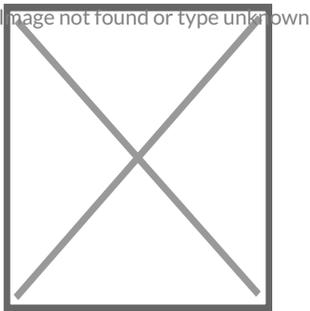


Businesses and Bankruptcy: What You Need to Know



By Maggie Puccini, Bouhan Falligant LLP

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Earlier this month, Hancock Fabrics, Inc. declared bankruptcy. This is the second time in less than a decade that the company – one of the largest fabric sellers in the United States with 250 locations in 37 states – has sought protection from creditors. A company spokesperson said the company would use the bankruptcy as an opportunity to explore a sale, close stores (70 immediately) and expand its online presence.

If you are a business owner – whether of a startup entrepreneurial company or a large company like Hancock Fabrics – you have probably already experienced or will experience hard times in the life cycle of your business. It is during these hard times that many businesses fail, so it is important to know in advance when bankruptcy might be the best choice to save your business.

The time to consider bankruptcy is actually at the time you are establishing your business. Sound strange? While no one starts a business with plans to fail, it is imperative to consider that possibility so you can structure your new enterprise accordingly. Setting up your business as a corporation, limited liability company (LLC), or other limited-liability entity will help keep your personal and business assets separate and protect personal assets from business creditors, whereas businesses operating as sole proprietorships or partnerships can expose the owner's personal assets to greater risk of

attachment from business creditors.

If you are at the point where you think bankruptcy is an option for your business, it is important to understand the different kinds of bankruptcy filings available to you. While most people have heard of Chapter 11 and think that it is appropriate only for large, publicly-traded corporations, it is also used by many small companies to reorganize their business – often by re-structuring debt. In some cases, a Chapter 13, which is not available for a corporate entity, may be a more appropriate filing for the small business owner who is a sole proprietor, as the cost of the reorganization will be much less than with a Chapter 11. (However, if your debt exceeds a certain amount, you will not be eligible for Chapter 13 and would have to file under Chapter 11.) Chapter 13 allows you to keep your assets while reorganizing and paying off all or a portion of your debts through a repayment plan, usually over a three- to five-year period. The amount paid back generally depends on your income, expenses, value of assets, and types of debt incurred. Certain debts, called “priority debts,” have to be repaid regardless of income. These include certain taxes and domestic support obligations.

If a re-organization is not possible at all, perhaps due to lack of an ongoing revenue stream, then a Chapter 7 filing would be the only remaining choice. Simply put, Chapter 7 is a liquidation that marks the end of the business. This option eliminates many of the debts for which you as the sole proprietor are personally liable. This includes credit card bills, lawsuit judgments, medical bills, unsecured business debts, obligations under leases and contracts entered into by a sole proprietor, and personal loans and promissory notes. Debts not discharged in a Chapter 7 filing include domestic support, liability from certain wrongdoing, criminal penalties, certain taxes, debts incurred through fraud, and loans to a pension plan. If your business is a corporation or an LLC, you may still be able to use Chapter 7 to bring about an orderly liquidation of the business, but the corporate entity is not eligible for a Chapter 7 discharge.

Remember: it is best to avoid bankruptcy in the first place. A solid business plan can help reduce the possibility of many financial losses if followed properly. When your business hits the inevitable bumps in the road, consider cutting back rather than gambling with personal resources, and never, under any circumstances, withdraw money from your IRA, 401K, etc., to put into the business. While bankruptcy may not always be the answer to financial problems, seeking trusted legal counsel is an important step in determining whether you can avoid bankruptcy, and if not, what option is the best one for your business.

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- Banks & Financial Institutions
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