

Assignment for the Benefit of Creditors: An Alternative to Bankruptcy ©

By Mark Leipold¹

Some businesses cannot continue to operate and must therefore be sold or liquidated and the proceeds distributed to creditors. An Assignment for the Benefit of Creditors (hereinafter an “Assignment” or “ABC”) is a well-established tool that is an alternative to bankruptcy and can provide a benefit to troubled companies and present an opportunity for potential buyers. Assignments are structured to save time and expense in concluding the affairs of an insolvent company. Through an Assignment, the insolvent company’s assets can be sold quickly and efficiently, and the liquidation proceeds can be distributed to creditors shortly thereafter. In general, after the secured creditors are paid first, then tax and wage claims are paid. Secured creditors may find an Assignment useful, because it is relieved of the legal costs and risks associated with the foreclosure and sale of its collateral. Secured creditors may be willing to allow some portion of the proceeds from the sale of its collateral to pay the fees and costs of the Assignee, as well as tax and wage claims.

Similar to a Chapter 7 Case

An Assignment is analogous to a Chapter 7 liquidation proceeding under the Bankruptcy Code. It can either be pursuant to a statute, like California, or common law, like Illinois. In most instances, ABCs are statutory. An Assignment, however, is not recognized or used in all states.

In Illinois, an Assignment is simply a contract whereby the troubled entity (Assignor) transfers legal and equitable title, as well as custody and control of its property, to a third party (Assignee) in trust, to apply the proceeds of the liquidation of the assets to the Assignor’s creditors in accord with priorities established by law. Unlike a Chapter 7 however, an Assignee can more easily elect to keep the business operating while he tries to sell the company as a going concern.

Neither Illinois’ nor California’s ABCs require a court filing. A court filing, however, is required in many states and it is not uncommon for the Assignee to have to post a fiduciary bond.

An Assignee is generally an individual selected by a troubled company. The decision to undertake an Assignment must be approved by the equity owners. The Assignee is charged with the responsibility of gathering all of the Assignor’s assets and selling the Assignor’s right, title and interest in those assets. The Assignee has a fiduciary duty to all creditors. The Assignor must turn over and assign all right, title and interest in its assets to the Assignee together with a complete listing of all creditors, their addresses and the amount of indebtedness shown on the debtor’s books and records. The Assignee is required to give notice of the Assignment to the creditors and invite each creditor to file a claim in the Assignment estate. The notice or state

¹ Mark Leipold is a partner in the Creditor Rights and Bankruptcy practice group of Gould & Ratner LLP in Chicago. Mark may be contacted at 312/899-1651 or by email at mleipold@gouldratner.com.

statute (e.g. New Jersey) may provide a bar date, by which all claims must be filed. After the bar date, the Assignee will reconcile the claims and object to those deemed to be improper.

Unlike a bankruptcy filing, there is no automatic stay in Assignments. Creditors will be able to continue to pursue the Assignor. A judgment against the Assignor, though, will most likely have little value because the Assignor no longer has title to or interest in the assigned assets. Consequently, an informal (and often incomplete) automatic stay will result from an ABC.

Liquidation of Assets

As a general rule, the Assignee will assemble the Assignor's assets and advertise an auction sale. The assets will be liquidated either piecemeal or in bulk, whichever method will yield the highest price. An Assignee generally will obtain at least one liquidation appraisal, and if the Assignee can find a buyer for the entire asset pool which exceeds the appraised liquidation value by a reasonable amount, the Assignee may immediately sell to such buyer without advertising or an auction.

Fees and Costs of an Assignment

In general, the fees and costs associated with an Assignment are about the same as a Chapter 7 bankruptcy case. In an Assignment, the Assignor pays the fees and costs of its professionals, including the fees and costs of an attorney experienced in insolvency matters. Before an Assignment occurs, the company retains an attorney to evaluate the financial situation of the business and consider the various options available to the entity. If the attorney and company determine that an Assignment is the best option, the attorney will assist the company in selecting an independent Assignee and in the preparation of the Assignment documents. The Assignee's fees and costs are paid from the proceeds of the sale of the assets. In general, the Assignee will prepare the Assignment documents.

Right, Title and Interest

The buyer of the assets will receive an Assignee's bill of sale establishing that the buyer has received the Assignee's right, title and interest in the purchased assets on an AS IS, WHERE IS basis without any warranties, representations or covenants. The buyer at an Assignee's sale is advised to obtain a thorough lien search before consummating such a purchase. The sale is free and clear of only known liens, claims and encumbrances. The purchase price must be sufficient to satisfy these secured claims, or the buyer and the unpaid lienholder will need to enter into a settlement. This differs from bankruptcy in that the assets can be purchased through a bankruptcy sale free and clear of all liens, claims and encumbrances notwithstanding the purchase price or the agreement of a lienholder. Even if the Assignee is willing to give the buyer a warranty, a representation or covenant, the Assignee's liability is generally limited to the proceeds of the sale. If the breach of any of the foregoing is not discovered until after the assets are liquidated and disbursed, the Assignee will not have any funds to pay any damages. In some instances, if the Assignee's conduct amounts to gross negligence or willful misconduct, a court may require the Assignee to pay claims from its own resources.

Assignment for the Benefit of Creditors: Preservation of Value

Goodwill may be a significant asset whose value can be realized only through the sale of the business as a going concern. In fact, many potential buyers are identified prior to the Assignment. An assignee may also operate a business for a short period of time in hopes of locating a buyer of the company as a going concern, and/or conduct an orderly liquidation of the debtor's assets that would maximize the value over a straight public auction. A Chapter 7 Trustee has no incentive to undertake this type of extra work or spend the time and money required seeking court approval to pursue this type of turnkey sale.

Avoidance Actions

Obviously, most states have some version of the Uniform Fraudulent Transfer Act, or its predecessor, the Uniform Fraudulent Conveyance Act. Most courts will recognize the Assignee's standing to bring such claims for the benefit of the creditors. However, preferences are not as simple. First, not all states recognize preferences. For example, Illinois – which employs a common law ABC – does not have “mini-preference” provisions. California and Delaware – which have statutory ABCs – do have mini-preference provisions. There is an issue however as to whether Section 547 of Title 11 of the United States Code has preempted these mini-preference provisions. *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1202 (9th Cir. 2005) (Bankruptcy Code §547 preempts California's mini-preference statute); *contra Credit Managers Ass'n of California v. Countrywide Home Loans, Inc.*, 144 Cal.App.4th 590, 593, 50 Cal.Rptr.3d 259, 260 (Cal.App. 4th Dist. 2006) and *Spector v. Melee Entertainment LLC*, 2008 WL 362125, 1 (Del.Super. 2008) (interpreting California's assignment for the benefit of creditors mini-preference provision is not preempted by §547) *Ready Fixtures Co. v. Stevens Cabinets*, 488 F.Supp.2d 787 (W.D. Wis. 2007) (holding Wisconsin's mini-preference provision is not preempted).

Risk Factors

One of the risks inherent in an Assignment is that three unsecured creditors of the Assignor might file an involuntary bankruptcy proceeding against the entity. If this happens, the Assignee will often have to return the assets to the entity. Bankruptcy courts may abstain from exercising jurisdiction over the case and dismiss it if the Assignee can establish that the Assignee's administration of the estate is competent and continued administration by the Assignee will best serve the interests of the creditors.

© Mark E. Leipold