

Drummond Woodsum Challenges Chapter 13 "Disincorporation" and Wins Motion for Relief from the Automatic Stay



By
Kaitlyn M. Husar
Attorney

Creditors face a myriad of issues whenever a small business borrower files for bankruptcy, but creditors in only a handful of districts in the country routinely must navigate the even murkier waters of bankruptcy when a small closely held business "disincorporates" and the principal files individually under Chapter 13 of the bankruptcy code. In its most simple terms, "disincorporation" refers to the practice in which a small closely-held limited liability company or corporation transfers all its assets and its liabilities to an individual (generally a principal of the company) and then the individual files for Chapter 13. Debtors disincorporate in order to use the simpler, less costly and more debtor-friendly reorganization process available under Chapter 13, rather than Chapter 11 reorganization. Bankruptcy courts in Maine, and a handful of other districts, have generally allowed this practice and left creditors who entered into loans with business entities to navigate the prospect of enforcing their bankruptcy rights in the context of an individual debtor case, but a recent favorable decision on a creditor's motion for relief from stay by Judge Peter Cary of the United States Bankruptcy Court District of Maine provides guidance on one approach to successfully challenge a disincorporated debtor.

In the matter of In re Kurt L. Gagnon and Pauline C. Gagnon (17-20478), the debtors operated a business, organized as a corporation under the laws of Maine, in which they sold motors, boats and trailers financed by an inventory floor plan agreement with Wells Fargo Commercial Distribution Finance, LLC. Following the entry of a state court order granting Wells Fargo possession of the collateral, the corporate borrower transferred the inventory and the associated liabilities to Mr. Gagnon individually and Mr. and Mrs. Gagnon filed petitions under Chapter 13 of the bankruptcy code. Drummond Woodsum represented Wells Fargo in successfully obtaining relief from the automatic stay and turnover of the collateral by demonstrating at trial that only the corporate entity had agreements with the manufacturers and therefore the individual debtors could not sell the inventory with the manufacturer's warranty. Drummond Woodsum also demonstrated that the individual debtors did not have the necessary dealer licenses from the state of Maine in order to lawfully sell the collateral. The order on the motion for relief from stay was entered less than 30 days after the debtors had filed for bankruptcy relief.

While Maine bankruptcy courts continue to accept the practice of disincorporation, the Gagnon decision shows that creditors can successfully challenge disincorporation by presenting the court with specific consequences flowing from the disincorporation which adversely affect the value of the collateral, the rights of the creditor or the ability of the debtor to carry on the business. Additionally, creditors and their counsel should think critically about what remedy - dismissal of the case or more limited relief such as relief from the automatic stay - will be most effective in a given case to challenge a debtor's seemingly unfettered right in Maine to disincorporate.

Drummond Woodsum's bankruptcy attorneys are among the best in northern New England, handling bankruptcy matters for our clients regionally and across the country, including the federal bankruptcy courts for the Districts of Maine, New Hampshire, Vermont, Delaware, and the Southern District of New York. Our attorneys represent secured and unsecured creditors, creditors' committees, bankruptcy trustees and other parties affected by financial insolvency issues. Our practice draws upon our bankruptcy attorneys' broad experience, as well as the diverse legal specialties of colleagues throughout the firm, providing our clients with practical advice and creative solutions.

For more information please contact [Kaitlyn M. Husar](#) or any member of Drummond Woodsum's [Bankruptcy, Restructuring, and Creditors' Rights Practice](#).

If you have any questions about any of the topics discussed in this advisory, please contact Drummond Woodsum.

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