BUSINESS CHAPTER 7 BEST PRACTICES

Pros & Cons of Business Chapter 7

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BENCH BAR RETREAT

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Please consider the following before filing a liquidation proceeding (Chapter 7 for a corporation, LLC or partnership):

A. Corporations do not receive a discharge. 11 U.S.C. §727 recites that "the court shall grant the debtor a discharge unless…the debtor is not an individual". While it is not unusual for a business entity in a rehabilitation proceeding to convert the case or have the case converted to a Chapter 7 proceeding counsel who initially files the case as Chapter 7 must understand that the business entity does not continue its existence and is liquidated by the Chapter 7 trustee.

B. Business entities other than individuals operating a business enterprise as a sole proprietorship (and thus files a Schedule C together with the federal tax return) are not provided with any exemptions. Bankruptcy Schedule C should thus be left blank or the practitioner may insert the word "none". See 11 U.S.C. §522(b)(1). Thus, upon liquidation neither the business entity nor its shareholders generally will have any claim of right to estate property or resulting proceeds of sale.

C. Other than in the case of conversion from a Chapter 11 proceeding to a Chapter 7, in my experience the great majority of business 7s is filed by small businesses which are often service related. Creditors do not often provide loans to the business entity without obtaining the guarantee of one or more principals. Filing a Chapter 7 liquidation proceeding on behalf of the business entity will not provide any protection to the guarantor or surety (except, perhaps, delaying litigation which has already been filed with both the business and the principal named as party defendants) and the business's co-obligor remains responsible for payment of the obligation which often times results in a concurrent insolvency proceeding. There is no co-debtor stay in Chapter 7 proceedings unlike the co-debtor stay provided in Chapter 13 cases pursuant to the provisions of 11 U.S.C. §1301. Corporate and other business entities are ineligible to be a debtor in a Chapter 13 proceeding.

D. Business entities such as corporations, LLCs and partnerships must be represented by counsel. There are no *pro se* business bankruptcies with the exception of sole proprietors. The Supreme Court of Ohio has exclusive authority under Article IV of the Ohio Constitution to regulate the practice of law. See Article IV of the Ohio Constitution, Section 2(B). Only an attorney licensed in the state may file an insolvency proceeding on behalf of a corporate or other business entity.

E. In most circumstances best practices would dictate that should the business entity and its principal/co-obligor both seek bankruptcy protection, two counsel should be utilized, one to represent the business entity and one to represent the individual. All too often there are conflicts of interest which preclude one attorney from representing both the business and its majority or sole shareholder. Small businesses often rely upon cash infusions by corporate ownership. You must be careful to ensure that you are not representing both the corporation and a creditor of the corporation. All too often this ethical consideration is overlooked.

F. While partnerships may file Chapter 7 proceedings the results are never very

pretty. You are strongly discouraged from even thinking about this course of action. See the provisions of 11 U.S.C. §723 which is being appended hereto for your convenience. Do you really want to expose all of the general partners to the collection efforts of the Chapter 7 trustee?

G. Neither the debtor, the debtor's principal nor counsel maintain any control over the liquidation process. Trustees typically act as expeditiously as possible. This typically results in liquidation proceeds which are less than if the business entity, by the efforts of its principals and agents, sold the assets of the business. Liquidation of business assets outside of the bankruptcy arena typically produces a greater return to creditors than that provided by the bankruptcy fiduciary. Furthermore, and as you almost certainly understand, most small businesses have few if any assets which are not subject to security interests.

The only logical reason for the filing of a Chapter 7 for a corporation or LLC is the easy, orderly liquidation of the business's assets saving the principal the rigors of dealing with pesky business creditors. In essence, the insolvency proceeding takes the place of the wind down and formal dissolution required under Ohio law. Please refer to ORC 1701.86.

Finally, your attention is drawn to the fact that when businesses run into financial difficulties, are sued by creditors and become judgment debtors with respect to significant obligations it is not unusual for counsel to tell the principal "lets stop the business operations of John's Painting, Inc. and thereafter restart business operations with a new corporate identity known as John's Good Painting, Inc." In that fashion business continues but is conducted by a different corporate entity notwithstanding the fact that the shareholders and other principals remain the same, that work in progress continues as if nothing happened and that there will almost always be the wholesale transfer of the assets of the old business to the new one. Please recall that business assets are not confined to tangible assets but also include goodwill, telephone numbers, websites, customer lists, accounts receivable and other specific and general intangibles. It makes more sense to put the failing business into Chapter 7, have a trustee calculate the value of all business assets, tangible and intangible, and then work something out whereby the principal purchases the assets from the trustee and then transfers the assets, tangible and intangible, to the principal or, if the new entity has already been established, the sale could be from the trustee directly to the new business entity. This will typically avoid having to defend your client from legal actions predicated upon alter-ego theory and successor liability.

BIOGRAPHY

Harold A. Corzin is a member of the firm Corzin, Sansilo & Ufholz, LLC and has been practicing bankruptcy and commercial law for nearly 40 years. Mr. Corzin has been a Chapter 7 panel trustee since 1978. He has taught business law, commercial law and bankruptcy law at the University of Akron and Kent State University. He is a U.S. Navy Veteran (1968-1972), enjoys traveling and playing golf and remains a licensed pilot. He is married to bankruptcy practitioner Christine K. Corzin.