troutman pepper locke

CREDITOR'S RIGHTS TOOLKIT

How Does a Chapter 7 Case Work in General?

A Chapter 7 bankruptcy case is often called a "liquidation bankruptcy." The essence of a Chapter 7 business bankruptcy is the orderly liquidation of the business debtor's assets by a bankruptcy trustee, and the distribution of funds to creditors. From the perspective of a creditor, a Chapter 7 filing means the end of the business partner (although in very rare cases, the Chapter 7 trustee will operate the business for a short period of time in order to sell the assets as a going concern). While there are many similarities between a Chapter 11 case and a Chapter 7 case, there are important differences that a creditor will want to understand.

Key Issues

- **APPOINTMENT OF CHAPTER 7 BANKRUPTCY TRUSTEE**

  Unlike Chapter 11, where management remains in charge, immediately following the filing of a Chapter 7 petition, a Chapter 7 bankruptcy trustee is appointed over the debtor's estate, replacing incumbent management and displacing the debtor's control of the business. In a Chapter 7, the business debtor's role is limited to making a complete disclosure of assets and liabilities, providing information relating to financial affairs, cooperating with the Chapter 7 trustee, turning over all property to the Chapter 7 trustee, and submitting to at least one examination under oath by the trustee and creditors.

- **REJECTION OF EXECUTORY CONTRACT AND UNEXPIRED LEASES**

  Whereas in a Chapter 11 case, a debtor may reject executory contracts, unexpired leases of residential real property, and unexpired leases of personal property at any time before confirmation of the plan, in a Chapter 7 case, these agreements will be deemed rejected if they are not assumed within 60 days after the order for relief. Moreover, since certain executory contracts may not be needed as a result of the debtor ceasing business operations, a nondebtor party to an executory contract may wish to reach out to the trustee immediately upon the filing to see if the trustee is willing to agree that the executory contract can be immediately rejected.

- **FILING OF PROOF OF CLAIMS**

  Unlike Chapter 11, in Chapter 7 cases, the trustee will only establish a deadline for creditors to assert claims if the trustee determines that there are assets available to administer. Once that determination is made, the Chapter 7 trustee will provide notice to creditors. As with a Chapter 11 case, it is critical that a creditor timely submit a claim in order share in any distribution.

- **TIMING OF DISTRIBUTIONS TO CREDITORS**

  In general, in a Chapter 11 case, payments to creditors require confirmation of a plan, which the process can take months. In comparison, because there is no plan to be confirmed in a Chapter 7 case, in theory, Chapter 7 cases can move quickly, resulting in more prompt payments to creditors. In practice, Chapter 7 proceedings involving even moderately large businesses can sometimes take years to be fully administered, particularly where the trustee is pursuing litigation on behalf of the debtor's estate.

Takeaway

While there are many similarities between a Chapter 11 case and a Chapter 7 case, such as the effect of the automatic stay, the establishment of a deadline for creditors to file claims, and the ability to claw back preferential payments, there are differences that are important for a creditor to understand. A creditor who is owed money by a company that has filed for Chapter 7 should consult with experienced bankruptcy counsel to understand these differences and to make sure that its interests are fully protected.