

## **A Technology Focused Introduction to Bankruptcy and Insolvency**

“This purpose of the [Bankruptcy] act has been again and again emphasized by the courts as being of public, as well as private, interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.” *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

To the uninitiated, bankruptcy can be a murky and complex area of American jurisprudence. The Latin *origin bancus* (bench or table) and *ruptus* (broken) is said to refer to the symbolic practice of breaking a merchant’s bench or table to signal to others that the merchant could no longer afford to conduct business or pay its debts. Although a bankruptcy case may indeed be painful for many involved, it is the bedrock of our economic system.<sup>1</sup> American bankruptcy jurisprudence has developed a helpful and effective means of providing relief to distressed individuals and corporations alike. Bankruptcy is one of the most active legal arenas businesses and individuals are likely to encounter at some point, and bankruptcy practitioners owe a duty their clients to stay abreast of technological innovations and the potential impact on bankruptcy jurisprudence.<sup>2</sup> This paper will provide a broad overview of the business bankruptcy process. It will then turn to focusing on the impact technological innovations are having in bankruptcy cases as well as how bankruptcy courts have been resolving new questions thrust upon them through various technology-focused cases.

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<sup>1</sup> Jackson, Thomas H. and Skeel, David A. Jr., "*Bankruptcy and Economic Recovery*" (2013). All Faculty Scholarship. 476.

<sup>2</sup> United States Courts, *Bankruptcy Filings Rise 13 Percent*, October 26, 2023, <https://www.uscourts.gov/news/2023/10/26/bankruptcy-filings-rise-13-percent>

## **The Various Chapters of the Bankruptcy Code**

The Bankruptcy Code is housed in title 11 of the United States Code. It is divided further into particular chapters. Those chapters denote the particular type of bankruptcy proceeding. Of them, there are three chapters of bankruptcy filings that are by and far the most common to encounter: a chapter 7 liquidation, a chapter 11 reorganization, and a chapter 13 consumer case. Chapter 12 of the Bankruptcy Code is a hybrid of chapter 11 and chapter 13 and only for certain types of agricultural cases. Chapter 15 of the Bankruptcy Code addresses ancillary and cross-border cases.

Available to both corporations and individuals, a chapter 7 liquidation may be what most people think of when they imagine the bankruptcy process. In a liquidation, a court-appointed trustee takes control of the debtor's assets, reduces them to cash, and makes distributions to creditors, subject to specific exemptions.<sup>3</sup> The trustee is selected from a panel of trustees in the district in which the case is filed, and typically is a bankruptcy lawyer, but sometimes is an accountant or other type of professional. The trustee owes fiduciary duties to the bankruptcy estate and its creditors.<sup>4</sup> A chapter 7 trustee is tasked with administration of the estate's assets.

Typically in a chapter 7, the trustee will conduct a creditors' meeting at which (in the case of a business filing), a corporate representative will testify regarding information contained in the schedules of assets and liabilities and the statement of financial affairs. The trustee's questions are aimed at determining whether any assets exist that may be liquidated to cash for distribution to creditors. The trustee distributes any cash to creditors pursuant to a waterfall mandated by the Bankruptcy Code in section 726. Of note, the Bankruptcy Code establishes compensation to

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<sup>3</sup> United States Courts, *Process – Bankruptcy Basics*, <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics>.

<sup>4</sup> United States Courts, *Bankruptcy Basics Glossary*, <https://www.uscourts.gov/educational-resources/educational-activities/bankruptcy-basics-glossary#content-for-t>.

chapter 7 trustees. *See* Bankruptcy Code § 326. Thus, a chapter 7 trustee is both motivated to spend as little time as possible on a “no asset” case and as much effort as possible in an “asset” case as compensation increases with each dollar distributed to creditors. *See* Bankruptcy Code § 544. In a “no asset” chapter 7 case, a chapter 7 trustee will make a docket entry similar to the below:

The United States Trustee (the arm of the Department of Justice that oversees the administration of bankruptcy cases under all chapters) will review the chapter 7 trustee’s final report, and the case will typically be closed after that. In a business chapter 7 case, the business does not receive a discharge, but does die a “corporate death,” so there is no ability to collect on any judgment or claim against the entity. Nolo, *Which Business Debts Are Discharged in Chapter 7 Bankruptcy?*, <https://www.nolo.com/legal-encyclopedia/business-debts-discharged-chapter-7-bankruptcy-32415.html>.

A chapter 11 reorganization typically involves a commercial entity seeking to continue its business while repaying creditors through a court approved plan of reorganization. The debtor is required to disclose certain pertinent information to the court and its creditors before seeking “confirmation” of its plan for repayment and continued operations. A chapter 11 debtor has special rights related to its contracts and leases, the sale and recovery of assets, and its administrative operations during the case.

While liquidations and reorganizations can be filed by corporations and individuals alike, chapter 13 consumer filings are reserved exclusively for individuals and their spouses. A chapter 13 case is more similar to a reorganization than a liquidation as the debtor retains its assets while working to formulate a plan to repay its creditors.

Chapter 11 also has a new “subchapter v,” which is for small business cases in which the debtor entity has debt less than \$2,000,000. *See* Bankruptcy Code § 101(51)(d). Congress created subchapter v of Chapter 11 in 2019 toward the goal of making chapter 11 more accessible (both in terms of expense, time, and opportunity) for smaller businesses.

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