In Bankruptcy
the Plucky Come First

Time and Effort Are Needed But a Contractor Can Collect From a Bankrupt Customer

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The word “bankrupt” has special overtones when it is mentioned in the construction industry.

There are few wall and ceiling contractors—indeed, contractors of any specialty or size—who have not, at least once, swallowed hard in the wee hours of the morning, sweating out the threat of a “belly up” situation.

Some did more than roll and toss in their bed, quietly furious with their wife who was sleeping soundly and unaware of any business problems. Those who did more are the contractors who actually have gone into bankruptcy.

They are the ones who . . . if they were plucky enough and tough enough . . . picked themselves up off the ground and came firing back. When, their colleagues wink and giggle nervously about “another chapter 11” these are the contractors who know the hurt.

The major reason that bankruptcy has such peculiar familiarity with contractors lies in the nature of the industry. Many individuals who have gone into business such as a retail store, a food operation, or a similar type business are often in a better position to pull out before the damage is too great.

A contractor, on the other hand, quickly becomes involved in large sums and his cash flow, financial health and avoidance of bankruptcy is furthermore directly contingent upon the continued good health of other construction firms.

Thus, a single contractor can get in trouble deeply, quickly, and irrevocably- with only a single customer, too.

It comes as no surprise that when a big general contractor goes down he can draw a group of subcontractors into bankruptcy with him. Those who survive may have avoided “getting in too deep;” they may have had sufficiently large financial reserves to weather the problem, or they made the right moves and were able to collect enough cash to stay afloat.

The last tactic is important. A contractor has to know what to do when a customer goes into bankruptcy.

Many contractors throw up their hands and are resigned to a loss when this happens. That’s neither the proper attitude nor the proper reaction. Unsecured creditors needn’t give up hope of collecting something.

It will take time and effort to collect. But often something can be saved.

First, a contractor should remember that the theory of bankruptcy is to allow the debtor to start over. Once the debtor has filed the bankruptcy petition, unsecured creditors must file their claims with the referee

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—or a court-approved trustee—and wait.

**Sale of Assets**

If there are any assets they will eventually be sold. The proceeds from these sales, of course, will be distributed to creditors. Their claims are then discharged.

If the bankrupt later gets back on his feet, creditors have no legal right to press those claims.

There are exceptions, though. Certain claims aren’t affected by the filing of bankruptcy. They can still be pressed, maybe even during the proceedings. A careful review of these claims is worthwhile. They are:

- **Secured debts:** Creditors who have secured debts can immediately liquidate collateral and keep the proceeds (up to the amount owed). If the proceeds aren’t enough, they have an unsecured claim for the balance.

As a result, these claims become part of the bankruptcy proceedings. Along with the other unsecured creditors, there is still a chance of recovering something.

- **Unsecured debts not listed:** If the bankrupt fails to list a contractor as a creditor, the contractor can’t hope to share in what other creditors get. This is why it’s essential to move quickly once the bankruptcy petition is filed.

- **Court judgments:** If a contractor has a court judgment that arose out of personal injuries, filing for bankruptcy won’t discharge these kinds of claims.

Other claims that are not dischargeable include penalties and fines levied by courts and government agencies, and certain taxes.

Taxes that have been assessed within three years of the filing of the bankruptcy petition are one kind. If the taxes were incurred more than three years before the filing, the bankruptcy proceeding will discharge these.

Also, payroll taxes withheld and penalties imposed on "responsible" officers of the corporation for late payment of payroll taxes may not be discharged.

**Contractor Must Do Some Work**

Some hard work and digging will go a long way toward increasing the assets that are available for distribution to creditors.

As an example, consider a debtor who gives away assets to members of his family within one year of filing. The trustee may be able to recover them for the creditors, but if they were sold for fair value, they probably can’t be recovered.

If the debtor paid old bills just before filing bankruptcy, similar reasoning applies. The debtor may have been attempting to provide preferential treatment to some of his creditors. In a case such as this, the cutoff is four months before the bankruptcy filing.

In any bankruptcy proceeding, the referee is supposed to raise these fundamental questions. If he doesn’t, the creditors have a right to pursue them at the creditors’ meeting.

Now, it may take some penetrating questions by the subcontractor. Of course, if a contractor turns up something all creditors will benefit, not just the individual who raised the question.

When a customer of a contractor files bankruptcy and lists the contractor’s company as a creditor, that contractor will be notified of the meeting of creditors.

It is perfectly understandable that a contractor could be inclined to write off his debt, assuming as do many that there will be few assets left to distribute except perhaps a few office chairs and some badly-in-need-of-repair tools.

But—it might pay to go—or to send a lawyer. Since bankruptcy doesn’t discharge all debts, yours might just be one of the exceptions.