

## What Can Go Wrong Before a Bankruptcy Filing

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By avoiding common mistakes made by debtors before a bankruptcy filing, businesses may give themselves a fighting chance to avoid that arena, or, if that is not practical, to succeed in Chapter 11. The mistakes include:

- Letting go of accounting personnel.  
While there may be some merit to the conclusion that the accounting personnel contributed to the financial crisis and that their retention will only prolong the agony, hiring new personnel before terminating the old group is generally better. (This assumes that there are no issues of fraud, defalcation, incompetence, intentional or misreporting.) Without some transition from old to new, the new personnel's task may more imitate forensic accounting than regular reporting.
- Refusing to communicate with or misleading creditors.  
Whether a restructuring is to take place as an out-of-court workout or through a bankruptcy plan, maintaining good relationships with the company creditors is a wise practice that could be the glue that makes even a bad case good. Ignoring the telephone calls and inquiries will almost always result in creditors presuming that there is something more to hide than just the fact that they aren't being paid. What is worse than refusing to return that call, however, is communicating incorrect or misleading information, which gives rise to distrust when the truth is discovered. Disseminating accurate and consistent financial information is a key in maintaining rapport with creditors and in maximizing the chance for a successful reorganization.
- Misleading employees.  
Employees should be treated with no less respect than creditors and should not be victims of inaccurate or misleading information.
- Failure to timely identify and eliminate "bleeders."  
Depending on the nature of the business and magnitude of its operations, the company should be able to independently analyze selected aspects (i.e., divisions) of its structure. Separate limbs of the company that drain more from the bottom line than they contribute must be classified as bleeders. And it is important to act promptly to eliminate identified bleeders.
- Failure to cut overhead; keeping the sacred cows.  
In addition to cost-cutting measures that take place when management reduces labor expenses, a careful eye should be directed towards reducing overhead or operating expenses (travel, insurance and supplies). Some that can result in significant expense reduction may fall into the category of "sacred cows," such as the prestige of an office in a high-rent district that's more beneficial to employees than finances.
- Failure to build a sufficient war chest.  
To the extent creditors have not already put the company on cash on delivery terms, it is

to be expected that such a policy will be implemented upon the public knowledge of financial distress or the filing of a bankruptcy reorganization case. For this reason and others, such as a need for cash for expense items unique to bankruptcy cases (U.S. trustee fees, appraiser fees to defend motions for relief from the automatic stay), it is important that the pre-filing debtor generate cash to be used in the bankruptcy case. Generating cash can be done via liquidating nonessential property, retaining proceeds of accounts that would otherwise be turned over to the secured lender, new borrowing, sale of securities, etc. While the goal of raising the necessary war chest is important, counsel must be careful not to advise the client to engage in cash-raising activities that raise issues more problematic than a lack of cash.

- Using trust funds to operate the business.  
Since many companies control the remittance of funds to governmental agencies from payroll withholdings, the temptation in financially troubled times is to treat such agencies as involuntary lenders. While the motivation is generally to ensure a continuous supply of needed goods and services, it may cause problems for management and confirmation of a Chapter 11 plan. Responsible persons may be individually liable. And the unpaid tax makes it more difficult to confirm a plan. Also, the tax claim is a debt that must be paid in full through the plan. Depending on the claim's magnitude, this requirement may affect the company's ability to prove the plan is feasible.