



Basics of Bankruptcy: They Filed for Bankruptcy, but Owe Me Money, Now What?!

Have you been selling materials or providing services to a contractor that is paying late, or stopped paying altogether? Have you received a “Notice of Bankruptcy” from the tenant renting your space? Have you sued a company to collect what is owed, but received a “Suggestion of Bankruptcy?”

If any of these situations sounds familiar to you, you are not alone. In the time of COVID, corporate bankruptcies in the United States have hit a 10-year high. Along with iconic brands like JC Penney and Hertz, businesses of all sizes and industries continue to file for bankruptcy protections every day.

In a series of articles, *Basics of Bankruptcy*, the Andrews Myers bankruptcy team will walk through real world examples that your business may face to cut through the technical and seemingly unapproachable world of bankruptcy. In this first installment, we focus on four critical questions your business may encounter when a company you work with files for bankruptcy. In the case below, the company collecting money is the “creditor” while the company filing for bankruptcy is the “debtor.”

What kind of bankruptcy is it?

When deciphering the type of situation you are dealing with, you will want to look for the number 7, 9, 11, 12, 13, or 15 which refer to the applicable chapter of the U.S. Bankruptcy Code and designates the type of bankruptcy. The two most common types of bankruptcies in the commercial context are chapter 7 and chapter 11.

- **Chapter 7:** A chapter 7 liquidation bankruptcy is the most common type of bankruptcy filing. In a chapter 7, a bankruptcy trustee (essentially the superintendent of the bankruptcy) will collect the assets of the debtor (now the “bankruptcy estate”), sell the nonexempt assets, and distribute the proceeds to creditors. The trustee’s goal is to maximize the return to the debtor’s unsecured creditors. However, a “no asset” chapter 7 means that all of the debtor’s assets are exempt or subject to valid liens, and there will generally be no distribution (payout) to unsecured creditors. Individuals can file for chapter 7 as well.
- **Chapter 11:** A chapter 11 bankruptcy reorganizes, with the goal of salvaging, the business. The primary purpose of a chapter 11 is to confirm a plan of reorganization that keeps the business viable and can pay off creditors over an extended period. Unlike a

chapter 7, a chapter 11 bankruptcy typically focuses on the continued operation of the debtor's business during the reorganization.

- **Chapters 12 and 13:** A chapter 12 bankruptcy deals with "family farmers" or "family fishermen," while a chapter 13 bankruptcy is used by individuals with regular income to develop a plan to repay all or part of their debt over a period of time.
- **Chapter 9:** A chapter 9 bankruptcy allows municipalities to reorganize their debt. While the term "municipality" is far reaching – including cities, counties, school districts, and public improvements districts. They are less frequent with only six chapter 9 bankruptcies filed in 2019.
- **Chapter 15:** A chapter 15 bankruptcy allows a foreign debtor to file in the United States.

What kind of claim do you have?

After deciphering the kind of bankruptcy you are dealing with, it is essential that you determine what kind of "claim" you have. A claim is a creditor's right to receive payment for a debt owed on the date the debtor files for bankruptcy. The key question is do you have a security interest in the debtor's property? In a chapter 7, your type of claim determines where you are in the pecking order for potential distributions. In a chapter 11, the treatment of claims is determined on a class-by-class basis, as described in the plan.

- **Secured Claim:** A claim backed by a lien against property of the debtor. Common examples include a mortgage, a security interest in a car, a statutory lien, or a judgment. Another way for a claim to be "secured" is if the creditor owes the debtor money.
- **Unsecured Claim:** A claim not backed by a security interest. These can include priority unsecured claims mandated by the Bankruptcy Code and nonpriority unsecured claims. A claim may be partly unsecured if the amount of the claim exceeds the value of the creditor's property which has a lien. Unsecured claims can include amounts owed for goods sold, services rendered, personal injury claims, or obligations and liabilities under a contract.

What is a proof of claim?

A "proof of claim" is the form and supporting documents used by the creditor to indicate the amount of the debt owed by the debtor on the date of the bankruptcy filing. Evidence documenting the claim, like the relevant agreement, unpaid invoices, or a copy of a lien, must be included with the form. While some bankruptcy notices will contain a form, the document is available on the bankruptcy court's website. The bankruptcy notice will also include information on how and where to submit your proof of claim. You can also submit the form electronically with the court of with a claims agent.

In a chapter 11, any creditor whose claim is not listed by the debtor on the debtor's schedules, or is scheduled as disputed, contingent, or unliquidated, must file a proof of claim. In a "no asset" chapter 7, there is no need for unsecured creditors to file proofs of claim because there will be no distribution. However, if the trustee does find assets during the course of the bankruptcy, you may need to file a proof of claim to preserve your right to payment.

Although a secured creditor does not need to file a proof of claim in a chapter 7 case to preserve its security interest or lien, there may be other reasons to file a claim. Because the process for determining what kind of claim you have, what kind of supporting documentation you need, and if/how/when you need to file can be complicated, it is important that you seek counsel from a bankruptcy attorney.

Are you currently trying to collect a debt from the debtor?

If you are, hit the brakes. When filing the bankruptcy petition, an “automatic stay” is imposed immediately. This means that creditors must stop all actions to collect debts from the debtor or proceed against property of the debtor. Any actions taken in violation of the stay, such as lawsuits, foreclosures, or garnishments, are void and could lead to serious consequences. Additionally, if you are currently doing business with the debtor pursuant to a contract, you cannot immediately cut off business with the debtor simply because they are in bankruptcy. Any amounts incurred after the bankruptcy filing should be paid in the ordinary course of business.

How can you prepare?

To prevent some of the inevitable headache when a business that owes you money files for bankruptcy, be sure to save and organize your accounts receivable log, invoices, agreements, guaranties, receipts, and liens that you may have filed while doing business with the debtor so that it is easier to respond.

Basics of Bankruptcy intends to give a brief overview of issues routinely faced by businesses, and is not exhaustive. Each case comes with its own variety of issues. The bankruptcy team at Andrews Myers stands ready to assist your business in navigating bankruptcy issues.

For more information, please contact [Patrick Kelly](#).