Bankruptcy: Recovery and Resurgence

By Jonathan Moore, CPA, CM&AA, Partner and Andrew Suh, CPA, Partner

Are the funds from your PPP loan about to run out? Have your operations been crippled by the pandemic? Are you starting to feel pressure from your creditors? Have you thought about restructuring your existing obligations but don't know where to begin?

If you are facing questions like these, rest assured, you are not alone. The unprecedented challenges to businesses and business owners created by COVID-19 continue with no clear end to the pandemic in sight. While the government has offered lifelines to business owners, many of the funds obtained through these programs may be close to being exhausted or insufficient to sustain operations.

After considering all of the alternatives, the fresh start that bankruptcy reorganization offers may be the most viable option and requires serious consideration.

Different Bankruptcy Options for Businesses

The most common types of bankruptcies filed by businesses are Chapter 11 (i.e., business continues to operate through reorganization/restructuring) and Chapter 7 (i.e., liquidation and cessation of operations).

Chapter 11

With a Chapter 11 bankruptcy, a debtor can seek relief from its creditors while forming a reorganization plan which would enable pay down of debt (typically less than full amounts owed) and reorganization of operating costs to regain sufficient profits. The debtor can continue business operations during the bankruptcy process, under the direct supervision of the U.S. trustee, while making payments through the debt repayment plan.

After the payment plan has been completed, the debtor can request the court for a discharge of the remainder of its unsecured debts, which concludes the Chapter 11 bankruptcy. A notable provision in Chapter 11 is the Absolute Priority Rule, which stipulates that equity interest holders cannot retain an ownership interest in the debtor unless all creditor claims are paid in full. As a result, many small business owners may be faced with the prospect of losing control of their business through a traditional Chapter 11 filing.

New Subchapter V for Small Businesses

The Small Business Reorganization Act of 2019 (SBRA), which went into effect on February 19, 2020, created a new Subchapter V to Chapter 11 under the provisions of the United States Bankruptcy Code. In the past, struggling small business owners found that reorganization under the previous provisions available through Chapter 11 was too costly, time consuming and, while providing relief from debt, resulted in losing control of their business.

The SBRA aims to provide a faster and less costly reorganization process for small businesses – and most importantly, may provide a lifeline for owners to retain equity in their businesses as subchapter V eliminates the Absolute Priority Rule. Furthermore, creditors can be repaid over time based on the business's projected income and the CARES Act temporarily expanded eligibility to businesses with $7.5 million or less in liabilities.

Additional details about Subchapter V can be found in our article New Bankruptcy Relief Provisions for Small Businesses.

Chapter 7

In a Chapter 7 bankruptcy, the business is turned over to a court-appointed trustee who will oversee an orderly liquidation. Unlike Chapter 11, the business stops operating and the proceeds from the asset liquidation are utilized to pay creditors to the fullest extent possible. Generally, there are not enough proceeds to fully pay off the debts, which are discharged at the conclusion of a Chapter 7 bankruptcy and business owners are off the hook (except for any debts where the owner has a personal liability). In the past most struggling businesses liquidated without invoking bankruptcy. However, new rules highlighted below could change the landscape for struggling businesses.

Our Restructuring Expertise

During these uncertain times, PKF O'Connor Davies' team of bankruptcy and restructuring specialists can provide expertise to help you navigate these perilous times with the goal of achieving recovery and resurgence. With Certified Insolvency and Restructuring Advisor (CIRA) credentials issued by the Association of Insolvency and Restructuring Advisors (AIRA) as well as Certified Turnaround Professional (CTP) credentials issued by the Turnaround Management Association (TMA), our restructuring services include:

- Reorganization plan development
- Debt structuring and renegotiation
- Loan covenant waivers negotiation
- Creditor, vendor, and stakeholder negotiations
- Identification of new sources of capital
- Exit strategy formulation
- Pre-bankruptcy planning and subsequent collaboration and negotiation

Contact Us

Whether it's evaluating cash flow forecasts, helping renegotiate with lenders, or evaluating the viability of other financial tools, such as determining if you qualify for a Subchapter V bankruptcy reorganization, we are here to help. Please contact the partner in charge of your account or:

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About PKF O'Connor Davies

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