

South Dakota Chamber of Commerce and Industry
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BUSINESS CONTINUATION
SERIES:
BANKRUPTCY

*Remember that great sale you celebrated three months ago?
 The party is over, the customer just filed **BANKRUPTCY**.*

The business continuation series ends on the topic of bankruptcy. Bankruptcy is unique among the disasters discussed in this series because it is the only one for which you cannot buy insurance as a method of covering potential losses. Bankruptcy is specifically mentioned in the Constitution of the United States and is a concept that has been part of every civilization, including Biblical references.

How many bankruptcies are there in South Dakota? Table 1 shows there have been an average of just over 2,200 bankruptcies a year for the past four years. Less than 10 of these have been business reorganizations (Chapter 11) and the vast majority of them have been individual liquidations (Chapter 7).

Table 1: TOTAL FILINGS
UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA

	<u>Ch. 7</u>	<u>Ch. 11</u>	<u>Ch. 12</u>	<u>Ch. 13</u>	<u>TOTAL</u>
1982	595	111	NA	76	782
1983	557	136	NA	82	775
1984	567	174	NA	125	866
1985	768	202	NA	100	1070
1986	1060	329	59	134	1582
1987	1023	77	433	120	1653
1988	994	32	94	90	1210
1989	1074	31	70	79	1254
1990	1282	28	70	113	1493
1991	1371	31	42	97	1541
1992	1285	25	49	107	1466
1993	1280	19	42	61	1402
1994	1108	11	33	65	1217
1995	1323	9	27	92	1451
1996	1742	14	39	118	1913
1997	2180	14	37	134	2365
1998	2119	8	40	129	2296

1999	2110	4	29	78	2221
2000	2004	9	7	84	2104
2001	1948	7	0	75	2030

Table 1 Note: Is there abuse of bankruptcy filings? It is most likely impossible to judge with certainty whether bankruptcy is being abused. There was one study done by the courts that looked at 100 randomly chosen cases. These cases were scrutinized and the study concluded that there were questionable filings in 3% of the cases. The most frequent reason individuals report seeking bankruptcy protection is the debt from medical bills.

NOTE – The information contained in this article is subject to change with legislation pending before Congress. The information printed here is designed to be general in nature and the Chamber highly recommends anyone involved in bankruptcy proceedings, whether as creditor or debtor, use professional legal counsel.

Section One – Quick Review of Various Types of Bankruptcy

(Notes from Bankruptcy Basics made available by Judge Hoyt, Bankruptcy Judge.

Chapter 7 – Liquidation is a court-supervised collection of debtor’s assets to be turned into cash for paying as many debts as the cash allows. Debtors are allowed to retain certain property such as clothing and necessary vehicles. When Chapter 7 is complete, the debtor receives a discharge and is released from personal liability for debts.

Chapter 13 – Wage Earners Reorganization is used when the debtor has regular income and can repay debts on a schedule set up under the supervision of the court. Repayment takes three-to-five years and the debtor retains possession of major assets. The debtor is protected from lawsuits, garnishments and other creditor action while the repayment plan is in effect.

Chapter 12 – Family Farmer Adjustment of Debt is very similar to wage earners reorganization above.

Chapter 11 – Reorganization is used by commercial enterprises that want to continue to operate and repay debt over time under a court-approved plan. This plan starts with the debtor submitting a reorganization plan that must include a disclosure statement with adequate information to enable creditors to evaluate the feasibility of the plan. Chapter 11 can allow debtors to terminate burdensome contracts and leases, recover assets, and re-scale operations to become profitable.

Chapter 9 – Municipality Adjustment of Debt is very similar to Chapter 11 above, but is designed for units of government.

Section Two: When Your Customers File – “Just hold this bag . . . we’ll be right back.”

It has been said “the best defense is a good offense” and it is especially true if you are going to avoid being left holding an empty bag when one of your customers files for bankruptcy protection. While there are differences between a customer going through reorganization and one being liquidated, there are several general starting places that are the same.

Know the rules of who gets paid and when they get paid. You might be able to move to a higher position among creditors and increase the chance of recovering your money. There are instances where

state law determines the priority among creditors. You may find out that another creditor has a first claim on all items in the debtor's inventory and you cannot even reclaim the merchandise you sold them to settle your own claim!!

One attorney who was interviewed for this article pointed out that bankruptcy is a changing situation and you have to keep up with the changes. "This isn't like a car wreck where the facts don't change because it happened and now you are trying to discover what really happened and who is to blame."

Stay with the details, know the deadlines and check all the information made available by the debtor.

To Repeat: The Chamber recognizes the very special nature of bankruptcy law and highly suggests using professional legal counsel if you have a need to be involved in a bankruptcy action.

If they choose Chapter 7 – Liquidation: Secured creditors will get paid first. They will be entitled to any money from the sale of their collateral, which may or may not satisfy the debt. Taxes are always among the highest priority of unsecured creditors. Specific priorities are listed in state law (see table 2). The bottom of this food chain is unsecured general debt. For example, work by professionals such as plumbers or painters, office supplies and other services.

If they choose Chapter 11 – Reorganization: As a creditor there are more options following this route. This brings with it more work and details, but can also result in better chances of getting most or all of your money by the end of the process. Chapter 11 is often seen as a negotiation strategy that gives a debtor business a chance to renegotiate their debt, reshape their business and a short period of "time out" to get it all worked out.

Look at the Plan – The debtor in a Chapter 11 bankruptcy has an obligation to file a plan and must provide a disclosure statement with enough information for you and other creditors to evaluate the plan. In essence, the debtor gets some time (120 days) free of collection actions to put together a plan to keep operating and repay all or most of the debt. In exchange for this time period, and possible relief from deadlines of debt, the business filing for Chapter 11 must put all of its financial cards on the table for everyone to examine and must allow others to affect how the business is to be run.

When you are a creditor you must be active in the review of these plans and participate in the shaping of the plans, or you could end up as the one in line with little hope of getting anything to put in that bag they asked you to hold.

There are three outcomes to watch for if one of your customers is involved in Chapter 11 Reorganization.

- **Dismissal/Liquidation** – Chapter 11 does not guarantee a company will be allowed to restructure their business or the debt. If a plan cannot be built that seems feasible to the court, the Chapter 11 can be dismissed and the debtor then put in a position of liquidation.
- **Sale of Assets** – There are times when something can be made of a bad situation by selling the assets of the business and allowing someone else to keep it as a going concern. This is often preferable when a complete shut down will leave everyone with nothing to recover. This has the effect of removing the owners that had placed the business in the untenable position from any further connection with the business and looking for others to take a chance on its successful

operation. This is especially important when it involves essential services to an area and a large number of jobs that can be retained under new direction.

■ **Successful Reorganization and Emergence** – Often the best route for all creditors is to set aside the debt repayment for awhile and work on getting the business to a break-even point, so debts can be repaid later. In this case debtors actually will help run the business. Trustees can be appointed (replacing the former owners) in extreme cases to run the business. In some cases Creditor Committees are appointed. These committees are made up of the largest creditors, which may well include your business. Trustees can appoint creditors to a committee, which can have a great deal of influence in the debtor’s operations and formulation of the plan.

This can be a painful process for the customer that must “bare their soul” to you and the courts, but it gives new life to a business and helps lead them to a stronger future, while allowing former creditors to receive repayment.

Some Advice on Avoiding This Mess

The eastern concept of yin and yang being seemingly opposite forces finding balance is a good vision for business when it comes to the forces of wanting sales and extending credit. The business cannot survive without sales and many good customers expect and deserve a period of time to pay bills. Many of your best sales would not happen if you demanded payment on delivery.

The entire housing market and ability for young families to own a home and a car is dependent on someone being willing to take risks by extending credit. Here are several suggestions from people who deal with bankruptcy.

Manage your receivables. Always conduct an ongoing assessment of credit you extend. A good customer that is sliding from the 30 day to the 60 day, or worse, column may be a candidate for a visit or a slight change in your relationship.

“The bigger they are . . .the harder they fall.” With the recent news that Polaroid and Bethlehem Steel will file Chapter 11, there is clear evidence that doing business with large nationally-known accounts is not the same as “money in the bank.” If you have a significant customer sending out signals that problems are imminent, there are several methods that can keep your sales but limit the risks.

C.O.D. – Ask that future orders be done on a cash basis. If a customer has a large balance that seems to be getting older, it might be prudent to suggest a “cash on delivery” basis while they work on the old balance.

Purchase Order Lien – By giving notice ahead of the sale and delivery you can secure your items against other claims on inventory with a purchase order lien. In this process you must clearly identify what items are yours so they can be separated from other inventory and returned to you. Did we mention attorneys are handy in this process?

Ask for Backup – If you are starting to question a customer’s ability to pay balances or experience payment problems one solution is to seek a direct backup from your customer’s bank. Often the bank financing your customer will have a strong interest in maintaining on-going operations, even if the business is struggling. If you supply something that is essential to those operations, the bank may give you access to a letter of credit on the customer or offer other guarantees for future business.

Make Sure Your Security is Secure -- The proper filing of liens and instruments of security is essential. When the feeding frenzy starts, you may find attorneys for other creditors reviewing things like UCC filings to make sure they are done right. If there are any deficiencies with these papers, they may be thrown out by the court. This could change you from a secured creditor with a good chance at partial recovery to an unsecured creditor with virtually no chance to recover anything, leaving you and your empty bag at the end of the line with the Orkin guy, waiting to see if there is anything left. This is known as making sure your security is “perfected.”

Section Three– A Look at the Other Side – If You’re the One That Needs Protection

The Chamber talked with several businesses that had filed Chapter 11 Bankruptcy and had a successful reorganization. Should you ever face the need to renegotiate debt and turn to a Chapter 11 filing here is what to expect:

Stigma – Bankruptcies are public documents and when businesses file Chapter 11 it is often a story in the newspaper and/or TV. Even if you know that the only reason you had to file for reorganization was the failure of your largest customer it still “feels awful.”

Endless Details – Writing a plan requires endless accounting of all business transactions, complete review of who owes you money and the debts you need to reorganize. All assets need to be listed and all expenses are going to be reviewed and challenged.

Complete Disclosure – Every record, every transaction, all your bills, debts and business deals are now open to inspection and critique. As one attorney put it, “The price for protection is baring your soul and following some tough rules.”

Scrutiny – Suddenly you are no longer alone in running your business. Everyone you had as suppliers (the good old days when you were the valued customer), your bank and others who have had part of your financial picture will now have a say in every aspect of the business. They will help determine which bills to pay, which of your old customers can still have credit, the inventory you maintain, the trips you take for conferences and markets you attend.

Real Help – In spite of feeling pushed, and at times oppressed, those who stayed with businesses during these reorganizations had a sense of appreciation for the fact that the business survived and was running better, credit for which is given to the oversight by creditors. It may have been a struggle but most deemed it helpful.

Section Four – General Questions

Here are several excellent questions reviewed in the guide handed out by the courts entitled Bankruptcy Basics.

Is all debt forgiven when someone files a Chapter 7 bankruptcy?

No – Several types of debt cannot be discharged through bankruptcy including: Tax claims, debts not listed in the filing, alimony, child support, spousal support, debts arising from willful or malicious injuries to person or property, debts to government such as fines and penalties, government guaranteed student loans, and debts from injuries inflicted while driving under the influence of alcohol.

I hate deadbeats. Can I fire an employee if they file for bankruptcy?

No – The law prohibits discriminatory treatment of debtors. The law says you cannot discriminate with respect to employment if the discrimination is based solely on the bankruptcy filing.

Can a bankruptcy discharge be revoked?

Yes – Typically a request to revoke a debtor’s discharge must be filed within one year and can be done if there is proof that the debtor obtained the discharge fraudulently. This can involve the debtor withholding information about property that could be used for the settlement or lying about other means to repay debt.

Can I accept payment from someone that has been granted a bankruptcy petition and is officially discharged from the debt?

Yes – A debtor may voluntarily repay debt even though it cannot be legally enforced upon them. This is often done when the debtor is close to someone or the debt was owed to family.

Heck with it – What happens if I just keep calling this deadbeat after the bankruptcy is done?

The granting of a discharge petition means you no longer have a legal claim against the person who filed the bankruptcy. If they file a complaint against you for continuing to try to collect you could face a civil contempt citation, which most often results in a fine.

Over the past few months, we have presented a series of specific business continuation articles that were made possible through the generous contributions of our talented membership. We wish to acknowledge their efforts and express our appreciation for the expertise and experience that was so willingly shared. The following outline provides topics and contributors for the 2001 Business Continuation Series.

FIRE (Volume 16, Issue 3):

Dick Hainje, Division Chief of the Sioux Falls Fire Department, Sioux Falls, SD
Dave Gerdes, Partner, May, Adam, Gerdes & Thompson, Pierre, SD
Jeff Pray, CPCU, Culbert Davis Co., Insurors, Sioux Falls, SD

EMBEZZLEMENT (Volume 16, Issue 4):

Paul Hinderaker, Partner, Austin, Hinderaker, Hopper, Strait & Bratland,
Watertown, SD
Doug Taveirme, Dam, Snell and Taveirme, CPAs, Chicago, IL

FATALITIES (Volume 16, Issue 5):

Jim Books, Organizational Consultant and Jolee Thurn, Human Resources
Consultant, RSM McGladrey, Sioux Falls, SD
Rob Anderson, Partner, May, Adam, Gerdes & Thompson, Pierre, SD
Glenn Gardner, B.S. Mechanical Engineering Senior Loss Control Representative
and Phillip DeGreef, M.S. Industrial Management Claims Supervisor,
Berkley Risk Administrators, Pierre, SD

NATURAL DISASTERS (Volume 16, Issue 6):

Jerry Thomsen, Trail King, Mitchell, SD
John Miedema, John Miedema Sanitation, Mitchell, SD
Ardell Nelson, SD Insurance Alliance, Milbank, SD
Allan Miller, Director of Office of Emergency Management for Davison County,
Mitchell, SD
Federal Office of Emergency Management (FEMA)

Many other members contributed “anonymously” by sharing their personal experiences with each of the disasters covered in this series. For their input, we are extremely grateful.

A Resolution Regarding the Terrorist Attack Against the United States, Striking the World Trade Center and the Pentagon September 11, 2001

In light of the terrorist attacks of September 11, 2001, the South Dakota Chamber of Commerce and Industry Board of Directors passed the following resolution. This resolution has been sent, along with letters of support, to state and federal leaders.

America, having suffered a heinous and evil act of terrorism, is responding as it always has, with strength in the search for justice, sorrow for the loss of life, compassion for the afflicted, appreciation for those bearing the responsibility of response and determination that the light of hope shall never be extinguished.

The People of South Dakota stand united with all America and the civilized world, in horror at this villainous assault. We share a resolve that refuses intimidation that demonstrates a truly free people value life, and that makes evident we will emphatically meet any provocation.

The South Dakota Chamber of Commerce and Industry, on behalf of the business community:

- **Condemns** this cowardly and reprehensible act of terrorism and those who support any deed that has as its goal the slaying of innocents.
- **Joins** in the mourning for those deprived of the most basic "self-evident right" - that of life itself.
- **Salutes** those who have worked tirelessly in horrendous conditions who attempted to rescue those who were trapped and brought aid to those who are injured.
- **Praises** employees, friends and neighbors in the SD National Guard and Reserve who responded to the call of a stricken nation and went, without hesitation, to face an unknown threat.
- **Applauds** the support given by employers of Guard and Reserve personnel and encourages them to continue assisting this nation by accommodating the absence of these fine employees.
- **Honors** the nation's political and governmental leaders for their unity and for facing these threats and meeting these challenges in a manner consistent with the values that have guided this nation to greatness. The resources of the members of this organization are pledged to help you in seeking justice and making America's future secure.

Passed on the 14th day of September 2001.