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Tip # 4: Bankruptcy doesn't mean shutting down your business, unless you want it to.

By Kim Fineman

A bankruptcy case filing does not necessarily mean a business is closing its doors. Either a liquidation or a reorganization can be accomplished through a bankruptcy case and it is important to understand the difference between these two options.

> ***Liquidation*** *(noun) the process of bringing a business to an end and distributing tis assets to creditors or claimants.*
>
> ***Reorganization*** *(noun) a significant overhaul of a troubled business intended to restore it to profitability.*

For businesses, a liquidation bankruptcy is often called a "Chapter 7" and a reorganization bankruptcy is called a "Chapter 11." These names refer to the subsections of the Bankruptcy Code that are specifically applicable to that type of bankruptcy. A business filing a bankruptcy case must choose between these two chapters at the time a bankruptcy case is filed. (Though it is beyond the scope of this post, please note that an "involuntary" bankruptcy case can also be filed against a business by its creditors, in some circumstances—in which case, the petitioning creditor(s) would decide the chapter.)

A liquidation under Chapter 7 is the most common form of bankruptcy in the United States. Both businesses and individuals can file under Chapter 7. The key difference between an individual and a business Chapter 7 case is that a business does not receive a discharge of its debts as it is not meant to continue after the liquidation. Businesses generally file under Chapter 7 only when there is no possibility or desire to reorganize under Chapter 11. In a Chapter 7 case, a trustee is appointed to assume control, liquidate the assets, and distribute the proceeds to the creditors in accordance with the hierarchy for payments mandated by the Bankruptcy Code. Other than filling out the initial filing information and designating an individual to provide information to the trustee, a company has little involvement in or control over a Chapter 7 case once it is filed. Think of a Chapter 7 as turning over the keys and walking away.

By contrast, when a company is reorganized under Chapter 11, its assets are not actually sold. Instead, if the debtor business is able to meet the Bankruptcy Code's requirements and confirm a plan of reorganization (more on this in Tip # 7), then the creditors' pre-bankruptcy claims are extinguished in exchange for claims against or interest in the new, reorganized debtor. Think of this as the company being fictionally "sold" to existing creditors who pay for the company with their existing claims and interests. Those post-bankruptcy claims or interests can look quite different from their pre-bankruptcy counterparts. The business debtor has some discretion as to these alterations and the reorganized business can continue operating after the bankruptcy case. A liquidating plan is also an option under Chapter 11. In that scenario, the debtor business can control the liquidation of its assets (more on that in Tip # 8).

While a Chapter 11 provides more flexibility, it is not for all troubled businesses. As noted in Tip # 1, a business must remain current on all expenses arising after the bankruptcy filing (also called the "post-petition" period) to remain in a Chapter 11 case. If not, any creditor can move to either have the case converted to Chapter 7 or an independent Chapter 11 trustee appointed to take control. Or the Court may decide to do so on its own if the judge is not satisfied with your efforts. A Chapter 11 debtor has some latitude, but not unlimited time or discretion.