

**Houston Bar Association  
Bench Bar Conference**

**Business Issues for Consumer Lawyers**

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by

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# Debtor Engaged in Business

- (a) A debtor that is self-employed and incurs trade credit in the production of income from such employment is engaged in business.
- (b) Unless the court orders otherwise, a debtor engaged in business may operate the business of the debtor and, subject to any limitations on a trustee under sections 363(c) and 364 of this title and to such limitations or conditions as the court prescribes, shall have, exclusive of the trustee, the rights and powers of the trustee under such sections.
- (c) A debtor engaged in business shall perform the duties of the trustee specified in section 704(a)(8) of this title.
- **11 U.S. Code § 1304**

# Does the Debtor have a Business

- Factors to consider to identify a business case:
  - The petition contains a “D/B/A”
  - Debtor is self employed on Schedule I
  - Debts include loans for business assets or trade credit incurred in the production of income
  - Debtor has one or more employees
  - Debtor owes 940/941 taxes

## Does the Debtor have a Business

- Factors to consider to identify a business case (cont'd):
  - Assets on Schedules A or B indicate business real estate, inventory and/or business equipment such as office equipment, farm equipment, machinery, accounts receivable, inventory, stock or interest in an incorporated business, partnership or a joint venture, rights to patents, copyrights, licenses or franchises
  - Debtor has leases for business property and/or office equipment
  - Income and expenses on Schedules I and J are from self employment, a D/B/A or other company in which debtor owns an interest
  - Completion of items 4, 6 – 11, 18, Part 11 #27 - 28 on the SOFA (Official Form 107) indicating debtor has or had a business operation or had a connection to a business
  - If the debtor claims he only receives a 1099, inquire whether such debtor receives a 1099 from one source or many sources?

# Scheduling Business Assets

- Debtor's documents to review:
  - Copies of federal and state tax returns for at least the last two years
  - Copies of prepared financial statements for at least the last two years
  - Copies of financial statements the debtor may have provided to secured creditors for at least the last two years
  - Check registers and bank statements for at least the last two years
  - Current accounts receivable and accounts payable
  - Summary of jobs in progress
  - Copies of insurance policies, licenses, registrations, etc.

# Scheduling Business Assets

- Schedule A/B Property (Official Form 106A/B):
  - #3 requires the debtor to disclose vehicles. If a vehicle is used for business purposes it is important to identify as such in “other” as a vehicle used primarily for business is not subject to the 910 Day Rule.
  - #4 requires the debtor to disclose boats, trailers, RVs, ATVs. It is possible such are used for business purposes.
  - #17 requires the debtor to disclose deposits of money. Be sure to identify which accounts are used for business purposes versus accounts used for personal use. Discuss with the debtor if accounts have been commingled (i.e. used for both personal and business uses interchangeably).
  - #19 requires the debtor to disclose any interest in “non-publicly traded stock and interests in incorporated and unincorporated business, including an interest in an LLC, partnership, and joint venture. This is key to full and accurate disclosure. Review all corp documents, LLC documents, partnership documents and joint venture documents as the trustee is likely to request copies. Know if these entities are in good standing with the State of Texas and have all required returns been provided. Review copies of financial statements and balance sheets to determine value.
  - #26 requires the debtor to disclose “patents, copyrights, trademarks, trade secrets, and other intellectual property” the debtor has an interest in.
  - #27 requires the debtor to disclose “licenses, franchises and other general intangibles.” If the debtor discloses an interest in any of these types of assets it may be an indicator that the debtor has an interest in some type of business.
  - Part 5 Describe Any Business-Related Property You Own or Have an Interest In. #37 requires the debtor to disclose any legal or equitable interest in business property. #38 requires the debtor to disclose accounts receivable or commissions. #39 requires the debtor to disclose “office equipment, furnishings, and supplies” and “machinery, fixtures, equipment, and supplies used in business.” If the debtor discloses an interest in any of these types of assets it may be an indicator that the debtor has an interest in some type of business.

# Scheduling Business Assets

- Statement of Financial Affairs:
  - Question #4 requires the debtor to disclose income from employment or operation of a business for the year to date and the two prior years, including the source of the income.
  - Question #6 requires the debtor to identify if debts are primarily consumer debts or business debts. Question the debtor as to the purpose for which loans were taken or credit cards used. What appears on its face as a consumer debt may in fact be a business debt. When in doubt as for a copy of the loan documents or credit card statements.
  - Questions # 7 – 8 requires the debtor to disclose transfers made to insiders.
  - Questions # 9 – 11 requires the debtor to disclose legal actions, repossessions and foreclosures which will include both consumer related matters and business related matters.
  - Question #27 requires the debtor to disclose all interests the debtor has or had for all businesses in which the debtor was an officer, director, partner, managing executive, sole proprietorship or was self-employed for the four (4) years prior to the petition date. And to provide detailed information regarding such interests.
  - Question #26 requires the debtor to provide information as to any financial information provided to anyone about the business within the two (2) years prior to petition date.

# Scheduling Business Creditors

- Schedule D-H :
  - The debtor lists secured, priority and unsecured debts that are contingent, unliquidated or liquidated which pertain to a business rather than are consumer in nature. The debtor lists executory contracts or co-debtors which pertain to a business.

# Contingent, Unliquidated and Disputed

- A **contingent debt** depends on some future occurrence, which may never happen.
- An **unliquidated debt** is an obligation you owe, but for an unknown amount.
- A **disputed debt** is one that a creditor may say you owe, but you disagree.

# Contingent, Unliquidated and Disputed

- **Contingent debt.** These are debts that you may owe in the future, but they depend on a certain event that has not yet happened. The most common example of a contingent debt is if you cosign someone else's loan. You only owe money if the other person defaults. Since that may never happen, you may never actually owe the debt. Therefore, if the primary borrower is not in default when you file bankruptcy, then the loan is your contingent debt.

# Contingent, Unliquidated and Disputed

- **Unliquidated debt.** Like contingent debts, an unliquidated debt is an obligation you may owe now or in the future, but the monetary amount is currently incalculable. For example, you may be in the midst of a personal injury lawsuit. Your attorney in that matter may collect contingency fees, which means the lawyer gets a percentage of the settlement or verdict at the end of the case. You will owe your attorney's fees, but you cannot know how much you owe until your case concludes. Therefore, personal injury attorney fees are typically unliquidated debt, if the case is still in progress.

# Contingent, Unliquidated and Disputed

- **Disputed debt.** Sometimes, a creditor may claim you owe a certain amount, but you disagree with the sum or with the claim altogether. This is a disputed debt, which can involve virtually any kind of creditor. However, you must have a legal reason why you disagree with the amount due.
- For example, if a credit card company charged you 30 percent interest for missed payments, but your original contract stated that this penalty would only be 15 percent, then this may be a disputed debt.

## In re Beach, 2024 WL 638668 (D. NM, February 15, 2024)

- A debt is noncontingent "if all events giving rise to liability occurred prior to the filing of the bankruptcy petition."
- A debt is contingent "if the debt is one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor and if such triggering event or occurrence was one reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred."
- "A debt is not automatically rendered 'contingent' solely by virtue of its being disputed."
- One useful conceptual distinction between contingent debts and disputed debts lies in the difference between conditions precedent and subsequent:
  - Contingent debts (in the sense of dependency on a future event) involve no liability unless the condition precedent (e.g., a default by a principal) occurs.
  - Disputed debts involve presumptive liability unless cut off by a condition subsequent (entry of judgment for the debtor).

# Personal Liability

- Debtor has an LLC or Partnership
  - Review all contracts and documents to determine whether the loan is secured or unsecured.
  - Determine if the the LLC or Partnership is going to continue making paying on the debts
  - Determine if the loan should be direct pay or paid through the plan
  - Piercing the corporate veil

In re Ramus, 2024 WL 3246406  
(Bankr. N.D. Ohio, June 28, 2024)

Debtor previously held the position of Vice President of Business Development and National Wholesale at AEM, which was engaged in real estate wholesaling and “flipping” activities. However, it is alleged that AEM Services actually operated a Ponzi scheme, where investments were solicited under false pretenses to sustain the scheme rather than for legitimate real estate transactions.

# Cash Collateral

- The Bankruptcy Code defines cash collateral as including “cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents...in which the estate and any entity other than the estate have an interest...”
- **11 U.S. Code § 363**
- In Chapter 13 what types of cases may require filing a motion for use of cash collateral: rental properties (review loan documents to determine if lender has an assignment of rents); a business that generates accounts receivable.
- Review for IRS tax liens and possible priming per the 45 Day Rule.

# Valuation of a Business

- Fair valuation – § 101(32)(a)
- Reasonably equivalent value – § 548(a)(1)(B)
- Indubitable equivalent – USC § 1129(b)(2)(A)

Is the issue of “going concern” an issue as to valuing the business?

The issue as to debtor’s interest in business interests in which there are other members, shareholders, or partners will look at the % of the debtor’s interest; balance sheets; and financial statements of the overall business.

How to value a debtor’s fractional business interest such as a doctor in a multi doctor facility, surgical center, hospital, etc?

Expert Witness(s) v. Debtor’s Testimony

# Operating a Business in Bankruptcy

- Insurance
- Taxes
- Licenses
- Piercing the corporate veil

# Operating a Business in Bankruptcy

- Taxes
  - A “return” must have been filed – 11 U.S.C. §523(a)(1)(B)(i)
  - Must be income tax liability only – 11 U.S.C. §523(a), 11 U.S.C. §507(a)(8)(A)
  - 3 Year Rule: More than 3 years must have elapsed since tax return generating liability was due (due date – deal) - 11 U.S.C. §523(a), 11 U.S.C. §507(a)(8)(A)(i)
  - 240 Day Rule: Taxes must have been assessed more than 240 days before filing
  - 2 Year Rule: Return must have been filed more than 2 years before filing; 11 U.S.C. §523(a)(1)(B)(ii)
  - No fraud or willful evasion of tax
  - 11 U.S.C. 1308(a) debtor must file all returns for tax periods ending during the four (4) year prior to filing the petition not later than the day before the date set for the first meeting of creditors (the first date not adjourned first meetings).

# Operating a Business in Bankruptcy

- . Business registration
- . Texas State Comptroller Office registration
- . State licenses for regulated industries and professions:
- . Special state permits
- . Federal tax ID
- . Other local licenses and permits
- . Federal licenses and registrations

# Operating a Business in Bankruptcy

- Piercing the corporate veil
  - Looking for comingling of funds
  - Failure to maintain separate identities between the company and owner
- Possible treatment
  - Treat business debts and income as part of the individual case

# Scheduling Business Income

- Schedule I - Income:
  - Is there a similarity between the name of the employer and the debtor?
  - Is the address of the employer the same as the debtor's residence?
  - There are joint debtors both employed by the same employer and only one debtor claims to receive income.
  - There are no payroll taxes withheld from the debtor's income. This may be an indicator that the debtor receives an officer's draw.
  - The obvious indicator is that the debtor discloses income from the operation of a business on Schedule I rather than or in addition to the traditional income disclosure.
  - #8a requires the debtor to disclose all "net income from rental property and from operating a business, profession, or farm." The debtor must also attach to Schedule I a statement showing gross receipts and expenses. This information should reflect a monthly average based on the last twelve (12) months of operations or if using a pro forma indicate such. Be prepared to provide the supporting documentation to the trustee.

Thank You!