



CONSIDERING OR COPING WITH BANKRUPTCY

by Mark E. Battersby

Recently released figures show that fewer of your customers and competitors are filing for bankruptcy. The bad news is those same figures illustrate how difficult—and expensive—it has become for any financially troubled pressure cleaning business to use bankruptcy as a tool for recovery.

Bankruptcy filings in the federal courts dropped 70 percent in 2006, the first full year after the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the first major reform of the bankruptcy laws in over 25 years. According to the Administrative Office of the U.S. Courts, filings involving predominantly business debts, totaling 19,695, fell 50 percent in 2006 when compared to the 39,201 business bankruptcies filed in 2005.

The federal bankruptcy laws have long provided a safe harbor for troubled pressure cleaning businesses to

reorganize, refinance, and begin the turnaround to profitability free from pressure by their creditors. Now, new bankruptcy laws severely reduce that safe harbor while, at the same time, making it more difficult for every contractor, supplier, and equipment dealer to deal with suppliers and customers that are in, or about to enter, bankruptcy.

How Bankruptcy Works

Bankruptcy proceedings begin with the filing of a petition with the bankruptcy court. The filing of the petition creates a bankruptcy estate, which generally consists of all the assets of the person or business filing the bankruptcy petition.

As under the former bankruptcy laws, the two principal types of legal bankruptcy are: Chapter 7, or involuntary, where one or more creditors petition to have a debtor judged insolvent by a court; and Chapter 11, or voluntary,

when the debtor brings the petition. As in the past, the objective has been an orderly and equitable settlement of obligations. The new legislation, however, takes a harder line than the old system.

Generally, when a debt owed to another is cancelled, the amount cancelled or forgiven is considered income that is taxed to the person owing the debt. If a debt is cancelled under a bankruptcy proceeding, however, the amount cancelled is not taxable income. The canceled debt does, of course, reduce the amount of other tax benefits the debtor might otherwise be entitled to.

Under bankruptcy proceedings, higher priority claims are paid in full before the claims in a lower priority receive anything. The order of payment is as follows:

- (1) Claims for debts to a spouse or children for court ordered support;
- (2) Administrative expenses of the bankruptcy;
- (3) Unsecured, post petition claims in an involuntary case;
- (4) Wage claims of employees and independent salespersons up to \$4300 per claim;
- (5) Contributions to employee benefit plans up to \$4300 per employee;
- (6) Claims of farmers and fishermen against debtors operating storage or processing facilities;
- (7) Layaway claims of individuals who did not get the item they made the deposit on;
- (8) Recent income, sales, employment, or gross receipts taxes; and
- (9) Commitments to maintain the capital of a bank or savings and loan.

Secured claims are paid from the proceeds of the collateral; if the collateral is insufficient to pay the claim in full, the balance becomes an unsecured claim.

Even Creditors Have Options

All too often, when a bankruptcy notice is received, the assumption is made that there are neither rights nor alternatives when it comes to the claim of the pressure cleaning business. Creditors do have rights, fortunately.

For example, creditors in a bankruptcy are entitled to share in any distribution from the bankruptcy estate, usually depending on the priority of their claim. Under the reformed bankruptcy laws, creditors also have the right to be heard in court regarding the payment plan and the liquidation of the debtor's non-exempt assets and payments from the assets of the estate.

Even more importantly, a creditor has the right to challenge a debtor's right to a discharge or to discharge the debt owed the creditor. In other words, creditors can voice their opinions about debts that might or might not be forgiven. They can also argue about assets that, perhaps, should have been included in the bankruptcy estate.

When it comes to dealing with a customer or supplier after discovering they are bankrupt, the pressure cleaning business should immediately cease any collection action. This automatic stay is designed to protect the debtor and his property from all forms of collection during the bankruptcy. Naturally, when a notice of the bankruptcy is received, proof of a claim should be promptly filed with the court. And, keep in mind that deadlines are strictly enforced in bankruptcy cases.

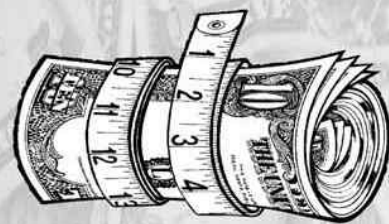
So-called "secured creditors" are at the top of the payback list and have specific rights to the property which is the collateral for their claim. Secured creditors also have the best chance of getting relief from the automatic stay or "adequate protection payments" to prevent a decline in the equity available to secure their claim.

Whether the pressure cleaning operation is a secured or unsecured creditor, the best deterrent to abuse of the bankruptcy system is creditor vigilance. Creditors are entitled to question the debtor under oath about assets, liabilities, and financial history at the first meeting of the creditors. Also, keep in mind that some bankruptcies are dismissed because of the debtor's failure



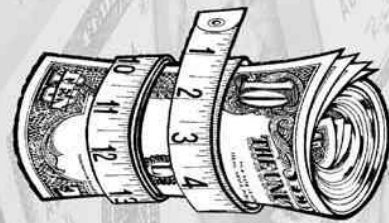
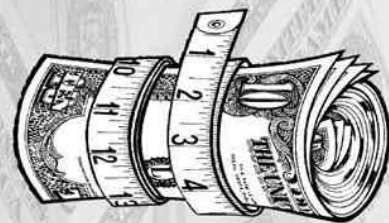
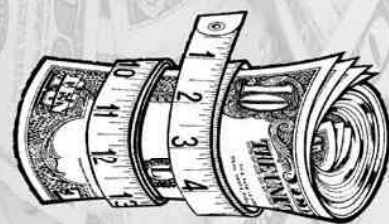
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to comply with the requirements of the bankruptcy law. When that happens, creditors are free to pursue collection according to state law. Sometimes cases originally classified as "no asset" cases blossom into asset cases from which a dividend may be paid. Be vigilant.

Is Bankruptcy an Option?

The owners and managers of every troubled pressure cleaning business must often confront the question of whether bankruptcy is for them. Is it?

Remember, corporations, limited liability companies, and partnerships are legal entities separate from their shareholders or partners. They can seek bankruptcy protection in their own right.

Sole proprietorships, however, are just an extension of their owner, they cannot file bankruptcy alone. Since the assets and liabilities of the business are really just one form of assets of the proprietor, the proprietor must file bankruptcy.

Designation as an S corporation is a matter of tax law, rather than anything to do with the kind of legal entity the corporation is. Watch out, however, if the S corporation files bankruptcy. Any taxable income generated after the bankruptcy may still be taxable to the shareholders, since the corporation is not a tax paying entity. Think of those forgiven debts as income.

When it comes to a partnership in a Chapter 7 bankruptcy, the trustee can sue the general partners of the partnership if the partnership's assets are insufficient to pay all claims for the amount by which the partnership assets fall short of partnership debts. As a result, partners may be facing a suit by a well-funded trustee suing for the benefit of all creditors of the partnership.

Would the pressure cleaning operation benefit from reorganization, or should it be liquidated? Reorganization cannot create a market, increase gross revenue, or make up for a poor fit between the skills available and the skills required to operate the business.

Reorganization under the bankruptcy laws could, however, free up cash from servicing the old debt to permit current operations, permit rejection of restrictive or expensive leases or contracts that are no longer advantageous, or prevent the loss of vital assets or cash to a creditor.

This relief could go a long way toward paying taxes or unpaid salaries while sale of the business could provide ongoing jobs for the work force under new ownership.

What's in Your Future?

Generally, businesses that require little capital, have few assets, or are merely extensions of the owner's skills and personality are ones that it may not pay to reorganize. The owners may be better off liquidating the business, in or out of bankruptcy, and beginning anew with a fresh entity.

A Chapter 7 bankruptcy, whether for an individual or a corporation, is often the best choice when:

- The business has no future;
- It has no substantial assets or qualities that cannot be reproduced after bankruptcy; or
- The debts are so overwhelming that restructuring them is not feasible.

Bankruptcy "reform" is now the law of the land. Congress passed the bankruptcy reforms in response to years of complaints from lending institutions and creditors that too many financially irresponsible people were abusing the bankruptcy laws, rather than honestly attempting to pay back their debts. While this is good news for pressure cleaning businesses that find themselves in the position of being creditors to troubled customers and/or suppliers, bankruptcy has become more complex and more expensive for those seeking its protection.

Among those reforms that are just now beginning to make themselves felt are the rules that every pressure cleaning business, troubled debtor, or cash-starved creditor must contend with. Like it or not, bankruptcy remains an option and, all-too-often, a reality that must be dealt with. *cr*



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