BUSINESS COMPOSITION AGREEMENTS

A BETTER ALTERNATIVE TO COMMERCIAL BANKRUPTCY?

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WHAT IS A COMPOSITION AGREEMENT?

A Composition Agreement is a binding legal contract between a debtor and its creditors to pay financial obligations of the business on an agreed upon basis without the expensive supervision, legal fees and costs of a court proceeding or third party intervention.

HOW DOES A COMPOSITION AGREEMENT WORK?

The person drafting the Composition Agreement will thoroughly review the financial information of the business, analyze the liabilities and develop a payment plan that the business, based upon the business' latest projections, can afford to pay to its creditors.

This plan is then documented, disclosing the facts about the business' financial condition to its creditors and explaining the plan for repayment and seeking the approval of a percentage of the creditors.

WHAT IS THE COST OF A COMPOSITION AGREEMENT?

Costs vary based upon the accuracy and availability of the business financial information, the number of creditors and the complexity of the plan. Typically a Composition Agreement fees are between $20,000 and $50,000. This is far less than the cost of a typical Chapter 11 reorganization plan or other restructuring plans.

HOW LONG DOES IT TAKE TO IMPLEMENT A COMPOSITION AGREEMENT?

The time frame depends on the accuracy and availability of the business financial information, the number of creditors and the complexity of the plan. However, a time frame of between 6-10 weeks is usually adequate to implement a Composition Agreement but, of course, the payment schedule will be determined by the business' ability to pay back its debts.

WHAT ARE THE KEYS TO A SUCCESSFUL COMPOSITION AGREEMENT?

I. Accurate financial information about its debts with realistic and reasonable projections about the future earnings of the business. *[It is important that the business make timely payments to the creditors to maintain the integrity of the Composition Agreement.]*

II. Absolute fairness and transparency of the Composition Agreement so that no special terms are made with any creditor. *[If the creditors do not believe that they are being treated equally with other creditors in their class the Composition Agreement will fail.]*

III. Structuring an incentivized Composition Agreement to encourage the business to pay the debts back faster if cash flow permits.

IV. Cooperation and honesty between the debtor and the lawyer drafting and implementing the Composition Agreement. *[The debtor business must promptly provide complete and accurate information so that the lawyer can fully explain the problems, the condition of the business and develop a realistic repayment schedule for the debts.]*

V. The skill and experience of the lawyer drafting and implementing the Composition Agreement.

The ability of the business to make money on a go-forward basis and fulfill the Composition Agreement.

QUESTIONS AND ANSWERS ABOUT COMPOSITION AGREEMENTS:

Q. What do I say to the creditors when they call?

A. The business is trying to live up to its obligations but due to difficult economic times the weight of these obligations have made it impossible for the business to pay its bills on time and survive so it had two choices; file bankruptcy and unsecured creditors would get nothing or, enter into a Composition Agreement and find a way to pay the creditors and remain in business.

Q. How can the business buy product from its creditors?

A. Future purchases will be CIA (cash in advance) for custom or specialty products manufactured for the business or COD (cash on delivery) if the products are a commodity or a standard or stock product.

Q. Why would the creditors continue to do business with the company?

A.

1. **The creditor will be paid back.**

2. **The creditor will keep a customer and continue to sell CIA or COD earning a profit on new sales without risk of non-payment.**

3. **The creditor will not incur any legal fees or expenses.**

Q. Why not just file bankruptcy?

A. Bankruptcy may be an option for certain debtors if the debtor requires the power of an automatic stay issued by the bankruptcy court. In a Composition Agreement there is no court intervention and it relies upon good common sense of the creditors and the debtor.

Also, the costs of bankruptcy reorganizations are extensive and the additional weight of these costs and third party intervention can be the cause for a business to financially fail.

If your business is experiencing financial difficulty consult an attorney experienced in the successful resolution of debtor and creditor conflicts.

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OUR BUSINESS IS NOT IN TROUBLE BUT ONE OF OUR CUSTOMERS OR VENDORS IS.

Suggesting that a customer or vendor consider a Composition Agreement may benefit you by helping that customer or vendor remain in business. In the case of a customer, it is difficult enough to find and establish a new customer. Replacing that customer could take time and you would not have to write off receivables. If the troubled business is a vendor, keeping the vendor in business means you do not have to find and qualify a new supplier of product for your business. It makes sense to consider alternatives to bankruptcy.

WHO DOES COMPOSITION AGREEMENTS?

There are a very few lawyers that have successful experience in drafting and implementing commercial Composition Agreements. The business should contact an attorney for advice and counsel concerning options available to them.

WHAT DOES THE BUSINESS NEED TO TAKE TO THEIR ATTORNEY?

- Details about the business (state of formation, type of entity, etc.)
- 2-3 years of fiscal year financial statements
- Interim Financial Statements
- List of Creditors (with names, account number, proper addresses (no PO Boxes), phone numbers and amount owed)
- Identify which unsecured creditors are critical vendors
- List of taxes owed, the type of tax and to what taxing entity
- List of payments due to employee benefit plans
- List of money owed to the owners
- List of secured creditors (with names, account number, addresses (no PO Boxes), phone numbers, payment amount, balance due, identify the security and current value of the security)
- Copies of any appraisals or valuations of assets or the business

- List of operating leases (with name of Lessor, account number, addresses (no PO Boxes), phone number, payment amount, balance due and the item being leased)

- List of financing leases (with name of Lessor, account number, addresses (no PO Boxes), phone number, payment amount, balance due and the item being leased)

- Identify what, if any, debts have been personally guaranteed (If any liability has been personally guaranteed, provide an updated Personal Financial Statement.)

THE PROCESS

The business' materials will be evaluated and a preliminary determination made if a viable plan can be developed.

Discussions will occur with the secured lenders and Lessors to discuss the outline of a composition plan.

After discussions with the secured lenders and Lessors the lawyer will make a determination if the components appear to be favorable to prepare a draft composition agreement and the business will then need to prepare revised financial projections for the business based upon those discussions.

Upon receipt of the revised financial projections the lawyer will prepare the draft composition agreement for your consideration.

After approving the draft composition plan, the lawyer will send the plan out to your creditors for approval. Often, the creditors will call with questions and all calls should be referred to the lawyer.

If all goes well, the composition plan will be approved by the business' creditors.

WHAT HAPPENS IF THE COMPOSITION PLAN FAILS?

Sometimes even the best plans do not work out as expected. Sales can decline, a major customer goes out of business or market conditions can change the landscape.

If this happens the plan can be reviewed and perhaps modified or the business retains its ability to pursue other options such as bankruptcy.

The author, Myron E. Siegel, is a licensed Illinois attorney who has successfully drafted and implemented Composition Agreements for companies with financial problems where a deferred payment of existing debt would allow the business to survive, thrive and prosper. He is the founder and president of Myron E. Siegel & Associates, Ltd, 2275 Half Day Road, Suite 350-1293, Bannockburn, IL 60015 847-919-0803.

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