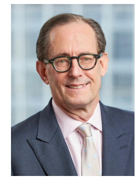
COVID Cash Crunch: Options for Reorganizing or Winding Down Your Company in Illinois



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Related Practice Areas

- Bankruptcy, Insolvency & Restructuring

Introduction

The financial distress caused by the COVID-19 pandemic has left many companies reeling. With no clear end in sight, the bad news is that some businesses will be forced to pursue options for winding down or reorganizing. The good news is, there *are* options.

Which of these options is best depends a great deal on the specific circumstances of the distressed business. But no matter the situation, it is better to act quickly and decisively than delay. Inaction often leads to creditor-dictated wind-down terms, constrained financial maneuverability, and reduced asset value.

State Dissolution Procedures

The first option to consider is a simple dissolution under Illinois law, which allows business entities of all types to dissolve, wind-up operations, and liquidate assets. The process is generally straightforward and is ideal for solvent companies — that is, companies that can otherwise satisfy their obligations upon liquidation. Company stakeholders simply vote to dissolve, file dissolution papers with the Illinois Secretary of State and make necessary distributions to creditors and shareholders.

The state dissolution statutes *may* also be a good option for insolvent companies with few or no assets available to satisfy creditors. However, for a company that is insolvent but does have material assets available to partially satisfy creditors, it usually does not make sense to rely solely on the state dissolution statutes, for several reasons. Creditors require assurance that the company is equitably satisfying claims; court proceedings are often required to resolve disputes and approve distributions; and third-parties may be reluctant to purchase the company's assets over concerns that they could incur successor liability for the company's debts.

Assignment for the Benefit of Creditors

Another option for winding down a business is an "assignment for the benefit of creditors" (ABC). An ABC is a voluntary assignment of all of the company's assets to a third-party (the assignee) pursuant to a written trust agreement, through which the assignee receives the assets subject to all liens, claims, and encumbrances of the company's creditors. The role of the assignee is to liquidate the company and distribute the proceeds to secured and unsecured creditors, less the administrative costs incurred.

The benefits of an ABC are that an independent, third-party fiduciary of the company's choosing is responsible for winding-down and liquidating the company, and the company's management is not subject to direct examination by creditors (as it would be in bankruptcy). ABCs also tend to be quicker and less expensive than filing for bankruptcy. The downsides are that there is no automatic stay of creditor litigation and assignees are not vested with the avoidance powers of a bankruptcy trustee to "clawback" certain transfers and maximize value for unsecured creditors of the company.

Chapter 7 Bankruptcy Case

A Chapter 7 bankruptcy case is a liquidation of a company under the supervision of a federal bankruptcy court. Chapter 7 bankruptcy cases are commenced by the filing of a bankruptcy petition, after which an independent, third-party trustee is appointed to oversee the liquidation of the company's assets and make distributions to creditors.

The role of a Chapter 7 trustee is to maximize the value of the bankruptcy estate for the benefit of creditors. To that end, a trustee's tasks will include: (i) investigating the financial affairs of the company and any liens asserted against the company's assets; (ii) filing lawsuits against third-parties to recover preferential or fraudulent transfers made by the company; (iii) analyzing and, if necessary, objecting to claims filed by creditors; (iv) selling any non-liquid assets of the company; and finally (v) distributing property of the bankruptcy estate to creditors and, if sufficient assets exist, to shareholders.

The benefits of a Chapter 7 bankruptcy case, as opposed to an ABC, include predictability, transparency, and finality. All creditor litigation is stayed, and both the trustee and creditors are permitted to interview the company's management and examine its books and records. The Bankruptcy Code ensures a prompt liquidation of assets according to an established priority scheme and offers assurances to asset purchasers that they will not be tagged with successor liability.

Chapter 11 Bankruptcy Case

Chapter 11 of the Bankruptcy Code is used by an operating company to (1) reorganize its balance sheets pursuant to a Chapter 11 plan of reorganization or (2) sell its assets as a going concern and liquidate. The benefit of a Chapter 11 bankruptcy case is that it provides the company some "breathing room" while it negotiates with creditors over the terms of a plan or a sale.

Like a Chapter 7 case, a Chapter 11 case is administered under the supervision of a federal bankruptcy court and is commenced by the filing of a Chapter 11 bankruptcy petition. Unlike a Chapter 7, however, a company in Chapter 11 may continue to operate and its pre-bankruptcy management continues to control the business. In addition, a committee of unsecured creditors may be appointed to represent the interests of all unsecured creditors in the case.

A company in Chapter 11 emerges from bankruptcy by confirming a "plan of reorganization," a contract establishing how the company will satisfy its obligations to creditors. Companies have wide latitude in determining how to implement the plan and fund payments to creditors, but most successful reorganizations involve direct negotiations with stakeholders. Once the plan is formulated, creditors must vote to confirm. If the company is unable to confirm a plan, the bankruptcy court will either dismiss the bankruptcy case or convert it to a Chapter 7 case.

The benefits of filing for Chapter 11 include the company's ability to right-size its balance sheet, reduce liabilities, reject or restructure burdensome leases and executory contracts, renegotiate funded debt, and sell its assets. One of the primary drawbacks to a Chapter 11 bankruptcy case is its expense. The cost is significantly higher in a Chapter 11 than a Chapter 7 or an ABC.

Small Business Reorganization Act (Small Business Chapter 11)

Last year, Congress enacted a new form of Chapter 11 pursuant to the Small Business Reorganization Act (SBRA) that became effective on February 19, 2020. The primary objective of the SBRA was to enable small businesses with non-contingent, liquidated debts of $2,725,625 or less to successfully emerge from bankruptcy with a plan of reorganization, without having to incur the costs associated with larger and lengthier Chapter 11 filings.

Reacting to the economic impact of COVID-19, Congress temporarily amended the SBRA to increase the debt limit for eligible companies to $7.5 million. The debt limit will revert to the lower number in March 2021, unless further extended by Congress.

If a company currently seeking to reorganize meets the $7.5 million debt limit, an SBRA case is a particularly attractive option. An SBRA bankruptcy case is similar to a regular Chapter 11 case but includes additional benefits. Owners are permitted to retain their equity in the reorganized company; creditors may be prevented from foreclosing on the owner's residence pledged as collateral; and no official committee of unsecured creditors is appointed, greatly reducing the administrative burden and costs.

Another difference is that a "standing trustee" is appointed and will remain throughout the payment period set forth in a confirmed Chapter 11 plan. The duties of the standing trustee include accounting for all of the property received by the company, reviewing the debtor's financial condition and business operations, and helping facilitate a plan of reorganization.

For questions about winding down or reorganizing your business, please contact Ira Bodenstein or David Doyle at Cozen O'Connor.