

5 STEPS EVERY SMALL BUSINESS OWNER MUST TAKE BEFORE REOPENING FROM A COVID-19 SHUTDOWN

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As a result of the COVID-19 pandemic many businesses have been forced to close their doors and the future of small business is uncertain. The long-term health and economic effects of the pandemic are still unknown. Some government funds have been made available to help small businesses survive.

Unfortunately, not all small businesses will get much needed assistance and for those that do receive assistance, it may not be enough for them to survive. Small business owners are trying to decide whether they should reopen, how they can reopen and how they can deal with the debt that has accumulated during the shut down.

This article will provide five key steps that every small business owner should take to address their COVID-19 related financial issues and determine if and how they can successfully reopen. This is not intended as legal advice in any particular situation but rather as a general overview. A consultation with a legal or financial professional to obtain information based upon each unique situation is absolutely necessary.

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STEP 1 **IDENTIFY AND MANAGE DEBT**

First you must identify and categorize each business-related debt. Debt categories include rent, utilities, insurance, payroll and payroll related expenses, taxes, loans, marketing, credit cards and trade debt. If you maintain your financial records electronically, such as on quick books, this information is easily gathered. If not, you can gather this information by looking through your bills and other business documents.

As to each listed debt you must determine who is liable on the debt. If the business is a sole proprietorship, the business owner is personally liable for all of the debt. If the small business is a corporation, an LLC or other business entity, potentially only the business is liable on the debt. It is possible, however, that the business owner might also be personally liable on the debt. Therefore, it is very important to look at the actual invoices to make sure who the creditor believes is responsible. The small business owner must also look to see if any of the debt is subject to a personal guaranty. A personal guarantee is an agreement by the business owner to be personally responsible to pay a debt if the company does not pay it. The smaller the business, the greater the chance that leases, bank loans and other debts are personally guaranteed.

STEP 2 **BE STRATEGIC WITH PAYMENTS**

If you have money to pay only some of your creditors be strategic as to which creditors and how much you pay. For instance, if your business has received recent COVID-19 government grant payments, make sure that you pay what the grant requires, most notably payroll. If you still have money available to pay some but not all of the outstanding debt, be strategic as to what debts you pay. Determine which creditors and vendors are absolutely needed to rebuild your business and pay them first. If possible, pay the creditors that hold personal guarantees to minimize your personal debt liability. The decision as to what bills to pay should involve consultation with legal counsel or other financial professional to devise an effective overall plan.

STEP 3 **COMMUNICATE WITH YOUR CREDITORS**

If you are unable to pay a creditor be proactive and reach out to that creditor. Let them know about how your business has been affected by the pandemic and shut down orders. Ask them if there are any available options to assist with repaying the debt. Try to get a sense as to which creditors will work with you when the doors reopen.

STEP 4 **DECIDE IF THE BUSINESS CAN SURVIVE**

Now that you have identified the debt and know whether your creditors might be flexible, you need to really think about whether your business can survive. After identifying the debt and the flexibility of the creditors and vendors, you need to do an analysis to determine if the business is financially viable. To do so, the next step is to make revenue projections to determine whether when the business reopens it will be able to pay its outstanding debts and ongoing expenses. Be sure to include additional costs that might be incurred to maintain social distancing and other requirements that might be imposed by the government. You must also decide whether it would be necessary to take on new business debt and whether it would be available. Importantly and with caution you must also determine whether you should invest personal funds to keep the business afloat.

Ultimately, the decision has to be made if the business can actually survive which is a difficult one as we do not know what the “new normal” will look like in the months ahead. This step should be made with the assistance of legal counsel or a financial advisor who will give impartial advice based upon the facts presented.

STEP 5 **UNDERSTAND YOUR BANKRUPTCY OPTIONS**

Hopefully, you will be able to either pay your creditors or negotiate with them and not need to file for Bankruptcy to eliminate your debt. In evaluating all your options, it is important and helpful to understand what the available Bankruptcy options are and what they can help achieve.

What is Bankruptcy?

Bankruptcy is a legal process by which an individual or business that cannot pay its debts can seek to have some or all of its debts eliminated. The concept of debt forgiveness actually has its roots in the Bible. It is provided for in the Constitution of the United States. Upon filing for bankruptcy the small business gets the benefit of what is known as the “automatic stay” which stops all collection efforts.

Types of Bankruptcy Available for Small Businesses

There are three types of bankruptcy that small businesses can use to eliminate their debt- Chapter 7, Chapter 11 and Chapter 13. Chapter 13 is only available to individuals and sole proprietorships and not to corporations.

Chapter 7 Bankruptcy

A Chapter 7 bankruptcy is generally only used by individuals including sole proprietors who are not trying to save their business but only want to eliminate the debt by getting a Chapter 7 discharge. The discharge legally releases the individual and sole proprietor from most debts including credit cards, loans, rent, personal guarantees and other obligations owed to creditors. It is important to consult with an attorney to learn which debts are and are not discharged, such as certain tax debt.

It is generally not recommended that corporations and Limited Liability Companies (LLC's) file a Chapter 7 bankruptcy. As noted above, the purpose of a Chapter 7 bankruptcy is to obtain a bankruptcy discharge. The bankruptcy discharge is only available to individuals and cannot be obtained by a business entity. A consultation with an attorney is necessary to learn alternatives to Chapter 7 for business entities.

Chapter 11 Bankruptcy

Chapter 11 is generally the type of bankruptcy that individuals and businesses use to save their business by restructuring. Congress passed the Small Business Reorganization Act ("SBRA") which added Subchapter V to Chapter 11 of the Bankruptcy Code effective on February 19, 2020. This created a more efficient and less costly process for small businesses to reorganize under Chapter 11. As enacted, the SBRA applied to businesses with debt not exceeding \$2,725,625. The Coronavirus, Aid, Relief and Economic Security Act (CARES Act) amended the SBRA to increase the debt limits to \$7.5 million. This debt limit is temporary and currently expires one year from March 27, 2020 when the debt limit returns to \$2,725,625.00. While Chapter 11 bankruptcies have traditionally been very expensive and difficult to complete, the laws governing small business bankruptcies have made it easier, quicker and less costly to pursue.

In a small business Chapter 11, a Plan is filed providing for catching up on missed rent, payroll, mortgage, equipment leases and/or secured bank debt, taxes and also for the payment of some or all of the amounts owed to vendors or other unsecured creditors.

The Plan must provide for payments over a period of three years, but if it is necessary it can be extended to up to five years. Those payments are made from future income. The Bankruptcy Court must approve the Plan. In certain cases, the Court can approve the Plan even if the creditors are not in agreement. After completion of the three to five-year period all remaining unpaid debts are discharged, meaning they are no longer owed.

Chapter 13 Bankruptcy

A Chapter 13 bankruptcy is commonly known as a wage earner reorganization. It is only available to individuals. That means it applies to sole proprietors who do not operate under any form of corporation or an LLC. To qualify to file under Chapter 13 the individual cannot have secured debt (meaning debt for which assets are put up as collateral) of more than \$1,257,850.00 and unsecured debt of more than \$419,275.00. Chapter 13 bankruptcies for sole proprietorships are less expensive than a small business Chapter 11 and move through the court quickly.

Like a small business Chapter 11, a Plan in a Chapter 13 bankruptcy must be filed with the Court. That Plan must provide for payments to be distributed to creditors over a three to five-year period. Once approved by the Bankruptcy Court and after all of the payments are made over the three to five-year period, all remaining unpaid debts are discharged.

Upon completion of this five-step process, small business owners will be able to make an informed decision as to whether to reopen and have a plan in place as to how to manage the debt once reopening occurs. As noted, this process will require the assistance of an attorney or other financial advisor. The lawyers at Levitt & Slafkes, P.C. in Maplewood, NJ concentrate their practice on representing individuals, sole proprietors and small businesses experiencing financial difficulties in bankruptcy and non-bankruptcy matters.

Feel free call us at 973-313-1200 or send an email to blevitt@lsbankruptcylaw.com to see how we can help you.

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