



18 Winding Lane  
Wilmington, DE 19809-2817  
phone: 302.765.2515  
fax: 302.765.2516  
www.biz911.com

## **The Debt Workout How to avoid bankruptcy and stay in business**

What's your worst nightmare as a creditor? How about getting a legal notice out of the blue, announcing the bankruptcy of your biggest customer and debtor? Or a written demand for the return of a "preferential payment" that you had received from your now-bankrupt customer.

You are unlikely to be aware of an impending bankruptcy, or be given the courtesy ahead of time to speak with the debtor firm, which received your precious goods or services on credit. As a result, you are unable to suggest alternative approaches to help and to minimize the damage to your own business. An insolvent company can stay under your radar while still ordering supplies, before all hell breaks loose and it finally disappears from view, taking your firm's capital with it.

When small corporations feel they have run out of options, they tend to close their doors or file for Chapter 7 bankruptcy liquidation. The costs of the alternative, Chapter 11 court-appointed workout, would protect from creditors in the meantime and keep the business operating. But it involves an up-front payment of perhaps forty thousand dollars or more. Business people who have hung on too long often complain that they can't come up with the cash. Besides, the vast majority of small firms that file Chapter 11 quickly realize that they have to liquidate and close down. And it is rare, indeed, for unsecured creditors to get anything of substance from this.

If your firm is struggling to stay in business, put yourself in the position of your creditors. Don't become their worst nightmare. It can make much more sense to speak plainly and honestly with them, in a structured process outside of bankruptcy known as a workout.

The basic format can be looked at as an "unofficial" Chapter 11 workout. In our experience, many firms in serious financial trouble want the situation turned around, or "worked out", to permit them to stay in business, as would Chapter 11. Your workout process must then be tailored to resolve disputes, delay and reduce payment commitments, and maintain a good working relationships between the different parties.

The bankruptcy process is cold and methodical, as proscribed by law. There is no need for pleasantries. A voluntary workout is different. Goodwill is important. It emphasizes courtesy and good communications in an environment designed to voluntarily reconcile the needs of creditors with those of your firm. You will need to share appropriate financial information to let others make an enlightened decision. Creditors normally want to see a snapshot of assets and liabilities, and particulars of what is planned, in order for your firm to stay in business and be retained as a paying customer.

The exercise starts with a debt management plan, which is your company's road map through the process. This identifies the type and urgency of each liability, these being characterized as secured or unsecured and corporate or personal. It is important to identify those contractual obligations, such as building or equipment leases, which would permit the lessor to close you down at short notice. And you have to highlight any judgments and suits in progress.

The workout generally starts by proposing restructured agreements to secured asset holders, to ease monthly cash flow commitments. Once this is done, you will have a better estimate of net cash flow in succeeding months with which to address unsecured payables.

A workout gives creditors the opportunity to make the settlement decisions your firm needs, in their own enlightened best interests. It can be shown that they will do better to accept the proposed debt settlements, and retain your firm as a customer, than to take legal action and possibly force your company out of business. Creditors may be invited to an informal meeting, but this is not often necessary or convenient. Communication by teleconference, fax and e-mail will normally suffice.

From your firm's perspective, a workout provides a number of advantages over Chapter 11. It holds the promise of a substantially reduced and restructured debt load within a much shorter period than bankruptcy protection. Proceedings are private and away from the public scrutiny of the bankruptcy court, which could ruin customer confidence and ultimate profitability. There is no huge up-front payment, as much of the work can be completed on a contingency basis. A mountain of time-consuming and onerous bankruptcy paperwork is avoided and there is no trustee to look over your shoulder, searching for process illegalities.

From your creditors' perspective, the workout holds the prospect of a higher, faster return than in Chapter 11, and certainly more than if your firm goes under. It takes weeks, not months or years. A well-executed process ensures that there is no preferential treatment. Unsecured creditors are offered similar pro rata settlements. The process incorporates clear communication and attention to detail, so few problems can be expected to emerge. Creditors come to understand that their losses can be minimized and that there is nothing to gain by pushing the company into bankruptcy and closing it down.

A workout in itself will not ensure your future success. But it provides breathing space to analyze what went wrong and establish how to return to solvency. If nothing else, you get the opportunity to stay alive. Considering the alternative, what could be better than that?

*Article © 2008 Ken Thomson. This article may not be reproduced without permission from the author.*