



# Construction and Land Use Newsletter

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## Succession Planning Part 1: Failing to Plan is Planning to Fail

By Timothy R. Hughes and Lauren Keenan

Most real estate and contracting businesses are closely held businesses owned by either a family or a small group of owners. Running the business generally overshadows thinking about the next generation of ownership. The reality is that failing to plan for ownership transition can destroy the business that owners are working so hard to build. In Part I of Succession Planning, we discuss why planning for ownership transition is critical for your business. In our next installment, we will discuss some of the key tools and concepts you need to understand in order to accomplish a successful ownership transition.

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- Alternative Dispute Resolution
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### *Why Engage in Business Succession Planning?*

Business succession planning is the on-going process of planning for the inevitable change in leadership that can take place in any business at any time. Owners need to identify and develop individuals who have the potential to fill key leadership positions within the company. A critical part of this effort is preparing for negative events such as disability, illness or death of a key employee. Life events such as divorce, illness or disability, retirement or death can happen suddenly and have a major impact on an existing business.

Without proper planning, these events can cripple a small or family-owned business. According to the Family Business Institute, only about 30% of family-owned businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family businesses operate into the fourth generation or beyond. The research further indicates that such business failures can essentially be traced to one factor: an unfortunate lack of family business succession planning.

The typical small business owner may think such planning and leadership development is more the realm of large Fortune 500 companies. Larger companies have large pools of resources and employees to draw from which is not so for the small business whose loss of a single key employee can be the demise of a small business. Recently, business succession

planning came front and center in the sports world when people started to ask what the owner (now 77 years old) of the Oakland Raider's NFL Football Team planned to do with his majority interest in the team upon his death. Would a member of his family take over the team? Or would the team have to be sold? The questions are the same no matter what the size of your business, and like many things in life, the sooner you start to plan, the better.

Businesses that fail to plan not only run the risk of experiencing a void in strong leadership within the organization, but failing to plan can also lead to unnecessary monetary losses and avoidable tax liabilities. According to an article published by online journal, Bizjournals.com, estate taxes alone can claim between 18 and 55 percent of a taxable estate, frequently resulting in businesses having to liquidate or take on tremendous amounts of debt just to stay afloat following an owner's death. Even with recent federal action with respect to estate taxes, small business transitions on death can result in high value transfers of ownership interests that can cause significant estate tax liability. Owners need to consider their liquid assets and whether they are sufficient to offset such taxes as part of estate planning and business succession planning. Timing can be critical too, as many individuals forced to sell real estate in the last couple years can attest.

Addressing these issues could take into account the experience of multiple professionals. Your financial planner, your accountant, your lawyer, and your insurance broker should all be familiar with your situation and work as a team. Successful planning requires communication, cooperation and understanding from each member of your team.

Business succession planning is critical to the long term health and viability of your operations. In our next installment, we will discuss some of the important tools and concepts that you should understand to accomplish your business transition goals.

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## **Bankruptcy - Not Necessarily an End to Construction Payments**

By Juanita F. Ferguson

Ask any construction professional what is one of the biggest concerns during a construction project and it is certain to be the threat of ongoing payment becoming stalled due to a bankruptcy filing. Whether the bankrupt party is an owner, a contractor, or any other party in a construction project, a bankruptcy petition has an immediate impact on the progress of work, payments, and fulfillment of obligations. Understanding the mechanics of bankruptcy law is essential to containing the fallout from a bankruptcy filing, as well as aggressively pursuing alternative theories of recovery.

### **Point 1. An automatic stay is in effect once a bankruptcy petition is filed.**

Section 362(a) of the Bankruptcy Code dictates that as soon as a debtor files a bankruptcy petition, an automatic stay goes into effect. This means that no one can file any type of action or continue any other type of legal proceeding to collect amounts due from the debtor, or to enforce any claims against the property of the debtor. The stay is enforced to protect the debtor while pursuing bankruptcy and to allow the debtor a period to exhale and to regroup.

### **Point 2. Certain parties can file for a relief from an automatic stay.**

Generally, the automatic stay does not prevent suits against co-debtors and guarantors of obligations owed by the debtor, as long as such pursuit does

not affect property that is a part of the bankruptcy estate. Even if the co-debtors are co-defendants with the debtor in a lawsuit, the automatic stay does not prevent the continuation of an action against the non-debtors.

**Point 3. Suppliers can reclaim materials from a debtor.**

Even if a debtor files a petition, Section 546(c) of the Bankruptcy Code provides a materialman or similar type vendor the right to reclaim goods used in the construction of a project. All that the materialman needs to do is to make a written demand for the return of the construction materials. The demand must be filed no later than 45 days after a debtor receives goods or 20 days after a bankruptcy petition is filed if the 45th day expires after the date of filing. Also, the goods must have been sold in the ordinary course of business and received by the debtor up to 90 days prior to the date that the petition is filed.

**Point 4. File an administrative claim.**

Section 503(b)(9) of the Bankruptcy Code provides that, after proper notice has been provided to a debtor and a hearing has been conducted, the Bankruptcy Court shall allow as an administrative expense “the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold by the debtor in the ordinary course of such debtor’s business.” Under Section 503(b)(9), even if a seller of goods fails to demand the return of the materials, the seller may still assert an administrative claim in the bankruptcy case equal to “the value of any goods received by the debtor within 20 days before the commencement of a case.” Section 503(b)(9) focuses on the value of the goods and not the goods themselves and provides relief that is not available even if the goods are not available to be reclaimed. The advantage of filing an administrative claim is that such claims are paid for up to 100% of its value prior to any payments on proofs of claim for general unsecured claims. Often, unsecured claims are paid at only a fraction of the value, making an

administrative claim an attractive alternative for the contractor who is diligent in pursuing recovery.

**Point 5. Mechanic’s liens may continue to be perfected.**

The automatic stay provision of the Bankruptcy Code provides that the filing of a bankruptcy petition shall act as a stay of any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title.

Notwithstanding the automatic stay provisions of Section 362(a), under Section 362(b) (3), creditors are permitted to file liens for the purpose of continuing the perfection of an existing lien. Section 362(b)(3) is an exception to the general prohibition against any post-petition efforts to obtain property of the estate or to perfect a lien. As long as there is some action that is required to perfect a creditor’s interest in the property, Section 362(b)(3) gives a creditor an alternative to pursue mechanic’s lien rights.

While a bankruptcy petition can present a real threat to a creditor obtaining payment from a debtor, prompt action can minimize adverse outcomes. Consult with a bankruptcy attorney for a complete understanding of available remedies/

*This article is not intended to provide specific legal advice but, instead, a general commentary regarding legal matters. You should consult with an attorney regarding your legal issues, as the advice will depend on your facts and the laws of your jurisdiction.*

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