



Life After Death for Chapter 7 Corporate Debtors? What Remains After a Corporate Liquidation

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Individuals filing for bankruptcy pursuant to Chapter 7 of Title 11 of the United States Code (the "Bankruptcy Code") generally do so to have their debts discharged and receive the proverbial "fresh start."² The same, however, is not true for corporations. The Bankruptcy Code is clear that a corporate debtor does not qualify for a discharge of its debts and thus cannot begin anew.³ Instead, the purpose of a Chapter 7 bankruptcy for corporations is "to distribute any assets equitably among existing creditors before laying the defunct corporation to rest."⁴ The Bankruptcy Code prevents corporations from being discharged in liquidation cases because "corporations are not in the same situation as individual debtors, and the discharge of a corporation promotes trafficking in corporate shells, a form of bankruptcy fraud."⁵ If corporations were able to discharge their debt in a liquidation case, "a corporation with a substantial tax loss but with all of its debts discharged would be an attractive vehicle to shield profits."⁶

Far from getting a "fresh start," courts have described corporations after Chapter 7 bankruptcy as being "defunct."⁷ These courts have elaborated that defunct status signals the de facto--though not formal--end of the corporation.⁸ In *U.S. Dismantlement Corp. v. Jeffrey M. Brown Associates*, the court addressed whether a corporate debtor could assert pre-petition claims after filing for Chapter 7 bankruptcy and liquidating the assets of the company.⁹ The court held that the corporate debtor could not pursue such causes of action because of its defunct status.¹⁰ The court first noted that Black's Law Dictionary defines "defunct" as "dead; extinct"

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² See 11 U.S.C. §§ 727(a)-(b).

³ *Id.*; *In re Blanton*, 105 B.R. 811, 824 (W.D. Tex. 1989).

⁴ *In re Blanton*, 105 B.R. at 824.

⁵ S. Rep. No. 95-989, at 7 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5793.

⁶ *United States Dismantlement Corp. v. Jeffrey M. Brown Assocs.*, No. 97-1309, 2000 U.S. Dist. LEXIS 5347, at *5-6 (E.D. Pa. April 13, 2000).

⁷ *In re Liberty Trust Co.*, 130 B.R. 467, 471 (W.D. Tex. 1991).

⁸ See *Id.*; *Dismantlement*, 2000 U.S. Dist. LEXIS 5347 at *6.

⁹ *Dismantlement*, 2000 U.S. Dist. LEXIS 5347.

¹⁰ *Id.* at *12.

and defines "extinct" to mean "no longer in existence."¹¹ The court next reviewed findings from other bankruptcy courts that had described the characteristics of a defunct corporation in the wake of a Chapter 7 bankruptcy.¹² First, the court cited to the *Blanton* court's language regarding the purpose of Chapter 7 bankruptcy--to "[lay] the defunct corporation to rest."¹³ The court reasoned that "[a] corporation that has been laid to rest does not pursue a cause of action."¹⁴ Next, the court reviewed *In re Tri-R Builders, Inc.* and highlighted its holding that defunct status means that the corporation "ceases to operate or own assets."¹⁵ The court explained that if a defunct corporation cannot own or operate assets, it cannot pursue causes of action because causes of action are considered assets under bankruptcy law.¹⁶ Finally, the court added that a leading bankruptcy law treatise stated that even though federal bankruptcy law cannot dissolve a corporation incorporated under state law, it does mark the de facto end of the corporation's existence.¹⁷

A district court in Texas considering the same issue as that in *U.S. Dismantlement* similarly held that defunct corporations cannot pursue pre-petition causes of action because they cease to exist for all practical purposes.¹⁸ In *Liberty Trust*, the court cited the Congressional record and concluded that "'defunct' depicts a status akin to that of a dissolved corporation or partnership."¹⁹ The court reasoned that while formal dissolution of the corporation would require a state-court proceeding, defunct status left the corporation "civilly dead."²⁰ Channeling its inner Shakespeare, the *Liberty Trust* court described the situation of a corporation that has passed through Chapter 7 bankruptcy but has not yet been formally dissolved under state law: "It is in a state of limbo, the soul having shaken off its mortal coil and begun, but not completed its journey to its ultimate destination (i.e. dissolution)."²¹

Although corporations that have undergone Chapter 7 bankruptcy cannot bring causes of action, they can still be sued for any outstanding debt should they decide to resume operations.²² In *N.L.R.B. v. Better Bldg. Supply Corp.*, the Ninth Circuit held that a corporation using an alter ego to resume its business after filing for Chapter 7 bankruptcy was still liable for any outstanding debt that was not satisfied after the liquidation of the business.²³ In making its decision, the court first noted that Chapter 7 bankruptcy proceedings do not have the effect of

¹¹ *Id.* at *8 (citing BLACK'S LAW DICTIONARY 434, 604 (7th ed. 1999)).

¹² *Dismantlement*, 2000 U.S. Dist. LEXIS 5347 at *8.

¹³ *Id.* (citing *In re Blanton*, 105 B.R. at 824).

¹⁴ *Dismantlement*, 2000 U.S. Dist. LEXIS 5347 at *8.

¹⁵ *Id.* (citing *In re Tri-R Builders, Inc.*, 86 B.R. 138, 140-41 (Bankr. N.D. Ind. 1986)).

¹⁶ *Dismantlement*, 2000 U.S. Dist. LEXIS 5347 at *8-9.

¹⁷ *Id.* at *9-10 (citing Norton, NORTON BANKR. LAW & PRAC. 2d § 74:2 n.13).

¹⁸ *Liberty Trust*, 130 B.R. 467.

¹⁹ *Id.* at 471.

²⁰ *Id.* at 472.

²¹ *Id.*

²² See *N.L.R.B. v. Better Building Supply Corp.*, 837 F.2d 377 (9th Cir. 1988).

²³ *Id.* at 380.

formally dissolving a corporation--this can only be done under state law.²⁴ The court reasoned that section 727 of the Bankruptcy Code did not make corporate debt dischargeable so that corporations were prohibited from attempting to escape liability by liquidating the corporation and then resuming the business debt free.²⁵ Thus, "[i]n adopting section 727(a)(1), Congress intended that corporate debt would survive Chapter 7 proceedings and be charged against the corporation when it resumed operations."²⁶

While corporations that have been liquidated under Chapter 7 bankruptcy proceedings may not technically be dissolved, they survive with one foot in the grave. They are not able to bring pre-petition causes of action and cannot own or operate assets. On the other hand, liquidated corporations are still liable for any debt that was not satisfied in the liquidation if they resume business operations. The result is that corporations after a Chapter 7 bankruptcy are useless for all practical purposes. The next logical step for such a corporation is dissolution under state law in order to fully close the affairs of the defunct corporation.

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²⁴ *Id.* at 379.

²⁵ *Id.*

²⁶ *Id.*