



Bankruptcy: When BK Doesn't Mean You Can Have It Your Way

■ JOHN SHUFELDT, MD, JD, MBA, FACEP

My favorite movie—other than *Wedding Crashers*, of course—is *It's a Wonderful Life*. I watch it every Christmas. One of the most memorable scenes is where Uncle Billy misplaces the envelope containing the deposits. Once George realizes the gravity of the situation, he confronts Uncle Billy:

“Where’s that money, you stupid old fool? Where’s that money? Do you realize what this means? It means bankruptcy and scandal and prison, that’s what it means! One of us is going to jail, and, well, it’s not gonna be me!”

Many providers believe the most common reason a healthcare professional is forced into bankruptcy is an adverse malpractice event. However, there are many more common reasons which can result in physicians finding themselves before a probate judge. They include, among others:

- uninsured or underinsured casualty losses
- ill-advised investments
- willingness of banks to loan money to providers who may not be good “risks”
- personal guarantees of business obligations
- alimony and property payments that could have been minimized with a prenuptial agreement
- inability or unwillingness to pay back student loans
- uninsured sexual harassment claims
- estate taxes caused by inadequate estate planning
- income tax
- cash flow issues during practice start-up
- victimization by fraud



John Shufeldt is the founder of the Shufeldt Law Firm, as well as the chief executive officer of NextCare, Inc., and sits on the Editorial Board of *JUCM*. He may be contacted at JJS@shufeldtlaw.com.



- liability for breach of fiduciary duty (e.g., ERISA claims, director or officer liability)
- real estate investments before a market downturn
- indemnification obligations.

Did you read this list of potential causes of bankruptcy and say to yourself, “Those could never happen to me?” Sadly, everyone believes that “it will never happen to me.” I know some very bright business people who have been caught up in one or more of these circumstances and have either lost it all or have come close to losing it all because of some seemingly very innocuous mistakes.

My advice is to keep your guard up. These days, it is not difficult to go from financial solvency to insolvency within a few months.

With the proliferation of—and subsequent, high-visibility failures of some—urgent care centers and retail clinics, it seems like a good time to discuss bankruptcy.

This article and the one in the September issue of *JUCM* will review the personal and legal implications of filing for bankruptcy. Although statistics on physician bankruptcy proceedings are scarce, suffice it to say that the numbers of

physicians declaring bankruptcy is increasing.

Let's start with some basics.

Often, an individual can be forced into bankruptcy by a creditor. However, there are occasions where an individual who is badly in debt can proactively seek bankruptcy protection under one of three possible Chapters in the United States Bankruptcy Code:

- Chapter 7 (liquidation)
- Chapter 13 (reorganization)
- or Chapter 11 (reorganization)

Chapter 7

Chapter 7 of the Bankruptcy Code governs the process of liquidation. It is the most common form of bankruptcy in the United States.

A Chapter 7 filing for a *business* means that the entity immediately ceases operations unless a Trustee is appointed. The Trustee is responsible for selling the assets of the business and distributing the proceeds to the investors.

When an *individual* declares bankruptcy under Chapter 7, the individual may be allowed by the court to keep certain assets such as their house, which may in fact be completely exempt from creditors; this varies by state.

Many debts are unsecured and will be legally discharged during the proceeding.

Other debts, like child support, spousal support, student loans, income tax less than three years old, court-ordered fines, and restitution are *not* discharged during a bankruptcy.

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act went into effect in an effort to prevent abuse of the bankruptcy laws. The most significant change Congress enacted was to allow for a conversion or a dismissal of a Chapter 7 upon a finding of substantial abuse.

Chapter 13

Under Chapter 13, Title 11 of the Bankruptcy Code, an individual debtor devises a plan to pay off his creditors over a three- to five-year period.

The good news is that the debtor gets to keep his property; the bad news, however, is that filing a Chapter 13 stays on your credit report for 10 years and during the repayment period, the debtor cannot obtain additional credit.

The debtor must start paying off creditors within 45 days of declaring bankruptcy. During the repayment period, creditors can attempt to collect only through the bankruptcy court. At the end of the day, the debtor keeps his property but has a black mark on his credit report, and the creditor ends up collecting less money.

Chapter 11

Under a Chapter 11 filing, a distressed business can seek

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protection from its creditors and stay in business while the bankruptcy court supervises the reorganization of the company's obligations. The rationale used by the courts and legislature is that sometimes the business is more profitable as a “going concern,” as opposed to simply selling off the assets.

As a precursor to seeking a Chapter 11, the proponents have to make and defend the argument that the creditors will end up with more money than they would have under a Chapter 7. The court can go so far as to grant a complete relief of much of the company's debt in order to gain a fresh start.

In the end, if the debts outweigh the assets, the business owners may end up with nothing and the creditors become owners of the newly reorganized company.

Chapter 11 is reorganization, as opposed to liquidation. Debtors may “emerge” from a Chapter 11 bankruptcy within a few months or within several years, depending on the size and complexity of the bankruptcy.

Advantages and Disadvantages

The advantages of Chapter 13 over Chapter 7 include the ability to stop foreclosure proceedings and to have a mortgage that has been accelerated declared reinstated upon bankruptcy plan completion.

A friend of mine from medical school called me last year looking for advice. He had racked up a tremendous amount of credit card debt and found himself on the losing end of a sexual harassment suit. (Is it wrong to have sex on the boss's desk? I've got to plead ignorance on this one).

When I asked him about his plan to pay off the debt and satisfy the judgment, he responded, “What's there to satisfy, I am going to ‘BK’ and get it all off my record.”

A quote from the movie *Billy Madison* came to my mind: “Mr. Madison (and my friend's last name is actually Madison!), what you've just said is one of the most insanely idiotic things I've ever heard. At no point in your rambling, incoherent response was there anything that could even be considered a rational thought. Everyone in this room is now dumber for having listened to it. I award you no points, and may God have mercy on your soul.”

In an effort to keep us from ever having a similar quote directed at us, the next issue will discuss bankruptcy proceedings, counsel, and how to avoid problems before, during, and after the proceedings.■