

Chapter 7 essentials: Steps every credit professional should take

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When most people think of bankruptcy, they picture Chapter 7—the liquidation chapter. Under Chapter 7 of the U.S. Bankruptcy Code, a trustee is appointed to take control of the debtor’s assets, sell property, and distribute any available proceeds to creditors.

For businesses, Chapter 7 typically means closure. The trustee liquidates assets, recovers value from preference claims or other causes of action, and winds down operations. For credit professionals, understanding this process is essential to protecting recovery rights and minimizing risk.

Why It matters: Responding properly to a Chapter 7 filing—by verifying the case, respecting the automatic stay, and filing a timely proof of claim—can make the difference between recovering funds and losing them.

Step 1: Verify the filing

Before taking action, confirm the bankruptcy is real. Acting on rumors can expose your company to penalties if collections continue after a filing. Use PACER (Public Access to Court Electronic Records) to verify official court data and gather key information—case number, filing date, amount owed, last payment, account records and supporting documents.

Step 2: Respect the automatic stay

Once a bankruptcy petition is filed, an automatic stay immediately halts all collection activity, lawsuits, and enforcement actions against the debtor. Any violation can result in sanctions, so creditors must stop all activity unless granted relief by the court. The stay gives the trustee time to assess assets and determine next steps.

Step 3: Identify and protect your claims

Determine the total debt owed and whether any portion qualifies as a priority claim. Check for mutual debts—if both parties owe each other, you may be able to use setoff, applying those obligations against one another. These rights must be preserved early in the process.

Step 4: File a Proof of Claim

Creditors must file a proof of claim to be eligible for any distributions from the estate. Include supporting documentation but avoid attaching confidential information, as claims become public.

“Creditors should be prepared to file a proof of claim to assert their rights against the debtor,” said Michael Papandrea of Lowenstein Sandler LLP. “Gather invoices, statements and other

documentation to support your claim and stay mindful of the bar date for filing proofs of claim—you don't want to miss that deadline."

If a case is designated "no-asset," creditors may receive notice that no claims are needed unless otherwise instructed. However, missing a filing deadline can eliminate recovery rights entirely.

Step 5: Understand priority and preference issues

Certain debts may qualify for priority status, such as 503(b)(9) claims for goods received within 20 days of the filing. Creditors typically must file a motion to assert these rights.

Another major concern is preference exposure—trustees often pursue payments made in the 90 days before filing to recover funds for all creditors. "In Chapter 7, there's usually no mechanism to release these claims, so creditors are more likely to get preference demands," Papandrea explained.

Step 6: Consider setoff and recoupment

If both you and the debtor owe each other money, setoff and recoupment may help reduce losses.

"If you have offsetting obligations, where the debtor owes you, and you owe the debtor, you may have setoff or recoupment rights," said Bruce Nathan, Esq., partner at Lowenstein Sandler LLP (New York, NY). "But you must assert them in your claim or seek relief from the stay. If you don't, you could lose that right and still be sued by the trustee."

Step 7: Monitor the case

Use PACER or similar tools to follow updates, especially motions that affect creditor rights, rejections of contracts, and any preference actions filed by the trustee. Staying informed ensures deadlines aren't missed and response strategies stay aligned.

The bottom line: A Chapter 7 bankruptcy might mark the end for the debtor—but for creditors, it's the start of a critical, time-sensitive process. Acting quickly, keeping records organized, and understanding your rights can make the difference between recovering value or walking away empty-handed.