

# Don't jump the gun

How to determine if your business really needs to file bankruptcy **Interviewed by Sue Ostrowski**

**Y**our business has been slapped with a lawsuit, and in a panic, you run to see a bankruptcy lawyer.

Is declaring bankruptcy really the best course of action? In some cases, this can be true. But in most instances, it may be time to step back and consider other options, says Lewis Landau, senior counsel at Dykema Gossett LLP.

"I have found that by the time the debtor arrives at a bankruptcy lawyer's office, there is an extreme bias in favor of pulling the bankruptcy trigger," Landau says. "It's almost as if the gravity pull of just going to a bankruptcy lawyer means you're ready to do it. However, bankruptcy is just one of several tools available to a debtor."

*Smart Business* spoke with Landau about how to determine the difference between needing to declare bankruptcy and simply wanting to declare it.

## What is the difference between needing to file and wanting to file?

Have-to-file cases are ones in which there is an immediate loss of control of something, such as a pending eviction, forthcoming foreclosure, or a bank account has been levied up and has already lost money. Control has been lost — or is imminently going to be lost — and the debtor needs to take action through the help of the bankruptcy process today to regain control. In those instances you generally will have to file.

Those are the easy calls. However, most cases are not have-to-files, they are want-to-files, when people feel the need to do something to cure their problems.

If there is nothing that elicits the immediate loss of assets, the attorney should ask what is creating the pressure, why are you here and why are you contemplating bankruptcy?

The answer is generally a lawsuit. The sheriff has come and scared the owner by handing over papers. They panic and wind up in a bankruptcy lawyer's office the next day because, having been served, they feel that they have to do something immediately.

However, lawsuits take a very long time to resolve; in Los Angeles, it generally takes a year. So you have to measure the cost of allowing the lawsuit process to continue. Even though you ultimately may wind up with a bad judgment,



**Lewis Landau**  
Senior counsel  
Dykema Gossett LLP

it could be smarter to let that timeline string out. You eventually could settle that case, and the problem is resolved.

Some of the hardest advice a bankruptcy lawyer gives is to not file when someone wants to do so. Your first reaction upon hearing that may be that the lawyer doesn't know what he or she is talking about, but there may be a better alternative.

## How can cost deter you from declaring bankruptcy?

To go into bankruptcy, you have to be able to afford it. Chapter 11 bankruptcy is a very expensive process. Much like you wouldn't want to drive to Las Vegas from Los Angeles on half a tank of gas because getting stuck in the desert is never good, you don't want to get involved in a bankruptcy case and not be able to finish the process because of the cost. At a minimum, figure \$50,000 to reorganize, and the sky is really the limit.

Another concern is that the moment you file, a whole host of new people and agencies are involved in your life who weren't before, such as the U.S. Department of Justice's Trustee Program and its trustee offices, the court and the creditors, who have a large stake and

influence in a debtor's future. There are degrees of loss of control that happen by filing that may not happen if you don't file, and those need to be measured and balanced.

## What else should a business owner be thinking about when considering filing?

A business cannot operate in the red in bankruptcy.

A company may go into bankruptcy and have a few months of losses before going back into the black, and that's OK if a debtor can show the low point of a seasonal business or orders that will create a profit in the future.

The reason why accrual of losses in bankruptcy is especially treacherous is that post-bankruptcy debt — to the extent that it is unpaid — receives administrative expense priority, which means it's the top priority at the same level as unpaid legal fees.

The day before bankruptcy, if credit is extended to a business without collateral, it is general unsecured debt. That same credit extended the day after bankruptcy is top priority and entitled to be repaid in full, immediately, in order to exit the bankruptcy. General unsecured debt, on the other hand, generally gets paid back over years, or not at all.

If too much post-bankruptcy debt is accrued and unpaid, the ship can't sail to its goal. It gets top heavy and falls over because the organization can't pay its debts to get out of bankruptcy.

The process is a partnership between the bankruptcy lawyer and the business. The lawyer can do a lot to make it work but can't do anything without a profitable business. Bankruptcy attorneys fundamentally take that profit component, drop it to the bottom line and make deals with creditors to split that. And if there is no profit, the attorney has nothing to work with.

If you have a bias toward filing, you will always be able to find a bankruptcy attorney to file for you. However, if an experienced bankruptcy attorney who knows the system and who understands the adverse consequences advises against it, it may be prudent to heed that advice. <<

**LEWIS LANDAU** is senior counsel at Dykema Gossett LLP. Reach him at (213) 457-1754 or L.Landau@Dykema.com.

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