the debtor.

Benefits:

- To the extent that the trustee can sell assets sufficient to pay off your creditors, the benefit is that many of your outstanding debts will be satisfied.
- An individual Chapter 7 debtor (but not a business entity Chapter 7 debtor) will receive a discharge and be relieved of the obligation to pay most remaining debts.

Drawbacks:

- The trustee controls the process once the filing is submitted, and the debtor has no further role.
- There are costs involved in a Chapter 7 filing, including filing and attorney fees, which may be substantial over the course of the process.
- Personal guarantees will not be discharged if a business entity files for bankruptcy under Chapter 7 (or Chapter 11). To discharge personal liability for the business debts, you will need to file for *personal* bankruptcy under Chapter 7, or negotiate a settlement with your creditors.

A filing under Chapter 11 assumes that you would like your business to continue as a going concern through the restructuring of outstanding debt. There are multiple advantages to this option, beginning with the recent changes to the Chapter 11 bankruptcy process under the Small Business Reorganization Act of 2019 (“SBRA”), which created a new SubChapter V specifically for small business owners in financial distress.

Benefits:

- Although a trustee is appointed under SBRA to “facilitate the development of a consensual plan of reorganization,” absent fraud or inability of the small business debtor to perform his/her obligations under SBRA, the debtor remains in control of the process, including filings of financial documentation and reports with the bankruptcy court, attending mandatory conferences, and developing a plan of reorganization.
- SBRA distinguishes between a consensual plan of reorganization and a “cramdown” (non-consensual). The type of plan confirmed by the Bankruptcy Court will impact (1) the timing of discharge and payment of administrative claims, (2) the trustee’s term of service, and (3) the debtor’s ability to modify the plan post-confirmation.
- Only the debtor – not creditors – can file the reorganization plan.
- Reduced costs.

Drawbacks:

- Eligibility for filing under SBRA is limited to a relatively narrow group of small business debtors – those with a total debt limit of \$7,500,000, a debt limit that will reset to \$2,725,625 beginning March 27, 2021.
- The debtor is in control of the process, which means he/she must be prepared to assume the responsibilities required of the process, including filings, reports with the bankruptcy court, participation in mandatory conferences, and development of a plan of reorganization.
- The timeframe for a small business debtor to file a plan is reduced to 90 days from 180, with a 90-day extension permitted only under circumstances beyond the debtor’s control.
- Trustee oversight is required.

Parties filing for individual bankruptcy may do so under Chapter 13, commonly called a “wage earner” bankruptcy. This may be an option if you do not want to liquidate your assets, but need debt relief. Chapter 13 assumes that debtors have a regular income and sufficient funds to pay at least some of their debts through a monthly repayment plan.

Benefits:

- You can stop foreclosure proceedings and potentially keep your property.
- Eliminates qualified debt through a repayment plan over a three to five year period.
- You’ll be able to catch up on missed mortgage, car, and non-dischargeable priority debt payments over time
- Once you’ve completed the repayment plan, your debt is discharged.

Drawbacks:

- Only individuals (including self-employed individuals or those operating an unincorporated business) are eligible to file
- You cannot have more than \$419,275 of unsecured debt or \$1,257,850 of secured debt. These amounts will be reset in 2022.
- Under this Chapter, a trustee will be appointed to evaluate your case and serves as a disbursing agent. Debtors are required to propose a repayment plan under which they’ll pay creditors through the trustee in installments over three to five years. You will be required to contribute all of your “disposable net income” to payments under your plan for the entire term of the plan.

- You cannot file for bankruptcy under Chapter 13 or any other Chapter of the Bankruptcy Code unless you have received credit counseling from an approved credit counseling agency either in an individual or group briefing within 180 days before filing, but this can be done by a relatively simple on-line process.

5. How long will the process take?

Depending on the type and complexity of the filing, the process may take anywhere from 3 to 4 months to several years.

6. What will a bankruptcy cost?

The total costs for bankruptcy, depending on the type of filing, can run from a few hundred dollars to several thousand dollars (or more), including filing fees (\$338 for Chapter 7; \$235 case filing fee; a \$78 administrative fee for Chapter 13, and \$1,738 for Chapter 11), attorney and credit counseling fees, among others.

7. Are there any out-of-court options that will allow me to avoid filing for bankruptcy?

If your creditors are open to it, you may be able to negotiate a consensual out-of-court workout, *i.e.*, restructuring, to resolve your debt obligations. There are advantages to this option, including potentially fewer transaction costs, speed of implementation, and it may be less disruptive to operations.

8. Will there be any post-bankruptcy impact on me or my business?

While you may wish to keep your bankruptcy filing private, bankruptcy cases are a matter of public record. In the case of a Chapter 13 bankruptcy, the trustee may notify your employer if payments are made through a payroll deduction and, if your creditors include family or friends, they will also receive notice. Bankruptcy will remain on your credit report for 7 to 10 years and will likely impact your ability to open credit card accounts or get approval for a loan with favorable rates.

9. Does bankruptcy provide any protections going forward for businesses that have filed for bankruptcy?

Yes, under provisions of the Bankruptcy Code most forms of post-bankruptcy discrimination by the government and by private employers are prohibited. The government cannot, for example, use your bankruptcy to deny or terminate your employment or public benefits. Private employers, or other private entities, also may not terminate your employment or otherwise engage in discriminatory behavior toward you simply because you filed for bankruptcy. Under the Fair Credit Reporting Act, credit agencies may not report a bankruptcy case after ten years.

10. Where do I go from here?

Before you consider filing for bankruptcy, speak with an experienced bankruptcy attorney who can advise you of the various bankruptcy (and non-bankruptcy) options unique to your circumstances. The New York City Bar has a Legal Referral Service that can help you with finding a lawyer specializing in bankruptcy. (917-983-2872; en Español 917-832-1927) The NYC Bankruptcy Assistance Project offers free bankruptcy guidance to small business owners. (646-442-3630).

GLOSSARY

Consensual plan of reorganization	Plan of debt restructuring that is negotiated between the debtor and its creditors. Under this plan debts are discharged upon plan confirmation.
“Cramdown” (non-consensual)	Debt restructuring plan that the bankruptcy court can impose on creditors, despite their objections and/or undesirable terms.
Creditor	Any entity to whom the debtor owes money.
Debtor	A business or individual that has filed a petition for relief under the Bankruptcy Code
“Discharged” debt	Financial liability from which the debtor has been released pursuant to a bankruptcy proceeding.
“Financially distressed”	A condition under which a business or individual that is unable to generate sufficient revenue or income cannot pay all of its debts as they become due.
“Going Concern”	A business with sufficient resources to continue its operations for the foreseeable future.
Liquidate	The process of selling off the debtor’s property in order to satisfy creditors.
Non-dischargeable debt	Debt that cannot be eliminated through bankruptcy.
Non-exempt Assets	Assets that are not exempt from sale by the bankruptcy trustee in order to satisfy some or all of your creditors.
Out-of-court workout	An alternative to a bankruptcy filing that involves the restructuring of a business’ debt through negotiations with creditors without involvement of the court.
Personal guarantees	The legal promise of an individual to repay a debt owed by another.
Restructure	The process through which an individual or company can reduce or renegotiate outstanding debts.
Secured debt	Debt that is subject to a lien on assets, which “secures” repayment of a debt, <i>i.e.</i> , your home, a car or cash, to reduce the risk associated with a debt. If the borrower defaults on the debt, the lender may foreclose on the assets.
Trustee	A private individual or corporation appointed by the bankruptcy court to represent the bankruptcy estate.
Unsecured debt	A debt that is not backed by collateral.

“Wage earner” bankruptcy

Another name for Chapter 13 bankruptcy, which allows those with a reliable source of income to repay all or part of their debt as an alternative to liquidation.