What's the Deal? Bankruptcy Tips and News

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Article
03.18.2021

A common misconception recently is that bankruptcy filings are at an all-time high. It's an understandable assumption when the news is saturated with stories about store closures and unemployment spawned by the COVID pandemic. Yet the truth is most areas of the country are not seeing a huge spike in bankruptcy cases, and few common reasons stand out.

Bankruptcy is designed to offer individuals and businesses a fresh start on their economic journey. It often makes sense to file a bankruptcy petition when a debtor has equity in assets that a bankruptcy filing will help them retain or the debtor has a reasonable belief that their economic situation will improve if they can discharge or restructure payments on their existing debts. But what if neither of these factors are in play so bankruptcy offers no more than a false start?

Although real estate values may be increasing in some cities, many prospective individual and business bankruptcy debtors who don't own real estate have depleted their cash and other assets in an effort to make ends meet during the pandemic. If a debtor is "judgment proof" because they don't own assets with enough value that a creditor could legally seize them and have them sold for a price that, after costs, would substantially reduce the debt, then there's little motivation to use bankruptcy to discharge the debt. The debtor might be better off waiting to file when the debtor has assets worth protecting. Besides, the statute of limitations for collecting on a debt may expire after a few years and bar collection even without a bankruptcy discharge.

The motivation to file for bankruptcy also declines when the prospects for future economic recovery are dim. For example, if a restaurant or small retail shop barely has enough ongoing business to stay afloat and has no reasonable assurance that matters will improve in the near term, then no amount of debt reduction or delayed payments will solve the problem of a vanishing income stream. Bankruptcy doesn't revive a business that's dead on arrival. The large department store chains we've seen in the news because of their Chapter 11 filings usually come to court prepared to show they have reasonable expectations of returning to profitability by using the bankruptcy process to downsize operations, shed unsecured debt and ease repayment terms on secured debt.

Lastly, it's likely that many bankruptcy filings have just been delayed. It's been common during the pandemic for creditors who haven't been paid as agreed to wait to start the collection process. Some creditors have delayed collection voluntarily, while others are subject to legal restrictions like foreclosure and eviction moratoriums. Even debtors who have assets worth protecting and businesses on the rebound may choose not to file a bankruptcy petition unless and until the collector is at the door. As the health crisis recedes, collection activity will resume, and an increase in bankruptcy filings is inevitable at that point.