

CHAPTER 11

Chapter 11 of the Bankruptcy Code governs the process of reorganization under the bankruptcy laws of the United States.

When a troubled business decides that it is unable to service its debt or pay its creditors, it can file (or be forced by its creditors to file) with a federal bankruptcy court for bankruptcy protection under either Chapter 7 (liquidation) or Chapter 11. A Chapter 7 filing means that the business intends to sell all its assets, distribute the proceeds to its creditors, and then cease operations. A Chapter 11 filing, on the other hand, is an attempt to stay in business while a bankruptcy court supervises the "reorganization" of the company's contractual and debt obligations. The court can grant complete or partial relief from most of the company's debts and its contracts, so that the company can make a fresh start. Often, if the company's debts exceed its assets, then at the completion of bankruptcy the company's owners (stockholders) all end up with nothing -- all their rights and interests are terminated -- and the company's creditors end up with ownership of the newly reorganized company, in the hopes that it will eventually succeed financially as compensation for their losses.

All creditors who register with the court can be heard by the court, which is responsible for determining whether the plan of reorganization complies with the purposes of the bankruptcy law and provides for fair and equitable treatment of all parties in interest. Priority of claims is determined by Section 507 of the

Bankruptcy Code, but as a general rule secured creditors, such as some banks and bondholders, have a higher-priority claim on the proceeds of the sale of corporate assets than unsecured creditors, such as vendors who have not been paid for products they previously delivered to the company (and who don't have any collateral for their claim). Once a business files for Chapter 11 bankruptcy, its creditors are not allowed to attempt to collect previously incurred debts except through the bankruptcy court. Under some circumstances, the creditors or the United States Trustee can ask the court either to convert the case to a liquidation under Chapter 7, or to appoint a trustee to manage the debtors business. The court will grant a motion to convert to Chapter 7 or appoint a trustee if either of these actions is in the best interest of all creditors (appointment of a trustee also requires some wrongdoing or gross mismanagement on the part of existing management, and is relatively rare).

Typical debts and contracts cancelled in a Chapter 11 bankruptcy include unsecured loans and, if canceling them would be financially favorable to the company, union contracts, supply or operating contracts (with both vendors and customers) and long-term real estate leases.

Once Chapter 11 is filed, the company may "emerge" from bankruptcy within a few months or within several years, depending on the size and complexity of the bankruptcy. All debtors filing Chapter 11 cases are required to propose a plan of reorganization: if the debtor fails to make a proposal, the court may consider proposals from creditors. If no plan of

reorganization is approved by the court (this process is called confirmation) then the court may either convert the case to a liquidation under Chapter 7 or, if in the best interests of the creditors and the estate, the case may be dismissed resulting into a return to the status quo ante bankruptcy.

If the company's stock is publicly traded, a Chapter 11 filing causes trading on it to be transferred to the NASDAQ if primary trading on it had been previously conducted at either the New York Stock Exchange or the American Stock Exchange, and the identifying letter "Q" is added to the end of its stock symbol, which is also lengthened to four letters, not including the "Q," if such a transfer is necessary (formerly, the site at which such a stock was traded was not moved and the "Q" was placed in front of the pre-existing stock symbol; a celebrated example was Penn Central, whose symbol was originally "PC" and became "QPC" after the company filed Chapter 11 in 1970).

The largest bankruptcy in history was of the US telecommunications corporation Worldcom, Inc., which listed over 103 billion dollars in assets as of its Chapter 11 filing in 2002; the bankruptcy was triggered by the discovery that in the previous several years, the company had fraudulently over reported its assets by an estimated 12 billion dollars.

Individuals may also file Chapter 11, but due to the complexity and expense of the proceeding, this option is rarely chosen by debtors who are eligible for Chapter 7 or Chapter 13 relief.

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