

Receivership or Chapter 11 Bankruptcy: Which One Is Right for Your Company?

By: David J. Espin

If your business has hit a rough patch, it's facing a big judgment, or if the bank is calling its loan due, you may be wondering what options are available for your company. Assuming you don't want to hand the keys to the bank and move on to a new venture, two options exist for Wisconsin business owners: (1) a receivership under chapter 128 of the Wisconsin statutes, or (2) filing a case under chapter 11 of the Bankruptcy Code. But which option is right for your business?

In general, the purpose of a chapter 128 receivership is to liquidate a company's assets, and to maximize the liquidation value for the company's creditors. A receiver is appointed by the court to decide how best to accomplish this. Sometimes a company may continue operating while the receivership is pending, but in most cases it is shut down and sold for its parts as quickly as possible.

On the other hand, the purpose of a chapter 11 filing is ordinarily to restructure a company's debts and pay them over time. The business almost always continues to operate while the case is pending, and the owners stay in place to run things and attempt to right the ship. If successful, the case ends in a confirmed plan of reorganization that allows the owners to maintain control and provides for a long term plan to repay creditors.

So, which option is right for your business? Well, at the risk of oversimplifying the analysis, it depends on your answers to several questions. First, do you *want* to maintain control of your business and continue operating, or would you rather cut your losses and move on? If you answered in the affirmative, are the fundamentals of the business strong? For example, is the business still producing excess cash flow after operating expenses have been paid? Ideal chapter 11 candidates are facing a large lump sum payment like a substantial judgment or a loan coming due which they would be able to pay over a long period of time but cannot pay immediately. In fact, you must prove to a bankruptcy judge that you will be able to pay these debts over time in order to confirm a chapter 11 plan.

Another situation where a chapter 11 might make sense would be if a company is looking to sell its assets, but due to pressure from the bank or a pending lawsuit, it is unable to properly market the assets and maximize their value. In fact, I represented a small business in this exact scenario. The company had entered into a forbearance agreement with the bank which was coming to an end. Pursuant to the forbearance agreement, on a date certain the company's assets would automatically be transferred to a receiver, who likely would have liquidated them and shut down the business.

On the brink of the forbearance agreement expiring, I filed for chapter 11 protection on behalf of the company and immediately hired a broker to market the company for sale. Instead of a receiver shutting things down and selling the company's parts for what would have likely been less than the bank's mortgage, it was marketed for almost a year, which gave it the needed breathing room to put together a marketing packet for potential purchasers, and allowed potential purchasers time to perform their due diligence. Unlike in a foreclosure proceeding, potential purchasers cannot assume they will be able to purchase the assets for below market value, since the company could always decide to simply re-structure its debts and avoid a sale completely. In short, a chapter 11 provides a distressed company with leverage to negotiate, which it ordinarily would not have outside of the chapter 11 context.

The company ended up selling its assets for nearly triple their fire-sale liquidation value, which was enough to pay off all of the company's creditors and still return \$700,000 in equity to its two owners.

If your company is facing a large payment coming due that puts its survival in jeopardy, make sure to consider all of your options before deciding how to proceed. It may be worth giving a chapter 11 filing a shot.