



# State of The Bankruptcy Court, What Will 2006 Bring, and Tips for Avoiding Bankruptcy

By TIMOTHY P. DUGGAN

**I**n 2005, the changes to the United States Bankruptcy Code were viewed by some as a devastating change in the law which would eliminate the final safety net for distressed individuals and businesses. For consumers, this may prove to be true as the great "Consumer Bankruptcy Rush of Late 2005" saw over 15,000 total bankruptcy cases filed in New Jersey in the month of October 2005, most filed by consumers before the bankruptcy changes became effective on October 17, 2005. For the same month in 2004, the total bankruptcy filings was 3,191. But what impact did the law have on business bankruptcies? At this point, very little since very few businesses have sought bankruptcy protection since October 2005. In the Central Jersey vicinage (Trenton), only 14 Chapter 11 cases were filed from January 1, 2006 to April 30, 2006, a decrease of 50% for the same time period in 2005. Statewide, only 55 Chapter 11 cases have been filed this year through April 2006 (down 35%).

The drop in business bankruptcies is a function of many factors, including the relatively strong economy in Central New Jersey. However, the increase in oil prices, increase in short and long-term interest rates, relaxed standards of some lending institutions in a competitive search for new borrowers, and the increase in vacancy rates for certain commercial properties (ie. Class B office space) are indicators of potential problems and future bankruptcy filings. Further, the cooling of the housing market and reaction to the numerous property revaluations (especially in Mercer County) may cause additional problems. When confronted with these challenges, it is advisable to take the appropriate steps to manage your business, cash flow and attempt to forecast your own business model. The changes to Chapter 11 bankruptcies will make it more difficult for many businesses to successfully confirm a bankruptcy plan. For example, the new bankruptcy law requires small business debtors to file additional reports and financial information which will increase the cost of the case. More problematic is certain time frames have been reduced which will add to the

pressure of operating a business under the watchful eye of the United States Trustee and anxious lenders. The days of staying in a Chapter 11 case for years while management contemplates its future (while drawing good paychecks) may be gone.

What can be done to avoid the new bankruptcy dynamics if your business starts experiencing cash flow problems? Consider the following:

Communicate with your creditors, especially your secured lenders. Contact your bank before you default and be prepared to provide accurate and timely financial information. Do not force a bank's hand by ignoring phone calls or promising documents which are never delivered.

Hire the right professionals who will help you recognize the company's problems and help the business act in a timely manner. A struggling business does not need a friend - it needs advisors who are brutally honest and can help management confront those overly optimistic executives who are in denial. Take legal advice from your lawyer, and business advice from a consultant or accountant.

If present management does not have the ability to right the ship, consider hiring a consultant or interim management. This is a very difficult task since most executives will not cede control and feel challenged by the new team members. Although the consultant or interim management will be an added expense to the business, a good manager can take a fresh and honest look at the business and help make the hard choices. No one wants to fire the longtime employee, even if he or she is dead weight.

Make certain that any business plan is honest and not based upon unrealistic assumptions. The plan must be consistent and take into account the realities of the business. For example, if sales are expected to double over a certain time period, all costs associated with the increase must be accounted for (ie. increased working capital needs).

Do not blindly contribute capital to the business, especially if it comes from retirement accounts or home equity. Although these are sources of cash that can get a business through a tough time, the

decision to exhaust these resources must be made once a long-term plan is developed.

Sometimes a business cannot be saved. This is a reality that must be confronted and addressed. There are too many companies who tried to reorganize their affairs at the expense of a viable liquidation strategy that could enable the owners to continue with their lives without being saddled with personal debt. A solid liquidation strategy can help management make certain that debts which result in personal liability (ie. withholding taxes, personal guarantees) are paid from the sale of the business or assets. An experienced insolvency/bankruptcy lawyer can discuss liquidation strategies which avoid the bankruptcy court, including state court assignments for the benefit of creditors, friendly foreclosure sales under the Uniform Commercial Code (a/k/a Article 9 sales), and asset sales to third parties. Many businesses are surprised when a bank assists a struggling customer to liquidate its assets since, in many cases, it is a win-win situation since the owners can seek a release from their guarantees by getting the bank paid in an orderly fashion. This process takes cooperation and cannot wait until the business is too far gone to salvage.

The New Jersey Bankruptcy Court is very quiet these days and it may be a long time before business bankruptcies take up most of the court's time. Most businesses appear to be able to manage the increased cost of fuel, healthcare benefits, interest rates and property taxes. The pressure to stop building in rural areas and potential changes to redevelopment laws in New Jersey may ultimately cause the construction industry to falter. There are a lot of mixed signals right now and prudent business owners must carefully manage their cash flow and try to forecast which factors will impact their business the most. If problems arise, deal with them immediately and seek the appropriate professional help. ■

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