I. INTRODUCTION

A. The representation of small business companies in Chapter 7 case, though sometimes perceived to be little different from the representation of the typical consumer debtor, offers a wide range of complex issues that counsel should recognize and address in the course of the representation. As we discuss more fully below, there are a number of reasons for this complexity, including:

- The role of shareholders, members, and officers of the company
- The potential presence of employees
- The potential presence of environmental issues
- The potential presence of ongoing business operations

B. The careful consideration of the above issues and other potential issues can play a significant role in both the conduct of the case and the successful representation of the client. Among the benefits are:

- The proper pricing of representation
- The reduction in postpetition tasks
- The reduction in the risk of malpractice claims

II. FACT PATTERNS

A. A family-owned grocery store chain with five operating stores located in two states is being subjected to a garnishment of its primary bank accounts. It has approximately 100 employees, all of whom except for officers are low wage employees. Each store is fully stocked with both perishable and non-perishable items typical for a grocery store. In addition, the company maintains a warehouse in which it stores additional items that it has purchased in bulk for resale in its stores. The company owns all five locations and the equipment and inventory in each store free of all liens except for Perishable Agricultural Commodities Act (“PACA”) liens on perishable items. The owners are in disagreement over what should be the future of the company.

B. A single member limited liability company has no business operations and its sole asset consists of a former coal preparation plant in Appalachia, Virginia. The operations of the plant created significant environmental issues and there are several holding ponds onsite that contain contaminated water. The site has no barriers limiting access to the property. The company has a very small tax basis in the property.

C. A limited liability company owned by husband and wife operated a hardwood plywood manufacturing plant in Bluefield. All employees are terminated prior to the closing of the
D. A farmers cooperative is unable to service the indebtedness incurred in the construction of a new building which secures the indebtedness and intends to close. The new building is reasonably well secured, though in a less trafficked area of the community. However, in addition to the new building, the cooperative continues to own its prior location which is in significant disrepair and can be accessed by the public. The remaining inventory is located in the new building as are all of the business records, some of which are kept on the cooperative’s computer system. The cooperative closes its business immediately prior to filing a petition and pays all salaries and wages due. The manager of the cooperative also causes the cooperative to repay him for money he loaned to the company. There are also members of the board of directors who have loaned the cooperative money and are not repaid. No employment tax returns are filed for the quarter during which the last wages are paid and no W-2s are issued to the employees.

III. ISSUES TO CONSIDER IN REPRESENTATION OF SMALL BUSINESS COMPANIES IN CHAPTER 7 CASES

A. **Pre-Filing Considerations**

A chapter 7 liquidation bankruptcy for a business is rare. The reason for this is because chapter 7 bankruptcies rarely provide a tangible benefit to the people who generally make the decision to file a bankruptcy—the people who own and operate the business. Often a person will request a consultation regarding a bankruptcy for a business when the person really needs a personal bankruptcy or no bankruptcy at all. Because, as discussed in greater detail below, a shuttered business cannot get a discharge in bankruptcy and cannot exempt any assets, an attorney must carefully consider whether a bankruptcy will meet the goals of the people seeking counsel.

1. Determining the proper Client and Counsel’s ability to represent the Client

   (i) The Business Entity: An initial question in the evaluation of the case by counsel must be whether the company should file, or whether to abandon the existing business and file for the owners, or whether bankruptcy can even provide any benefit at all. For example, in the right circumstances, an individual bankruptcy filing by the owners, discharging personally guarantied debts, can be followed by the creation of a new business.

   (ii) The Business Owner(s). The owner of a business is not necessarily the same individual that is sitting at the conference table. Stock corporations are owned by
shareholders. The directors of the corporation or the president of the corporation might not be the same as the shareholders, though they often are in small businesses. Limited liability companies are owned by members, and may be run by the members or may be run by managers who may or may not also be members. Non-stock corporations (not-for-profits) have no owners at all.

It is important to consider that the officers and directors of corporations are fiduciaries of the shareholders, and, in most instances involving potential bankruptcy counsel, courts have held that those fiduciary obligations shift to the company’s creditors.

The officers and directors may be held liable by the company’s creditors for breaching those fiduciary duties. Accordingly, it is important to keep those duties in mind, and advise the officers and directors of these duties, when they are seeking assistance relating to insolvency.

(iii) Other Possible Clients

(a) Guarantors of the Business’ Debt. Banks rarely lend money to small businesses without a personal guaranty. Even business credit cards are generally “business” cards in name only, and are actually a personal obligation of the person who signed the credit application. Vendors and suppliers often have personal guaranty provisions in credit applications that business owners signed many years prior and have since forgotten. In order to have a full picture of the benefits of a business bankruptcy, the debtor must investigate to determine all possible personal guaranties.

When the intended purpose of a business bankruptcy is to deal with a personally guarantied debt, the bankruptcy will provide no benefit to the guarantor unless the business has assets to pay the personally guarantied debts. Keep in mind that unless the personally guaranteed debt is secured and the collateral is sufficiently valuable, the bankruptcy trustee has no ability to pay guarantied debts prior to other debts.

Accordingly, if the primary purpose of the business bankruptcy is to deal with debts that are personally guarantied, perhaps the guarantors are better bankruptcy candidates than the company itself.

(b) Affiliates of the “Main Business.” A business may have one or more parent companies, subsidiaries, “sister” companies owned by the same parent, and so on. The bankruptcy for a parent company will not create an automatic stay effective against a creditor foreclosing on the assets of another legal entity, even a subsidiary.

Often, due to accountant or legal recommendations or lender requirements, companies will consist of a real estate ownership entity and an operations entity. Sometimes a business owner does not remember how exactly property is owned, between the operations entity, a special entity, or even by the
individual owner of the business. In many counties in Virginia real estate ownership can be determined from free online tax map systems, which can help guide decision-making, but ultimately these relevant facts will need to be determined by reviewing deeds, vehicle titles, bills of sale, and other ownership records.

2. Review of loan documents

   (i) Addressing Guaranteed Debt

   (a) No co-debtor stay in Chapter 7. Personal guarantors of business debt may be in for a rude surprise upon the filing of a business bankruptcy. A bankruptcy for a business does nothing whatsoever to stop lenders from pursuing personal guarantors. In fact, in many cases the bankruptcy will spur the creditors to pursue guarantors more aggressively. When considering a bankruptcy for a business, counsel should generally assume that all guarantors will be pursued by guarantors.

   (b) Business debt may be secured by assets of the business principal. Occasionally a lender will require that a guarantor grant personal assets as collateral. This can be particularly tricky when a debt owed by a business and personally guaranteed by the business owner is secured by the business owner’s personal residence. Tenancy by the entireties will not protect the residence and throwing the primary obligor’s business into a bankruptcy may quickly put the business owner’s home at risk.

   (ii) Scope of Liens/Cross-Collateralization

   In representing any business in bankruptcy, counsel needs to have a firm understanding of Article 9 of the Uniform Commercial Code as well as the state law requirements for perfecting liens on real and personal property. Most lenders will attempt to take as much collateral as security for a loan as a borrower and/or the guarantors of a borrower can offer. An unsophisticated borrower can unknowingly pledge significantly more collateral than it intended to pledge or not fully understand the consequences of its actions. Alternatively, even sophisticated borrowers experiencing financial hardship may have little bargaining power and will do whatever it takes to get the cash they believe is necessary to continue operations or keep the bank from declaring a default.

   Frequently, the owners of a small business don’t understand the full extent of the liens on the assets of the business. For example, an owner may be under the impression that a loan was for a single piece of equipment and upon further review of the loan documents, counsel discovers that the loan is not only secured by the specific piece of equipment, but also by all business assets, including accounts, inventory, equipment, instruments and chattel paper, general intangibles, etc. owned at the time the security interest was granted or later acquired. Additionally, it is not at all uncommon for security agreements and
deeds of trust to contain language that allows the subject collateral to serve as security not only for the specific debt that the security agreement and/or deed of trust was executed in connection with, but also for all other indebtedness the borrower may have with the lender. This is the concept of cross-collateralization. A borrower may believe that certain assets are almost “paid off,” and will often be surprised to learn that the assets will remain subject to the bank’s lien until all of the borrower’s obligations to the bank are satisfied.

Counsel should obtain and review copies of all loan documents and security instruments in order to determine the scope of the liens on the assets. Additionally, counsel should obtain a title search on all real estate and a UCC search to determine if the liens that were purportedly granted were properly perfected.

(iii) Identifying possible voidable transfers

(a) Payments on debt that was not incurred by the debtor

Commonly owners of small businesses have difficulty distinguishing between their company’s finances and their own finances. When company funds are used to pay a debt for which it is not liable or purchase an asset in the principal’s name, the payment constitutes a transfer for the benefit of the principal. These transfers may sometimes be avoidable by a chapter 7 trustee.

In order to find potential avoidable transfers, the trustee requests documentation, such as bank statements, tax returns, and title records. Review this documentation thoroughly prior to filing the case in order to (a) properly report and explain any transfers on the schedules, and (b) ensure that the discovery of a transfer by the trustee is not a surprise to the principal.

In some instances the debtor’s principal might have never taken a paycheck from the company and never taken a draw in the traditional sense, instead treating the company’s bank account largely as a personal account. In these instances the principal will often work with an accountant to divide the personal expenses from the business expenses for the purposes of reporting taxes. The funds used to pay personal expenses are treated as the principal’s draws from the business. In some cases these draws may be reasonable and in other cases they may constitute avoidable transfers. For example, when a company is in the realm of insolvency and the fiduciary duties have shifted to the creditors, it may be that no draws are appropriate and thus no payments of the principal’s personal debts would be appropriate either.

Additionally, use of the business’s account for payment of the principal’s personal bills may constitute partial grounds for a piercing suit against the principal by creditors of the business.
(b) Payment on debt that is unsecured

Occasionally particularly aggressive or favored creditors will receive payments from the debtor at a time when most creditors were not getting paid. If the payments to any one creditor within the 90 days prior to bankruptcy add up to more than $6,425.00, then those payments may constitute an avoidable preferential transfer. This is also true if a creditor obtains a lien in the debtor’s assets within the 90 days prior to a bankruptcy. If the payments were made (or lien given) with respect to a debt held by an insider, then the trustee gets a one year lookback period rather than 90 days.

The trustee’s ability to avoid a preferential transfer may work to further the goals of the business’s bankruptcy or it may create unforeseen issues. For example, if one aggressive unsecured creditor gets a judgment against the debtor and then garnishes the debtor’s bank account or obtains a judgment lien on real estate, a bankruptcy can allow for refund of the garnished funds or removal of the judgment lien. This often benefits not only the debtor’s remaining creditors, but also the principals of the company when it gets funds to guarantied debts. On the other hand, if the judgment creditor’s claim is one that is personally guarantied by the debtor’s principal, then the principal may prefer to not file a bankruptcy during the period in which the transfer may be avoided.

These considerations will likely make a difference in the principal’s decision of whether and when to file the bankruptcy.

3. Review of corporate formation and governance documents (articles of organization, operating agreement, bylaws, etc.)

(i) Authorization to file

A business entity must have proper authorization to file a bankruptcy petition. This authorization gets filed with the Court when the Petition is filed. Counsel must review these corporate documents to make a proper determination as to what authorization is needed. Review of the documentation is extremely important because it can make the difference between an effective filing and an ineffective filing.

A case filed without proper authorization may be challenged, though courts differ regarding the question of whether a creditor has standing to raise the issue. Nonetheless, if the court is presented with the question and determines that a case was filed without authorization, then the case will most likely be dismissed. This may be the difference as to whether or not a preferential transfer is avoidable.

To determine proper authorization for the filing, obtain copies of the company’s articles of incorporation or organization and the bylaws or operating agreement, with any amendments and relevant resolutions. The bankruptcy filing must be authorized by a resolution signed by the members of an LLC or directors of a
corporation in accordance with the terms of the organizing documents. The
organizing documents likely set a procedure for making decisions when the
company has more than one member or director. If not then majority decisions
rule—note that when there are two members or directors, a “majority vote” means
a “unanimous vote.” Counsel must determine whose signatures are needed in
order to have the minimum necessary to authorize the bankruptcy filing. Then it is
wise to get not only the minimum, but all possible signatures in order to remove
all question of authority to file.

Sometimes a member of an LLC may be another company or a trust. In that case,
to obtain the authorization of that entity, its own formalities must be followed.

(ii) Failure to maintain corporate formalities

(a) Using business funds for personal use, or vice versa, failing to have annual
board meetings for a corporation/failing to get corporation resolutions for
purchases, and using personal credit for business purposes, can all result in
lawsuits against the business owners individually under State law theories or
the Bankruptcy Code.

(b) Small businesses often fail to consider bylaws and operating agreements in
making business decisions and operating the business. In addition, a small
business may sometimes fail to file required annual reports with the State
Corporation Commission and/or fail to pay annual franchise fees, resulting in
the suspension or termination of the corporate existence. This can affect
business decisions and actions taken and the power to authorize a bankruptcy
filing.

When a company has been terminated by the state corporation commission, it
is not necessarily unable at that point to file a bankruptcy. The cleanest
procedure at that point would be to reinstate the company, which can be done
at any point within the five years after termination of the company. If the
company is not reinstated, then the former directors or members of the company
are assigned by statute as its trustees in liquidation and are obligated to liquidate
the assets of the company. When acting as trustees in liquidation the formalities
to accomplish acts for the terminated company are set forth by statute rather
than by the company’s organizing documents.


(i) Counsel should review vehicle and equipment titles, personal property tax
records, financial statements, and tax returns to discern how the equipment is
titled, who owns the equipment, and/or how the debtor has previously represented
the equipment as being owned.

(ii) In the small business context, there is often a bit of difficulty in determining the
ownership of equipment. There is a continuum of clarity ranging from equipment
that is clearly owned by someone other than the small business to clear ownership
by the business. Often the ownership is somewhere in the middle and entirely unclear. It is not uncommon for a representative of the business to advise counsel that a vehicle is owned by the business only for counsel to review the title and discover that the vehicle is in fact owned by the business owner individually, despite the fact that all payments on said vehicle have been made by the business.

5. What if the Case Converts? Given the rate of failure of Chapter 11 bankruptcy cases, counsel should consider the consequences of conversion of a Chapter 11 to Chapter 7 case prior to the filing of a Chapter 11 and advise the business owners accordingly.

B. Preservation and Protection of Records and Assets

Section 521 of the Bankruptcy Code places certain duties on all debtors. A business entity is not spared of these responsibilities, despite the fact that a business entity that has filed Chapter 7 no longer has any authority to operate and, therefore, no ability to compensate its employees/representatives for services provided post-petition. Therefore, a business debtor should take certain actions pre-petition to insure that its assets and records are properly preserved and protected to enable it to fulfill its obligations pursuant to 11 U.S.C. §521(a)(3) and (4) with minimal cost and effort. Taking these actions to preserve and protect the assets and records will also serve the dual purpose of compiling a large portion of the information a Chapter 7 trustee will need and require to be provided to properly administer the estate and minimize the administrative time and cost of providing the documentation and information.

The following is a list of assets and records that should be gathered pre-petition, reviewed by counsel in the preparation of the schedules and related documents, and then preserved and turned over the trustee as appropriate to evaluate the assets and affairs of the business debtor.

1. Computer systems and periodic financial statements

   The debtor should secure its computer system and maintain control of the system. If the debtor is operating in leased space, care should be taken to secure the computer system and/or business records prior to vacating the leased space. This is especially important if the computer system is used to generate financial reports and/or payroll. Generally, the authorized representative of the debtor will have access to the system and the financial reports and should be prepared to turn the computer system and/or financial reports over to the Chapter 7 trustee.

2. Payroll, Benefit, and Employment Records

   (i) Payroll and employment records will be necessary to schedule priority wage claims, complete final tax returns and W-2s, and needed by the trustee to evaluate wage and benefit claims that may be filed. Additionally, these records will contain personal identification information, such as social security numbers, which must be properly secured and eventually destroyed.
(ii) Employees. All employees should be terminated prior to the filing of a Chapter 7 petition since the business will have no authority or ability to pay wages going forward. Laid off employees should be entitled to unemployment benefits. Depending on the size of the business employees may be covered by the Worker Adjustment and Retraining Notification (WARN) Act, which requires 60-days advance notice with pay for plant closings and layoffs. Failure to comply with the WARN Act may result in employee’s having a claim against the company, though there are exceptions to the WARN Act that may apply in bankruptcy.

(iii) Wages and Benefits

The closure and liquidation of a company may have a significant impact upon an employee’s wages and benefits. Employees owed back wages, salaries or commissions within the 180-day period immediately preceding the petition date are entitled to priority pursuant to Section 507(a)(4) of the Bankruptcy Code, up to $12,475, which amount is subject to adjustment by the Judicial Conference of the United States. 11 U.S.C. § 507(a)(4).

Employees must file a Proof of Claim with the bankruptcy court for back pay along with supporting documentation like time sheets, sales records or employment contracts. Since Chapter 7 trustees make distributions at the end of the case, payments to employees for their last pay period may not be received for months or years, if they are received at all. In advising a business debtor as to the timing of a Chapter 7 bankruptcy filing, counsel should be aware of the business’s payroll schedule. If a business has the funds to make its final payroll, it can eliminate a great deal of hassle and angry former employees if final payroll is made prior to filing.

In advising a small business debtor, bankruptcy counsel should ascertain whether the business maintained any form of pension or retirement plan. It is not uncommon to discover that an employer that is experiencing financial hardship has failed to comply with the requirements for maintaining its retirement plan. Specifically, employers frequently fail to forward employee contributions to the retirement plan administrator and use the funds for operations. If a business failed to forward employee contributions to the retirement plan administrator, an employee must file a proof of claim with the bankruptcy court to recover the contributions. Certain contributions to an employee benefit plan are entitled to priority under Bankruptcy Code Section 507(a)(5).

For an employer that provides health insurance coverage, the coverage will cease upon the filing of the bankruptcy and cessation of the payment of the insurance premiums. Outside of bankruptcy, employees generally have the option to continue health coverage (but usually at their own cost plus a 2 percent administrative fee) for up to 18 months under the Consolidated Omnibus Budget Reconciliation Act (COBRA). However, COBRA typically does not apply after an employer files for bankruptcy under Chapter 7, since COBRA does not extend to members of health plans after an employer dissolves all group plans. Therefore,
the insurance provider should be contacted pre-petition to determine the employees’ rights and options.


Proper completion of the schedules will require obtaining information on all work in progress, outstanding accounts receivable, and accounts payable. All accounts payable should be properly listed in the schedules and the documentation used in scheduling the debts maintained and provided to the trustee as requested. This information may be needed to verify and/or object to claims. Additionally, the trustee will want information concerning the collectability of outstanding accounts receivable, so that he/she may attempt to collect such accounts.

4. Bank statements and cancelled checks.

(i) Ideally counsel would review 24 months of bank statements and cancelled checks to identify possible preferences and insider payments.

(ii) Timing of clearing of pre-petition checks. Checks that have not cleared as of the Petition Date may not be honored and/or the trustee may seek to recover the funds as unauthorized post-petition transfers of assets of the estate. Any critical payments should be paid in immediately available funds and payment delivered to the payee prior to the petition being filed.

(iii) Stop payments. Upon the filing of a Chapter 7 bankruptcy petition the debtor should stop paying on all accounts and debts and should advise the trustee as to any outstanding payments that have not cleared. The trustee may advise the Debtor to request the bank to stop payment on certain transactions.

5. Suits and garnishments

Counsel should use reasonable efforts to identify all pending lawsuits and garnishments. These actions must be listed in the Statement of Financial Affairs. Additionally, upon the filing of the bankruptcy petition, it is advisable to file a Notice of Bankruptcy and Suggestion of Stay in the state court where the action is proceeding to properly notice all interested parties and their counsel.

6. Tax returns (business and employment)

Copies of the federal, state, and payroll tax returns for the 3 years prior, including all schedules and attachments thereto should be obtained by counsel, reviewed in preparation of the schedules and statements, and provided to the trustee as requested. The trustee may request additional (or fewer) years depending on the specific facts of the case. If all returns have not been filed, the trustee should be advised of the same. Liability is frequently assessed for unfiled returns. Therefore, the trustee may determine that it is in the best interest of the estate to have the returns completed and the correct liability established for purposes of paying claims. Correspondingly, if there are no
assets the trustee may not file the delinquent returns. This could result potentially result liability for the former officers or owners of the business if the returns are never filed.

7. Security & Access

The debtor is obligated to allow the trustee to access all of the company’s assets and assist the trustee to a reasonable extent in preserving and liquidating the assets. For example, the trustee cannot easily sell a truck for which he has no key. Debtor’s counsel should obtain all relevant keys, access codes, etc. and send them to the trustee.

The debtor should also inform the trustee regarding any potential security concerns immediately upon filing. If the debtor owns hazardous materials, the trustee should be informed of this fact in order to allow him to take any necessary precautions. This might consist of anything from erecting a fence to abandoning the asset.

8. Utilities.

Counsel for the debtor should be aware of all utility service providers and the status of the utilities. Utility providers should be notified of a bankruptcy filing. Depending on the nature of the business and the location of the assets, it may be advisable to maintain utility services to protect the assets. The trustee should be advised as to the status of the utilities, especially if service has been terminated pre-petition and assets are at risk of becoming unsecure or at risk of spoilage.

Section 366 of the Bankruptcy Code prohibits a utility provider from discontinuing service for 20 days after a bankruptcy filing, which allows some time for the continuation of utility services, if needed. But the utility provider is under no obligations to continue services after that point and also is not obligated to reach out to the debtor or trustee regarding continuance of service. The Bankruptcy Code allows the utility provider to discontinue services when it does not have adequate assurance of payment.

9. Environmental and other hazards

(i) Counsel for the debtor should be aware of any environmental concerns. The presence of certain environmental hazards must be disclosed on the Petition and the trustee will need to be made aware of these hazards as soon as possible upon the filing of the Petition. Additionally, some courts have held that a bankruptcy petition does not relieve the debtor of obligations to comply with environmental standards. See e.g. US v. Hansen, 262 F.3d. 1217 (11th Cir. 2001).

(ii) Anyone in possession of the site whether debtor, receiver, vendee, or bankruptcy trustee must comply with environmental laws of the state. Midlantic v. NJ DEP, 474 US 494 (1986).

(i) Counsel should be aware of issues related to the Perishable Agricultural Commodities Act (“PACA”). PACA establishes a trust in favor of suppliers of perishable agricultural commodities. PACA trust creditors can have superriority, due to the fact that assets included in the PACA trust will be excluded from the bankruptcy estate.

11. Insurance Coverage.

(i) Copies of the declaration pages for all insurance policies should be provided to counsel and reviewed in connection with preparing the schedules. Frequently, these declaration pages will include equipment that counsel has not been previously aware of and may need to be addressed.

(ii) Insurance coverage should be maintained if at all possible. At a minimum counsel should be aware of when insurance will lapse and advise the trustee of this date as early as possible. Obtain ACORD Form 25 from the Debtor’s insurance agent in order to show a summary of the insurance policy in force and when it ends.

12. Website. The new bankruptcy forms require inclusion of the business’s web address. If possible the website should “come down” upon the filing of a Chapter 7 or should reflect the bankruptcy filing and advise customers and creditors of the same.

C. Tax Considerations and Concerns

1. Federal and State wage and unemployment reporting

Failure to complete and file proper sales tax returns, final payroll tax returns and a final tax return may cause unnecessary burden on the debtor’s principals down the road. The IRS will estimate the taxes owed for unfiled returns based on prior returns, and if the taxes are not paid by the trustee they will fall on the people responsible to ensure the taxes were paid. Additionally, a principal’s income tax return is often based largely on the results of the business’s return.

2. W-2s

Arrangements should be made to have these prepared, if possible. Failure to file W-2s may also cause liability on the part of the individual responsible for filing them. This is often overlooked when filing a bankruptcy in the middle of the year, but generally they are actually not particularly difficult or expensive to complete if tax reporting has been taking place, as it is based on the same data.

D. Administration of the Estate and Trustee Concerns

A business Chapter 7 bankruptcy case presents a distinct set of issues with respect to administration of the bankruptcy estate. As such, the Chapter 7 Trustee appointed to the
case will likely become engaged and involved in the case much sooner than in the average consumer case.

1. Need to contact U.S. Trustee’s Office prior to filing to advise the U.S. Trustee of any conditions that may affect the estate, such as ongoing business operations, environmental or public hazards, and risk of loss of assets.

2. Trustee’s Need for Information and Documentation. As discussed more fully above the following is a list of documents and items that the Chapter 7 Trustee assigned to a business case will generally want to have in his/her possession.

   (i) All financial records
   (ii) Keys to buildings, vehicles, and equipment
   (iii) Tax returns (corporate and employment)
   (iv) Liens & Security Interests
   (v) Bank statements and cancelled checks (24 months)
   (vi) Depreciation schedules

3. Status of worksites. Operations should cease prior to filing or conversion. The Bankruptcy Code does not provide authority for a Chapter 7 debtor to continue to operate its business. A business entity cannot claim exemptions in any property. Therefore there is no ability to retain property following a bankruptcy.

   (i) Removal of Equipment. All equipment should remain at the worksite if the location is secure. If equipment and/or assets are removed from the worksite a detailed inventory should be taken prior to moving and the Trustee should be provided with the inventory and location of the assets
   (ii) Notification of third parties. Any third parties that routinely access the worksite (employees, delivery persons, vendors, etc.) should be advised of the Chapter 7 filing and told to cease activity. The exception to this may be security personnel.
   (iii) Securing of site. The Trustee should be made aware of any security concerns and/or arrangements that have been made or need to be made to maintain the security of the worksite. The nature of the business will dictate the measures that need to be taken.

4. Use of proprietary signage, trademarks

   Section 365 of the Bankruptcy Code is just as applicable in chapter 7 cases as it is in chapter 11 cases. To the extent the value of a debtor’s assets depend on a license agreement with another party, the trustee has obligations if he intends to benefit from those agreements. This is important from the perspective of the debtor and its
principals because, if the trustee initially begins a case without cash, it is unlikely he will take steps to cure license agreements.

To the extent the value of or authorization to sell a debtor’s assets depends on a license agreement, the assets are likely to be abandoned by the bankruptcy trustee.

5. Potential Tax Consequences of Trustee Actions

Depending on the type of the entity that files bankruptcy the Trustee’s actions can have very significant tax consequences on the business owners and minimal tax consequences for the business itself. Many small businesses are S corporations, limited liability companies, or partnerships. These entities are “pass through” tax entities, which report the income and losses of the business on the personal tax returns of the owners. While an in-depth review of bankruptcy taxation is beyond the scope of this outline, counsel should be aware that the Trustee of a business estate will not pay any taxes that would not have otherwise been paid by the business entity. Therefore, if the Trustee sells assets that would result in gain to the business entity (as is frequently the case in situations where assets have been depreciated) this gain will pass through to the business owners, who may then find themselves with significant tax liability in connection with a now bankrupt business.

6. Potential Trustee Abandonment of Assets. The Trustee may opt to abandon and not to administer certain assets if they are burdensome, of inconsequential value or have no equity. If there are no unencumbered assets for a Chapter 7 Trustee to liquidate or causes of action to pursue to recover funds and/or if all of the assets are potentially burdensome to the estate, a Chapter 7 bankruptcy for a business entity may not accomplish much of anything at all in the eyes of the business owners (except for proving to the creditors there are no assets available).

E. Effect of No Discharge

Section 727(a)(1) states that “[t]he court shall grant the debtor a discharge, unless—the debtor is not an individual . . . .”

There is no fresh start for a business entity following a Chapter 7 bankruptcy. Since debt is not discharged it is important for the company with undischarged debts to dissolve following the bankruptcy and never to resume operations under the same legal entity. Issues can arise if the Trustee does not administer certain assets or if a secured creditor does not repossess certain equipment. The business owners should be advised that they do not have an automatic right to any “left over” assets unless all creditors were paid 100%.