



# Newsletter

JANUARY 2008

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Our office will be closed for the following holidays:

January 21, 2008 – Martin Luther King Jr. BD

February 18, 2008 – Presidents Day

Our next newsletter will be mailed out the beginning of April 2008.

Remember if you have an article that you would like to contribute to our newsletter just fax it to us for our review. We must receive the article no later than March 15<sup>th</sup> for our April newsletter.

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## IMPORTANT DELAWARE FRANCHISE TAX INFORMATION

All Delaware domestic corporations are required to file an Annual Report and pay any taxes and fees due on or before March 1st. In past years, you received a printed paper annual report and a separate instruction sheet for filing the Annual Report. The notification process has changed this year. Instead of the pre-printed paper report, you will receive a postcard notification which will include instructions for filing the Annual Report. You will be receiving the 5 1/2" x 8 1/2" neon green postcard in January.



The notification process has been changed this year to encourage electronic filing of Annual Reports in anticipation of complying with newly enacted legislation which becomes effective January 1, 2008. That legislation will require corporations to be declared void for failure to fully complete their Annual Report. In addition, the State will be prohibited from issuing a certificate of good standing on any corporation not complying with this law. Delaware will require 2007 Annual Franchise Tax Reports (due March 1, 2008) to be filed electronically.

We realize this change to our procedures is significant and should you have any questions or concerns as to how it will affect you and your business, please contact the Division of Corporations, Franchise Tax Section at 302-739-3073.

# IS YOUR BUSINESS IN FINANCIAL TROUBLE?

## Three Advantages of an Out-Of-Court Creditor Settlement

If your business is in serious financial difficulty don't rush to file Chapter 11. Try first to negotiate an out-of-court workout. Debt restructuring outside of bankruptcy court gives you and your creditors several big advantages:

- An out-of court workout is far less costly than Chapter 11 reorganization. It can cost \$50,000 or more in professional fees to navigate even a small business through a successful Chapter 11 reorganization. Negotiating the same arrangement with creditors-without Chapter 11 – may cut your fees in half.
- Privacy is another advantage. With an out-of-court workout your financial woes are private. This is important if you may lose vital clients who learn of your financial difficulties. Your employees, similarly, may seek more secure employment once your company goes into Chapter 11. An out-of-court workout provides considerably more confidentiality since no one but you and your creditors are involved.
- A third advantage of the out-of-court workout is that you avoid the many rules and restraints of a Chapter 11. You enjoy more flexibility both in how you may design your repayment plan and how you operate your business during the workout.

An out-of-court workout, however, is not always your ideal alternative. One big drawback: Dissenting creditors who do not accept your settlement plan can still use your business or petition it into bankruptcy. These dissenting creditors often upset a workout plan between a company and its assenting creditors.

Consider as an alternative a pre-packaged Chapter 11: Here your creditors accept your proposed repayment plan, but provide that if it should be necessary to file Chapter 11, creditor assent to the informal workout plan constitutes acceptance to an equivalent plan under Chapter 11. Convince only a majority of your creditors to accept your out-of-court plan and you can automatically force it upon the dissident creditors by filing a Chapter 11. The big benefit: You can quickly be out of Chapter 11 in a month or two instead of the year or two which is more typical when you go into Chapter 11 without a pre-approved plan. This strategy saves time, aggravation and the big fees of a long and drawn-out Chapter 11.

## When Chapter 11 is Your Right Remedy

Far too many troubled companies file Chapter 11 when less involved procedures, such as out-of-court workouts, could rehabilitate their business more efficiently and economically. But there are four cases when a Chapter 11 is the only solution:

- If the IRS is threatening seizure, or has already seized, and you cannot pay the taxes within the short time the IRS gives you. Under a Chapter 11 you have up to six years from the date of assessment to pay the IRS. The same is true of taxes owed state taxing agencies.
- If a secured lender is threatening seizure. The Chapter 11 automatically stays a foreclosure of assets or the repossession of leased equipment. The bankruptcy court may later allow the lender to foreclose, but in the interim your business is safe.
- If your business has been petitioned into bankruptcy by creditors and you cannot defend against the bankruptcy. You can then automatically put your business into Chapter 11 with a simple motion to convert proceedings from a Chapter 7 to Chapter 11.
- If you have so large a number of creditors that it's unlikely you can successfully reach agreement on a repayment plan without an orderly Chapter 11.

## How to Structure Successful Workout Plans

Whether your troubled business is in Chapter 11 or is attempting an out-of-court workout, the key to success is a debt repayment plan your creditors accept as *feasible, fair, and equitable*.

A plan that is *feasible* if your business can afford to repay what is promised, when it is promised. It is *fair* when the repayment is for an amount more than creditors would get under a forced liquidation. Finally, it is *equitable* when all creditors would get under a forced liquidation. Finally, it is *equitable* when all creditors (within each class) receive a proportionately equivalent amount on their claim. Still, within these three parameters there is considerable room for negotiations:

- *How much will you pay?* Obviously, the major objective of creditors is to be repaid as much as possible. A lowest settlement offer must at least equal what creditors would recover if your business were liquidated. You must inevitably offer more as an incentive for creditors to keep you in business. The maximum debt your business can safely carry into the future? The amount you can comfortably pay back from surplus cash flow within two or three years.

- *How much now and how much later?* Creditors also want fast payment. You cannot, however, pay more up-front cash than you have on hand. Nor can you promise future payments above what the business can afford. Tip: Use conservative cash flow projections and never allow creditors to intimidate you into investing more personal funds so they can receive faster or larger payments. Make your business stand on its own.
- *Length of payments?* Creditors will prod for as long a payment period as is necessary to fully repay what you owe. Don't let them mortgage your future for more than two or three years.
- *What about interest?* Creditors bargain for interest and interest at the prime rate is reasonable. Creditors should be reminded they'll wait two to three years to see payments under bankruptcy-and the bankruptcy court doesn't pay interest.
- *Will you personally guarantee the payments?* Whether you agree depends on the total debt, your personal financial situation, the risk, and how important the business is to you. Bargain for a limited guarantee. This limits your exposure while convincing creditors of your commitment to see the business succeed.
- *Will you secure the payments with a mortgage on your business?* Knowledgeable creditors bargain for a mortgage. A mortgage gives them an easy way to enforce their rights if you default. Equally important, it ensures current creditors receive priority of payment over future creditors should you fail later. This may be a point to concede.

There are many less important points to negotiate. Will you give your creditors some stock in your business? It may be an attractive proposition if it looks like your company will enjoy rapid growth and possibly go public. Will you agree to a bonus payment if your company makes more money than anticipated? Be creative. There are many possible terms to consider when designing a repayment plan with creditors. Being the architect of an attractive settlement plan may be just what it takes to save your business.

One powerful way to coax more creditors into accepting a payment plan: Offer several options. For example, you may offer creditors: 1) 20 percent of their claim payable in four annual installments of five percent each, 2) a lump sum payment of 10 percent of their claim, or 3) five percent now and a share of the profits over the next three years. Each creditor can elect to accept the option considered most attractive.

Why does this technique work so well on creditors? It's largely psychological. When you offer a creditor only one plan, the creditor is forced to decide whether he should accept or not. When you offer alternative plans, the creditor thinks in terms of "which plan should I accept," rather than "should I accept the offered plan." Psychology is all-important when your goal is to tame angry creditors.

## Six Reasons Your Business May Not Survive Chapter 11

Nearly nine out of ten companies that file Chapter 11 do not successfully emerge from bankruptcy court. They are instead liquidated under Chapter 7. Many that had their reorganization confirmed fail within three years of their reorganization. This leaves only a handful of companies that go into Chapter 11 alive three years later. Why do so many businesses succumb? What can you do to increase your chances of survival?

- One common reason for failure is that few smaller businesses can successfully finance themselves through a Chapter 11. While a Chapter 11 encourages more lenient credit and innovative borrowing, acute cash shortages can still prove fatal. When contemplating a Chapter 11 for your business, do so with a clear understanding of how you'll stay afloat-particularly if your company still operates with a negative cash flow and you lack strong lender and creditor cooperation.
- Companies also look to Chapter 11 as a safe harbor from foreclosing creditors. The protection is short lived if the bankruptcy court finds the lender is not adequately protected and authorizes foreclosure. And the court will if your company continues to lose money while collateral erodes and interest on the debt continues to mount.
- Creditors may force you to sell your most profitable units to raise quick cash for creditor dividends. While helpful to your creditors, this strategy is counter-productive to the long-term profitability and survivability of your business. This one big mistake accounts for a large number of reorganization failures.
- A surprisingly large number of businesses simply sink into the Chapter 11 quicksand of bureaucratic rules and restrictions, as well as the politics that abound in any Chapter 11. Bureaucratic death is particularly true of small businesses that are taken less seriously by bankruptcy courts.
- Creditors may also be hostile and unreceptive to even the most generous reorganization plan, particularly when creditors feel the owner has had less than honest dealings.
- Finally, is the fact that many companies mistakenly believe they've solved their problems simply by filing Chapter 11. These same firms come out of bankruptcy losing money just as before. The essence of Chapter 11, or any other business reorganization, is to give you another opportunity to put your business back on its feet. That means a business that earns a profit and operates with a positive cash flow.

Would your company survive a Chapter 11? Examine these five characteristics of long-term survivors:

- Survivors go into Chapter 11 with sufficient assets and a viable base of business activity from which to restructure and rebuild. Losers allow their asset base to dwindle until nothing is left to rebuild with.
- Survivors enjoy creditor cooperation and creditor support-particularly in obtaining new credit and financing. Losers have no credibility and earn no creditor cooperation.
- Survivors maintain a positive cash flow throughout the reorganization process. Losers continue to hemorrhage money.
- Survivors address and cure their underlying problems and design a coherent plan for new profitability and growth. Losers see no need to reshape for the future.
- Survivors restructure their debt to conform to the repayment capabilities of the company. Losers either offer too little and lose creditor support, or offer too much – only to default later and be liquidated by impatient creditors.

## How to Find Fast Cash in Your Failing Business

When creditors grow anxious, a key objective should be to turn unencumbered assets into cash as quickly as possible. This can provide you sufficient liquidity to finance your way through a Chapter 11. Cash-under any circumstances-gives you, not your creditors, the greatest flexibility should you have other objectives. Two assets often overlooked in this cash raising exercise: Accounts receivable and capital assets such as equipment, fixtures and motor vehicles.

Accounts receivable are best factored if they qualify for a factoring arrangement. This means your receivables must be owed by business customers with acceptable

credit, and that the amount owed you cost-justifies factoring. The upside: Once you factor your receivables you immediately receive cash for about 90 percent of your receivables. More importantly, with receivables factored, your creditors' loose access to them.

Factoring is perhaps your only solution short of Chapter 11 when the IRS attempts to levy your receivables. No business with substantial receivables can survive an IRS levy. Even if you should survive the cash flow crunch from an IRS intercept of all incoming checks, its adverse impact on customer relations is bound to destroy your business. As a practical matter you have no alternative but to factor your receivables so they are no longer subject to a threatened IRS levy.

Chart a similar course with capital assets. For example, here you may enter into a sale/leaseback arrangement. The sale/leaseback firm would buy your equipment, vehicles, or real estate, and then lease these assets back to you. Its net effect: You turned your equity into instance cash, which again, is a far more elusive asset for creditors to reach.

For these two cash-raising strategies to work, your receivables and capital assets must be free of liens and encumbrances. But even with liens, there may still be a sizeable equity to be tapped.

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You, yourself, have got to see that there is no just interpretation of life except in terms of life's best things. No pleasure philosophy, no sensuality, no place nor power, no material success can for a moment give such satisfaction as the sense of living for good purposes, for maintenance of integrity, for the preservation of self-approval.

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