



AMERICAN  
BANKRUPTCY  
INSTITUTE

## 2019 Annual Spring Meeting

# The ABCs (and DEFs) of Assignments for the Benefit of Creditors

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# AMERICAN BANKRUPTCY INSTITUTE

## ABI SPRING MEETING

### ASSIGNMENT FOR BENEFIT OF CREDITORS PANEL 4/13/2019

#### FACTS PRESENTED

##### Debtor/Assignor:

Don't Bite Me LLC ("Company"), is in the business of operating dog training centers in Los Angeles, San Francisco, San Diego, Sacramento, New York, Chicago and Philadelphia. All training centers are leased from different landlords. The Los Angeles site is the headquarters.

##### Assets:

Trademark (no valuation done to date)

Patent on dog training method (no valuation done to date)

Customer Lists

FF&E

"Going Concern Value" in an indeterminate amount (but material with \$1.5 million in EBITDA each of the past three years).

##### Employees:

150 employees- 110 in California, 40 among New York, Chicago and Philadelphia.

##### Debt:

1. Bark Bank-owed \$1M secured by IP and FF&E. Past due (term loan matured one month ago). Bark Bank has threatened foreclosure on the personal property collateral.

2. \$500K in funds advanced by the owners Don and Tricia (see below) over the past two years, though the advances were only evidenced by a note and perfected two months ago when the owners realized that they needed to properly reflect the terms of their advances.

3. Company was recently found liable for a judgment of \$5M (after 6 weeks of training one of the trained dogs who graduated with honors from the Los Angeles training center bit a child in the face that left a very slight scar on the child's cheek).

##### Owners/Goals:

The Company is currently owned 50% by Don Dog Lover and 50% by Tricia Trainer. Both owners want to keep the Company as they had plans for adding more high tech training methods, but don't have any funds now due to money they had to spend on commercials to counter the bad publicity from the dog bite owner and litigation. The Company has no money to pay off the matured loan or the judgment in any foreseeable time. The judgment has just been perfected.

Both owners want to know if there is a quick way to cleanse the Company from the judgment and the debt so they can keep the Company and its assets. Don Dog Lover has some family trust money he might use if there were an opportunity to buy the Company or retain his interest, but not to pay debt. Tricia Trainer does not have her own money but thinks that if there is a process to cleanse the Company of the debt she could get some friends to invest so she could buy it with Don. Don and Tricia don't think anyone else wants the Company given

## 2019 ANNUAL SPRING MEETING

the bad publicity from the lawsuit underlying the judgment, though a competitor has signaled a willingness to make a low bid to keep the business from returning to the market. They also suspect the judgment creditor may want the patent as the judgment creditor owns a dog daycare facility and Don and Tricia think the family made a bigger deal out of the dog bite because they want to start a training center and therefore want the Company out of business.

The owners have interviewed two potential assignees. One, "Easy as ABC" is well-known in the community for quick and efficient processes and, having reviewed the circumstances, has indicated that it will do an assignment for a fixed fee of \$50,000 if it can get comfortable that it can close a sale immediately after the assignment is made. The other, "Plan B Associates", has reviewed the situation and has indicated that it will take the assignment for \$10,000 and 10% of the value of the assets distributed to unsecured creditors.

### **Roles:**

Moderator and Debtor:	Robbin Itkin
Company Lawyer:	Tobias Keller
Bank Lawyer:	Andrew Caine
Judgment Creditor Lawyer:	Catherine Youngman
Assignee:	Peter Hartheimer

# **The ABCs (and DEFs) of Assignments for the Benefit of Creditors**

**ABI Annual Spring Meeting  
April 2019**



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# GENERAL ASSIGNMENTS FOR THE BENEFIT OF CREDITORS: THE ABCs OF ABCs (Third Edition)



Written by Geoffrey L. Berman  
Edited by David Gould

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## What Is a General Assignment?

A general assignment provides a means of liquidating the assets of a debtor<sup>4</sup> in an orderly, controlled manner. While some may believe that a general assignment is a form of reorganization, in actuality a general assignment is a vehicle used for the sale or liquidation of a business. It is not used to financially rehabilitate or “turn the business around.”<sup>5</sup> Generally, “[a]n assignment for the benefit of creditors is a business liquidation device available to an insolvent debtor as an alternative to formal bankruptcy proceedings.”<sup>6</sup>

Assignments are either creatures of common law or statute, and the law varies from state to state as to which form of assignment is utilized. Generally speaking, however, states will follow one of two approaches to the assignment process. One approach requires court supervision of the assignment and the assignee; the other permits assignments to proceed without court supervision, but requires that

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4 In this regard, “debtor” generally refers to a corporation, limited liability company or partnership, not an individual or a sole proprietorship.

5 A “stand still” or creditor composition agreement is the typical format used for out-of-court reorganizations.

6 *Credit Managers Ass’n v. National Independent Business Alliance*, 162 Cal. App. 3d 1166, 1169, 209 Cal. Rptr. 119 (1984); 15 California Law Revision Commission Reports 1121; Charles Jordan Tabb, *The Law of Bankruptcy* § 1.5; I Gerrard Glenn, *The Law of Fraudulent Conveyances and Preferences* § 102 at 201 (revised edition 1940); at common law, a general assignment “is an express trust which the debtor creates by a conveyance of his assets, the grantee (‘assignee’ as referred throughout the remainder of this book) to take the estate, not for his own uses, but in trust to liquidate and distribute among the grantor’s creditors.”

## What Is a General Assignment?

the assignee follow state laws applicable to and governing the liquidation of a business and its assets. In either case, the process of administering the assets of a debtor is similar. An agreement is executed by and between a debtor (*i.e.*, the assignor) and the assignee.<sup>7</sup>

The assignee is generally someone who is not related to or directly involved in the management or day-to-day operations of the debtor (*i.e.*, a disinterested third party). Assignees are usually individuals experienced in the process of liquidating businesses (*e.g.*, a lawyer or accountant); however, they may also be corporate entities with such experience. Upon acceptance of the assignment “contract,” all of the assignor’s right, title and interest in its assets is “transferred” to the assignee for the purpose of liquidation. The assignee then becomes a fiduciary on behalf of any and all creditors of the debtor, as well as for the debtor and, ultimately, its owners/shareholders. Under well-settled common law, an assignee who serves this function temporarily attains “title” to all of the liquidating company’s assets in order to sell off the assets for the benefit of the creditors.<sup>8</sup>

The transfer of the assets is subject to any and all existing liens, and the assignee is bound to honor all valid, *i.e.*, perfected and enforceable, liens. The execution and acceptance of the assignment contract creates an “estate,” which includes the transferred assets and the proceeds thereof, subject to the claims of the assignor’s creditors. In states where the process is court-supervised, the contract is filed with and, in some jurisdictions, approved by the appropriate court. Thereafter, sales of assets and the administration of the assignment estate are subject to state-specific rules and will generally

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7 Depending on the practice of a particular state, this agreement may be a contract, deed of assignment or other similar type instrument. For purposes of this guide, all such documents shall be referred to as the contract.

8 *Clark v. Williard*, 294 U.S. 211, 214 (1935); *Dambmann v. White*, 48 Cal. 439, 450 (1874).

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What Is a General Assignment?

require a hearing and court approval before any significant event can take place.

General assignments do not typically give a debtor a discharge, as a discharge of debts can only be achieved through a bankruptcy case.<sup>9</sup> In many instances, the assignment process is not one where creditors are required to “consent;” rather, they are required to file a claim with the assignee in order to share in the distribution of any proceeds generated from the liquidation of the debtor’s assets. Further, claims of creditors against third-party (or insider) guarantors are not stayed by the making of the assignment.<sup>10</sup>

In a practical sense, however, a general assignment stops creditors from pursuing the debtor through collection lawsuits. As stated above, assignments do not have the same ability to prohibit lawsuits from proceeding as provided for by the Bankruptcy Code. However, when the various individual aspects of state laws are brought into effect upon the making and acceptance of the general assignment, the practical effect is that creditor actions become ineffective. Specifically, the assignee has the rights of a lien creditor under Uniform Commercial Code § 9-309,<sup>11</sup> so that unperfected security interests fail against the rights of the assignee.

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9 A discharge is available to an individual debtor, subject, of course, to the provisions of §§ 523 and 727 of the Bankruptcy Code. A corporation does get a discharge under a confirmed plan of reorganization in a chapter 11 case.

10 There is no assignment equivalent of the “automatic stay” imposed by § 362(a) of the Bankruptcy Code, which prohibits the initiation or continuation of any lawsuit against a debtor unless there is an order from the bankruptcy court. Such relief may be granted only upon notice and a hearing.

11 This section is per the revised Uniform Commercial Code, effective July 1, 2001. The prior reference was Uniform Commercial Code § 9301. *See also* U.C.C. § 9-102(52)(A)(ii).

## Assignee Qualifications

**A**s noted above, the assignee is usually a professional (although not necessarily a lawyer) experienced in insolvency matters. Corporate entities can also serve as assignees in some states. The assignee is usually selected by the debtor or its counsel, and typically is someone with expertise in either the debtor's industry or in managing liquidations. In some instances, creditors can influence the selection of the assignee by threatening an action to upset the general assignment. There may also be situations where "co-assignees" are selected, one by the debtor and one by the creditors.<sup>18</sup> Other states have enacted legislation that requires the assignee to convert the assignment into a receivership.<sup>19</sup>

Many states require that the assignee post a bond to protect the interests of creditors against the assignee's potential misconduct. The amount of the bond varies, ranging from those states with no bond requirement<sup>20</sup> bonding an amount equal to twice the liquidation value of the assets assigned, to an amount that is determined by the

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18 There are states that protect creditors by requiring an assignee to call a meeting of creditors immediately upon the acceptance of the general assignment so that creditors may select an "agent" who has the power to confirm an assignee's decision in various matters, including the sale of assets, distributions, etc. This agent even gets to share in the assignee's fees. *See, e.g.*, South Carolina Code of Laws, Title 27, Chapter 25, § 40.

19 *See* Revised Code of Washington (RCW) § 7.08.030; Minnesota Revised Statutes 2013 § 576.22.

20 With respect to common law assignments, bonds are rarely required, and then only pursuant to the assignment agreement itself.

## Assignee Qualifications

supervising court.<sup>21</sup> The clear intent of this requirement is to give creditors a means of recovery in the event that the assignee fails to perform its duties consistent with the standards imposed by law. The practical effect is to make it more difficult for an inexperienced individual, or one without sufficient financial resources, to serve as an assignee.

Although generally required (and desirable), there is no ironclad rule that the assignee must be “disinterested.” Disinterestedness requires that the assignee not be a creditor, affiliate or insider of the debtor or otherwise have a claim against the estate, except for the fees and expenses to be paid pursuant to the assignment contract. The assignee should, however, be someone in whom both the assignor and creditors have confidence.

Another consideration will be the assignee’s ability to effectively manage the liquidation process and the assignment estate. Sometimes a specific assignee is selected because of his or her specialized knowledge and experience in a particular industry — notwithstanding the existence of a conflict of interest, such as a connection to a party in interest or status as a creditor of the assignor. Creditors should, in all events, look carefully at the credentials and experience of the proposed assignee in order to satisfy themselves that the assignee will treat each creditor fairly and equally within their specific classification. Otherwise, the benefits afforded by the assignment process and various statutes can be lost. The assignee does not assume the assignor’s contractual liabilities.<sup>22</sup>

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21 California is an example of a state without a bonding requirement. For an example of a state with such a requirement, *see* Ohio Rev. Code Ann. § 1313.01; for an example of a state where the bond amount is determined by the supervising court, *see* Florida Statute, Title XLI, § 727.109(2).

22 *Credit Managers Ass’n v. Brubaker*, *supra*, 233 Cal. App. 3d 1587, 1594, 285 Cal. Rptr. 417 (1991).

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## Assignee Qualifications

Creditors can challenge the validity of an assignment, and even seek the removal of the assignee, when they believe that the assignee is not acting as a neutral fiduciary or otherwise properly performing its requisite duties. Available alternatives to the assignment include the filing of an involuntary petition in bankruptcy against the debtor,<sup>23</sup> filing a complaint in the applicable supervising court, or filing a complaint against the assignee for breach of fiduciary duty. Each of these alternatives should only be considered with the advice of counsel as they represent significant attacks on the assignee and assignment estate and could result in significant sanctions against those creditors seeking such relief if the actions are subsequently found to be unwarranted.

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<sup>23</sup> This generally must be done within the first 120 days immediately after the execution of the general assignment. *See* § 303(h)(2) of the Bankruptcy Code.

## What Property Is Assignable?

Generally, all real and personal property of the debtor may and should be assigned. This includes any causes of action, bank accounts, intangible assets such as patents and trademarks, and credits of all kinds both in law and in equity. Most states, however, have limitations on the assignment of legal malpractice claims.<sup>24</sup> The practice has developed where the assignment agreement includes an assignment of the proceeds of such a nonassignable cause of action while appointing the assignee as the attorney in fact to prosecute the action in the name of the assignor.

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24 For example, see *Kracht v. Perrin, Gartland & Doyle*, 219 Cal. App. 3d 1019 (1990).

## Costs of Administration

Assignments for the benefit of creditors are generally less expensive to administer than a chapter 7 bankruptcy and generally provide for a less-cumbersome process. Still, there are significant costs that will be incurred. The following are some of the typical expenses that an assignee will likely incur in the administration of the assignment estate:

- administrative rent (*i.e.*, the cost of remaining on, or in possession of, the debtor's premises). This cost is generally based on the lease between the debtor and its landlord at the time of the assignment, unless otherwise negotiated between the assignee and the landlord.<sup>25</sup> In those instances where the debtor or the debtor's principal is the landlord, it may be possible to negotiate a reduced amount, or even a waiver of rent, as a means of creating greater value for creditors.
- actual out-of-pocket expenses, including telephone, postage (for mailing notices and distributions to creditors), rent, utilities, insurance and other similar costs.

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<sup>25</sup> For example, California law provides an assignee with a statutory right to occupy the assignor's premises for up to 90 days upon acceptance of the assignment, subject to paying rent and notwithstanding any provision in the lease for the termination of the lease upon the making of the assignment; the right to occupy is conditioned on the assignee making the monthly rent payment reserved in the lease. See California Civil Code § 1954.1 and N.J.S.A. 2A:19-31, 32.

Costs of Administration

- the fees and costs of professionals, including lawyers and accountants, real estate brokers, etc., to represent the assignee, the debtor and creditors' committees where appropriate.<sup>26</sup>
- the fees of the assignee. Depending on the jurisdiction involved, the fee charged by the assignee may be negotiated and made a part of the contract. Fees can range from as low as 1 percent of the amount realized from liquidation of estate assets to as much as 20 percent. On average, fees will range from 5 to 10 percent of the proceeds generated.<sup>27</sup> Alternatively, the assignee's fees may be fixed or "capped" by agreement, depending on the size of the assignor's estate and expected recoveries from the assets. Finally, some states set statutory limits on assignee's fees, eliminating negotiated fees.<sup>28</sup>

It is important to note that the cost of administering any assignment estate will be a function of the specific circumstances of each debtor. Where the assets are to be sold in bulk to a buyer on the date the assignment is accepted by the assignee, the costs will be substantially less than when an assignee has to manage a going-out-of-business sale or wait for a piecemeal auction. In those cases where a major estate asset is a cause of action in which the debtor is

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26 While assignments are not necessarily court proceedings, many issues arise during the administration of the estate that will require the assignee to make judgment calls as to how to proceed. To ensure that all applicable state laws are followed and the best possible recovery obtained, the assignee will usually hire professionals to provide guidance and counsel.

27 Although we are not aware of any definitive survey in this area, the size of the fee is usually related to the dollar value of the assets to be liquidated, the estimated liquidation value and the time and expense to liquidate the assets. Other factors are considered on a case-by-case basis.

28 See, e.g., N.J.S.A. 2A:19-43.

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the plaintiff, legal fees will be much higher and will often be disproportionate to the other expenses in the case.<sup>29</sup>

Many states have enacted provisions within their version of the Uniform Commercial Code giving an assignee the rights of a lien creditor.<sup>30</sup> This effectively limits creditors' claims to the status they had (*i.e.* unsecured, lien creditor, etc.) as of the moment the general assignment is made. This "lien right" is also important in giving an assignee the ability to avoid unperfected security interests or transfers that may be recoverable as fraudulent or "preferential" pursuant to applicable state laws.<sup>31</sup>

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29 In those instances where the assignor is a defendant in litigation, the assignee has several options. These include (a) allowing the creditor/plaintiff to obtain a judgment liquidating the amount of the claim where the lawsuit is one for goods and services (*i.e.*, a collection action); (b) defending a significant disputed claim on the merits, which would require analysis on a case-by-case basis; and (c) passing the cost of defense to a guarantor where the guarantor has exposure in the litigation.

30 See Uniform Commercial Code § 9-309(12) of the (revised) Uniform Commercial Code, which became effective July 1, 2001, even though that section does not specifically state that an assignee has the rights of a lien creditor. The definition of "lien creditor" (§ 9-102(a)(52A)) includes an assignee for the benefit of creditors. The definition does not, however, make the assignee a "secured party." Section 9-309(12) provides that as a lien creditor upon the making of the general assignment, the assignee does not have to take any additional acts to confirm its status as a lien creditor, and § 9-317 gives the assignee's lien-creditor status "priority over an unperfected security interest."

31 State statutes vary as to the reach-back periods for assignees to attempt to recover on preferential transfers. See Kentucky Revised Statute § 378.060; N.J.S.A. 2A:19-14 (120 days). California had a preference recovery statute (California Code of Civil Procedure § 1800); however, that statute was deemed preempted by the Ninth Circuit Court of Appeals ruling in the matter of *Sherwood Partners Inc. v. Lycos Inc.*, 394 F.3d 1198 (9th Cir. 2005) (*cert. denied*).



## Initial Estate Administration

In every general assignment, the assignee needs to know what assets comprise the assignment estate<sup>32</sup> and who has a claim against the assets or the proceeds thereof. Numerous states require the assignor to provide the assignee with a list of its shareholders and creditors, as well as an inventory of assets subject to the assignment.<sup>33</sup> From there, the assignee must provide creditors with notice of the general assignment, and creditors must be given an opportunity to file a claim with the assignee.<sup>34</sup> The time to file a claim with the assignee varies from as short as 15 days to as long as six months from the date of the assignment or notice.<sup>35</sup>

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32 As distinguished from a specific assignment, a general assignment by definition is an assignment of all of the debtor's assets. It is the assignee's responsibility to ensure that in fact the assignee has control over all the assets constituting the estate. In contrast, a specific assignment is when the debtor assigns some part, but not all, of its assets to the assignee.

33 See California Code of Civil Procedure § 1802; Kentucky Rev. Stat. Ann. § 379.020; and N.Y. Debt. & Cred. Law § 4.

34 See, e.g., Ohio Rev. Code Ann. § 1313.39; California Code of Civil Procedure § 1802; Texas Business & Commerce Code, Title 3, § 23.17; and PA Cons. Stat. § 81.

35 See Massachusetts Gen. Laws, Ch. 203 § 41; Texas Business & Commerce Code, Title 3, § 23-31; and California Code of Civil Procedure § 1802 for the six-month notice provision.

If a lender appears to have a security interest in all of the debtor's assets, the assignee should seek to obtain a subordination agreement with the secured lender *before* accepting the assignment.<sup>42</sup> If successful, this will ensure that the assignee is paid for its services and keeps the assignee from becoming a creditor of the assignment estate, as well as makes certain that the costs of administering the estate are paid. The effectiveness of the subordination agreement should be conditioned upon the creditor having a valid, perfected security in-

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39 Adopted in California at Code of Civil Procedure, § 2100 *et. seq.*

40 *See, e.g.*, California with respect to business inventory tax liens.

41 *See* footnote 56.

42 A subordination agreement is an agreement between the secured lender and the assignee pursuant to which the secured lender allows the assignee to take possession of its collateral, liquidate it and pay the proceeds of the liquidation, net of expenses, to the secured lender. This is not a "conspiracy" between the assignee and the lender, but a means of protecting all parties' interests in having an orderly and efficient liquidation process. Depending on the lawyer, other forms of agreement may be used, including a cash-collateral agreement, operating agreement, etc.

## Liquidation of Assets

**H**ow should the debtor's assets be liquidated in order to maximize their value? This question is usually best answered by an assignee after consultation with other professionals so that the maximum value is obtained from the assets, under the circumstances. The assignee must also take into account various factors, including the type(s), amount(s) and condition of the assets involved, saturation of the marketplace, the existence of ready buyers, and disposition-related costs and alternatives. Often, assignments will result in an immediate sale of all of the assets, in bulk, to a pre-arranged buyer in an effort to realize the maximum net value for these assets at a minimum controlled cost.

Generally, there are a variety of ways that inventory, fixtures and equipment are liquidated. These include the following:

- a going-out-of-business sale;
- an auction of the assets, either on a piecemeal (one at a time) basis or in bulk;
- a “negotiated” sale to a pre-arranged buyer; and
- a going-concern sale, with the assignee operating the business until the closing, in an effort to maximize the value of certain time-sensitive assets (typically supply contracts), or

## Liquidation of Assets

to reduce exposure to contingent liability claims (e.g., extended warranties).

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52 See California Uniform Commercial Code § 6103(c)(6).

53 At the risk of misusing the old saw “bad facts make for bad law,” a comment on an unpublished opinion of the California Court of Appeal must be made. In *El Saad v. Taralji*, 2011 Cal. App. Unpub. LEXIS 9056 (2011), the court was faced with an assignment with an immediate sale to an insider. The appellate court outlined the facts as follows.

On Feb. 5, 2009, the plaintiff obtained a fraud judgment against West Coast, a distributor of telephone calling cards. Eight days later, Platinum Touch was formed with one

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## Distribution of Funds

No distribution to general unsecured creditors should take place until the assignee is satisfied that all secured claims, taxes (*i.e.*, federal, state and local) and priority wage claims have been paid. In addition, no creditor who has failed to file a timely claim (or a consent, where one is required) may be paid. Whether the assignee makes one distribution or a series of distributions<sup>111</sup> to unsecured creditors is dependent on a number of factors, including the amount of money remaining in the estate after payment is made to the secured and priority creditors, the number of creditors, and whether additional funds can be expected from assets yet to be liquidated (such as accounts receivable, litigation proceeds or royalty payments due the debtor).

Typically, all distributions are made on a *pro rata* basis, meaning that each creditor shares in the money distributed based on the amount of its allowed claim and the total amount of all allowed claims. No one creditor of any given class should receive more (on a percentage basis) than any other member of that class. When all of the funds in the estate have been distributed, the assignee should provide an accounting<sup>112</sup> to all creditors concerning all funds handled during the administration of the estate.

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111 For example, Kentucky requires distributions when the assignee accumulates 5 percent of allowed claims. Ky. Rev. Stat. Ann. § 379.130.

112 Many states have this requirement, which, along with common sense, brings a level of confidence to the process for the affected creditors. See NY Debt & Cred. § 15 (10).

## Distribution of Funds

Generally, the assignee will question any filed claim that does not match the amount reflected in the debtor's books and records. Most assignments limit the amount of any claim to that which was owed on the date the assignment was made.<sup>113</sup> The most common basis for an assignee's objection to general unsecured claims is the addition of interest and other costs for the unpaid balance. The assignee must be diligent in its refusal to pay any interest on unsecured claims that has accrued after the date of the assignment.<sup>114</sup>

Interest will be paid only after principal on all filed claims has been paid.<sup>115</sup> There is little guidance on the rate of interest to be paid on such claims. Per § 726(a)(5) of the Bankruptcy Code, interest would be paid on claims at the legal rate as provided for in the state statutes for the state under which the general assignment was made.<sup>116</sup>

If there is a surplus, it will be held in trust by the assignee and returned to the assignor after creditors who did not participate have an opportunity to reach the surplus.<sup>117</sup>

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Some states have a requirement that an assignee make an accounting to the creditors on a yearly basis pursuant to "trust" law theories.

113 The exception to this is in the situation where there is an oversecured creditor, which would therefore be limited in the amount of interest to which it is entitled.

114 There may be an exception where there is an underlying contractual basis or statute that entitles the creditor to such interest. In *In re Newport Offshore Ltd.*, 219 B.R. 341 (Bankr. D. R.I. 1998), the bankruptcy court held that Rhode Island receivership law was not pre-empted by the Bankruptcy Code. Therefore, the assignee (or its counsel) must know state law in this area, as applicable in the situs of the general assignment.

115 See *McDougall v. Fuller*, 148 Cal. 521, 525, 83 p. 701 (1906).

116 See, e.g., Cal. Civ. Pro. Code § 685.010(a), which at the present time provides for interest at the rate of 10 percent per annum until satisfied.

117 See *Mechanics Bank v. Rosenbern*, 201 Cal. App. 2d 419, 424, 20 Cal. Rptr. 202 (1962). See also *Heath v. Wilson*, 139 Cal. 362, 369, 73 p. 182 (1903). By analogy to bankruptcy administration, if there ever were a surplus case, no doubt the assignee would give notice to those creditors that did not file claims of their right to file claims against the surplus.

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## Key Elements of an Assignment for the Benefit of the Creditors

This memo is designed to provide a basis for discussion of the key business issues inherent in an Assignment for the Benefit of the Creditors. This memo does not provide legal advice or offer a detailed analysis of ABC law which varies by state.

### I. Assignment for the Benefit of the Creditors (“ABC”)

#### Overview

An ABC is a business liquidation device available to an insolvent debtor and is an alternative to a formal bankruptcy filing. ABCs are governed by state law. As a company enters the zone of insolvency, the fiduciary obligation of its board and management is to the company’s enterprise value. An ABC allows the board and management to act in a reasonable manner to maximize value and creditor recovery while providing a framework to wind the company down and pay creditors.

In an ABC, the company transfers all of its rights, title and interest in its assets to an Assignee, which liquidates the property and distributes the net proceeds to the creditors. The Assignee serves in a capacity analogous to that of a bankruptcy trustee. In many cases, an ABC is a preferable liquidation mechanism compared to the more cumbersome federal statutory procedures governing Chapter 7 liquidations or liquidating Chapter 11 cases. Typically, ABCs involve less administrative expense and provide a faster and more flexible liquidation process.

An ABC allows the company to select an Assignee with appropriate industry expertise to conduct the wind-down and liquidation process of the business. In a Chapter 7 case, the trustee is not known and is not appointed until after the bankruptcy petition is filed.

In an ABC, Sherwood establishes a special purpose entity (the “Assignee”) to manage the ABC of the company (the “Assignor”). The cost and budget for an Assignment Estate is impacted by the amount and type of services required of the Assignee as well as the legal risks attached to the assignment estate. If the Assignee is required to operate the assignment estate or hire employees to assist in the monetization of the Assignor’s assets, then the amount of funding required increases accordingly.



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### **Initiation of an ABC**

The ABC is initiated by the execution of a General Assignment letter between the Assignor and the Assignee. Prior to the execution of the General Assignment, the Assignor must have the approval of its Board of Directors and the consent of its shareholders. Typically, consent of 51% or more of the outstanding shares are required (the actual percentage is dictated by the Assignor's Articles of Incorporation and By-Laws).

Sherwood's standard ABC documents which are forwarded to a proposed Assignor are:

- General Assignment Agreement. This is the document that officially creates the ABC. The Board Resolution and Stockholder Consent allow an officer of the Company to sign this Agreement.
- Unanimous Board Resolution approving the ABC. This is a draft of a Board Resolution that approves the ABC and the appointment of the Assignee. All Board members sign this resolution.
- Stockholder Consent approving the ABC. Company counsel should review the charter documents to determine the percentage of stockholder approval which is necessary to effectuate an ABC. The stockholders in a percentage in excess of the charter document requirements will need to sign this Consent.
- Interested Party List Declaration. This declaration is signed near the time of the ABC and is accompanied by a list of all creditors, equity holders and other interested parties, together with the amounts owed to all creditors (including contact information for all such parties). This facilitates communication with parties interested in the company about the fact that an ABC has taken place. An Officer of the Company signs this document.
- Assignee Compensation Letter Agreement. Generally signed by the same person that signs the General Assignment Agreement.
- Patent Assignment Agreement. This furthers the linkage of the assignment of the patents from the Company to the Assignee. Buyers of patents generally require this linkage in addition to the General Assignment Agreement. An Officer of the Company will need to sign this Agreement.
- Trademark Assignment Agreement. This furthers the linkage of the assignment of the trademarks from the Company to the Assignee. Buyers of trademarks generally require this linkage in addition to the General Assignment Agreement. An Officer of the Company will need to sign this Agreement.
- A document which appoints a new trustee of the 401(k). Please note that it is not necessary to appoint a new trustee of the 401(k). The 401(k) plan is not an asset of the Company which is transferred to the Assignment Estate. A 401(k) plan is an asset belonging to the plan participants and remains apart from the Assignment Estate. Typically, the current trustee of the 401(k) is a Company officer who does not want the responsibility of filing the reports necessary to terminate the plan or the responsibility to work with the plan administrator to have the funds disbursed. Sherwood has worked with Nick Saakvitne in other ABC's. Saakvitne is an attorney who specializes in 401(k) wind-downs and carries insurance coverage specifically

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for that task. The Assignor can determine if it would like to utilize Saakvitne's services. His services can be paid by either the Company or from the plan assets. Typical fees range between \$7,500 and \$10,000 depending upon the size of the plan.

- A list of Preliminary Required Information to get an ABC started.

### **Creditor Claims**

Shortly after the commencement of the ABC, the Assignee will send a notice of the ABC to all creditors, shareholders and other interested parties. The Assignment Notice is accompanied by a Proof of Claim form that allows any person or entity to submit a claim to the Assignee. The Assignee has the responsibility to review submitted claims and to verify their validity.

If funds are available for distribution to creditors, the Assignee is required to distribute the funds in a manner similar to the creditor class priorities in a federal bankruptcy proceeding. If disputes exist among two creditor classes or within a single creditor class, then the Assignee attempts to resolve the disputes in a manner that is cost efficient for the Assignment Estate. This risk and possible legal cost is included in the ABC budget.

### **Secured Creditor**

If the company has entered into a Loan and Security Agreement(s) with a secured creditor(s) whereby the secured creditor has a perfected priority lien(s) on all of the Company's assets, then the consent and cooperation of the secured creditor to the ABC sales process will be critical to its success. In order to sell the assets free and clear of the secured creditor's liens (which the buyer of the assets will clearly require), it is important that the secured creditor consent to the ABC and any asset sales process. In order to support the sales process, the secured creditor needs to understand that the process was comprehensive and designed in such a way to as maximize value.

### **Role of the Board of Directors and management team in an ABC**

Typically, the Board of Directors resigns upon the commencement of the ABC. As the company's assets, have been transferred to the Assignee, there is no role for board members.

All employees of the company are terminated prior to the commencement of the ABC. The Assignee enters into temporary employment agreements with former employees who are necessary to assist in the wind-down of the company or to operate it for a short period.

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## II. California and Delaware ABC Law

### California ABC Law

Under California law, an ABC is a non-judicial process. The Assignee has a fiduciary obligation to operate with reasonable care and professional judgment on behalf of the creditors of the Assignment Estate.

### Delaware ABC Law

In Delaware, ABCs are overseen by the Court of Chancery in the county in which the company operated or is registered. The Court's oversight is minimal and the process remains informal. It has been Sherwood's experience that an Assignee in a Delaware ABC possesses significant latitude in its actions in spite of the requirements associated with Delaware law. Key elements are that the Assignee:

- Must file an affidavit and inventory of the assets with the Court no later than thirty days after commencement of the ABC.
- Must petition the Court to appoint two disinterested parties to appraise the assets of the estate.
- Must post a bond with the Register of the Chancery.
- Must file periodic reports with the Court.
- Does not have the right to recover preferences or fraudulent transfers.
- Serves at the wishes of the Court who can remove the Assignee and appoint another party.

## III. Benefits of an ABC

An ABC has benefits for many key stakeholders in an insolvent situation. Benefits for some key stakeholders are as follows:

### Benefits for Board Members and Officers of an Assignor

- As an ABC is a form of insolvency under state law, it provides board members and officers of a company with the protections typically associated with insolvency proceedings.
- Any assets that are sold from an ABC estate are transferred by the Assignee. The Assignee takes responsibility for the sales price and any risks associated with the sale.
- Board members and officers are not a party to the sale of assets from an ABC. Therefore, they can not be attacked by creditors or other interested parties who would like to question the sale of the Assignor's assets (either in dollar value or process).



**Benefits for Buyer of Assets in an ABC**

- In a distressed financial situation, it is difficult to determine the liabilities of a company. In response, buyers frequently request initiation of an insolvency proceeding which will allow them to buy the assets of the company free of any liens or associated liabilities.
- An ABC provides the buyer with protection against possible successor liability claims.
- An ABC is not burdened by some of the more troublesome requirements of a federal bankruptcy proceeding. For instance, there are no requirements to seek court approvals or allow significant overbid time periods.
- An Assignee can set short timeframes with established guidelines which allow all interested parties to have the opportunity to buy the assets before their value diminishes substantially. An ABC can transfer assets substantially faster than alternative proceedings.

**Benefits for the Secured Creditor of an Assignor**

- Secured creditors do not view an asset sales process as their core competency.
- Secured creditors have a strong preference that outside experts manage an insolvent situation and any associated sales processes.
- In most instances, an ABC is less expensive and more expeditious for a secured creditor than their other alternatives and can result in a higher value being received.
  - An ABC is more expeditious and less cumbersome than a foreclosure process.
  - In a liquidating Chapter 11, new financing may be required and is typically not available. A Chapter 11 filing also involves much higher costs (court filings, creditor committees) and a significant amount of time and effort from management for tasks other than monetizing assets.
  - In a Chapter 7 filing, the company expertise is lost. A Trustee appointed by the court may or may not have experience in the company's industry, however the Trustee will likely not be appointed for a few weeks which results in a significant diminution of value.

**Benefits for Unsecured Creditors of an Assignor**

- An Assignee has a duty to engage in a sales process that is designed to market the assets and maximize the value of those assets.
- In a situation where time is of the essence, an Assignee has more flexibility than a bankruptcy trustee. An Assignee can react quickly to sell assets if a delay would lead to a significant diminution in value.



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- Frequently, creditors of an Assignor do not have a significant amount of confidence in the officers of an insolvent entity. An ABC helps them understand that a non-affiliated third party has been retained to work on their behalf. Creditors are much more likely to accept that a sales process was run in a fair and comprehensive manner if an outside party leads the process.
- Creditors are also more likely to accept that a lower value may in fact be actual market value if an outside third-party leads the sales process.

#### IV. Possible Asset Sale Process – Pre-Packaged ABC

In a “pre-packaged ABC” sales process Sherwood, as Assignee, would immediately contact potentially interested parties to see if the Company’s assets could be sold simultaneously with the commencement of the ABC.

Such a sale is more of a “going-concern” than “liquidation” concept and typically results in a greater return for a company’s creditors. Key aspects of a pre-packaged ABC sales process are:

- Immediate initiation of the process.
- As the Assignee will be the entity which sells the assets, it is critical that the Assignee lead the sales/marketing process in conjunction with the necessary personnel from the company. Such an arrangement allows the Assignee to justify the decision as to the winning bidder and protects the board and officers of a company from potential fraudulent conveyance claims.
- Identification of and contact with a broad range of potential acquirers.
- Execution by the interested parties of a Non-Disclosure Agreement (“NDA”) prior to participating in the sales process. While the marketplace will quickly become aware of the proposed sales process, it is preferable to maintain as much confidentiality as possible.
- Creation of an online data room providing information on the key company assets and other critical documents to the interested parties.
- Communication of the terms under which the assets will be sold (“where-is, as-is” basis with no reps or warranties from the seller; the Assignee) and the timeframe within which bids must be submitted.
- Establishment of a set deadline for bids on the company assets.

**The Assignee will consider the following criteria in determining the winning bidder:**

- Ability to close within the necessary timeframe
- Cash proceeds for creditors
- Assumption of unsecured liabilities
- Intangibles such as ability of purchaser to achieve goals and the financial viability of the purchaser.

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Sherwood will forward its standard ABC prepackaged documents (Pre-Pack Sales Process Letter and standard ABC Asset Purchase Agreement) to interested parties upon execution of the NDA. Access to the data room containing the key company information is granted at the same time.

### **Key items in regards to a pre-packaged ABC:**

- In a distressed situation, buyers will typically require an asset sale as opposed to a stock purchase sale due to the materiality of liabilities that have accrued as well as the uncertainty as to the actual amount of such liabilities.
- While an asset sale simplifies the due diligence for a buyer, the company's ability to quickly and efficiently provide detail as to the available assets will impact the Assignee's ability to market and sell the assets.
- The retention and institutional knowledge of ex-employees of the Assignor may be critical to a buyer and may be a prerequisite to a higher valued sale. It will be important to identify for the buyer the availability of individuals who possess key knowledge or sales relationships.
- It is possible that no buyer exists that values a company's assets with a "going-concern" concept. If after initial due diligence it becomes apparent that material offers are not available or likely, the company should enter into an immediate wind-down ABC. In such a scenario, the value received for the assets would be more consistent with realizable liquidation values which would be less favorable to the company's creditors.

### **V. "Operating ABC"**

In certain instances, the Assignee may elect to continue operations of a significant portion of the Assignor's business. In order to do so, the Assignee must have the consent of the secured creditor(s) to the use of the company's assets for that purpose as well as sufficient liquidity to meet go-forward obligations as they accrue. An "Operating ABC" is similar in concept to a Chapter 11 wind-down whereby a certain level of continued operations will result in greater proceeds for creditors than an immediate shut-down of all operations.

In order to act in a manner consistent with its fiduciary obligations, the Assignee (similar to a bankruptcy trustee) must remit payment for all services and/or product that are provided from the date of the ABC forward. This includes rent, utilities, and normal operating costs associated with the company. Most importantly, the Assignee rehires ex-employees of the Assignor as temporary employees. These temporary employees typically have relationships and institutional knowledge which will allow the Assignee to monetize assets at a higher realizable value.

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Some examples of the reasons for Operating ABCs could be:

- In a software company, continued maintenance and support for customers may be necessary in order for a purchaser of the company's intellectual property to submit an offer at a meaningful purchase price. The continued support also keeps the key engineers (and sometimes developers) associated with the product allowing the purchaser to quickly relaunch the product upon closure of the sale.
- In certain brick and mortar companies, continued servicing of customers helps liquidate inventory in an organized manner while incentivizing customers to pay outstanding accounts receivable within normal terms. Absent continued operations, the customers seek immediate alternatives and refuse to pay outstanding receivables forcing significant collection costs on the Assignee.

Similar to a bankruptcy, pre-ABC unsecured obligations are handled through a Proof of Claim Process. It has been Sherwood's experience that creditors (even those with significant pre-ABC amounts outstanding) will enter into a go-forward relationship with an Assignee as long as they are assured of payment for go-forward services. If sufficient liquidity exists, an Operating ABC can be a very favorable process to realize a higher value for a company's assets.

## VI. Assets to Monetize

Key assets that an Assignee would typically attempt to monetize include:

- Intellectual Property
- Accounts Receivable
- Inventory
- Fixed Assets
- Prepaid Assets
- Life Insurance

## VII. Liabilities

Key liabilities that an Assignee tries to understand include:

- Fiduciary obligation items that are typically paid pre-ABC including accrued amounts for payroll, vacation, expense reports, 401-k withholding and contributions, payroll taxes and sales tax.
- Severance obligations are typically discussed between management and its Board of Directors and are considered pre-ABC.
- D&O insurance tail coverage (typically paid pre-ABC)
- Final month health insurance (typically paid pre-ABC)
- Secured debt
- Priority unsecured debt
- Unsecured debt



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## VIII. Other Tasks

In addition to the monetization efforts and resolution of claims against the Assignment Estate, there are many other tactical issues that need to be addressed at the appropriate time. Some of these issues are:

- Opening a special operating account for the benefit of the creditors.
- Securing the Assignor's premises and protecting its assets.
- Reviewing a comprehensive set of all company records and documents.
- Contacting all applicable tax authorities to obtain tax claim information and to close tax accounts.
- Filing final tax returns (federal, state, local).
- Returning all leased or third-party owned equipment.
- Clearing out leased premises and returning them to the landlords in broom sweep condition (if applicable).
- Terminating all recurring accounts of the Assignor.
- Resolving outstanding disputes/litigation involving the Assignor.
- Forwarding Proof of Claim forms to all interested parties of the Assignor. Monitoring receipt of submitted claims and verifying the validity of submitted claims.
- Monitoring all correspondence sent to the former locations of the Assignor.
- Assisting the Assignor's 401-k trustees in identifying the appropriate professionals to terminate the 401-k plan.
- Preparing the books and records of the Assignor for storage (typically required to be held by the Assignee for seven years).

# # #



## ABC vs. Bankruptcy

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### Assignment for the Benefit of Creditors | ABC

#### Pros

- ♦ Ability to move with speed and flexibility | weeks vs. months
- ♦ Assignee assumes risks of sale transaction (Assignee, not Company sells assets)
- ♦ Generally, less expensive than a Bankruptcy
- ♦ Company appointed Assignee (Trustee)
- ♦ No stigma of Bankruptcy, required disclosures are limited

#### Cons

- ♦ Limited court oversight
- ♦ Buyer – risk of successor liabilities and fraudulent transfer
- ♦ Possible conversion to Bankruptcy

### Bankruptcy | Chapter 11

#### Pros

- ♦ Court oversight | Court approves significant business actions
- ♦ Protection for Buyer – successor liability, fraudulent transfer

#### Cons

- ♦ Much slow than an ABC, months vs. weeks; Court must approve decisions
- ♦ Court appointed Trustee, fear of the unknown, Management/Board can be scrutinized
- ♦ Generally, more expensive than an ABC
- ♦ Subject to over-bid | Risk of delay
- ♦ Stigma of a Bankruptcy





## The 1, 2, 3s of ABCs

□ By Andrew De Camara, Senior Managing Director, Sherwood Partners Inc.



An assignment for the benefit of the creditors (ABC) has become an increasingly well-known insolvency process. While an ABC may have certain advantages for a particular company over other insolvency alternatives (*e.g.*, a bankruptcy filing, foreclosure), the facts of each situation should be well understood and assessed by a company's board of directors and officers before deciding which insolvency option to pursue. The benefits and limitations of an ABC are important to understand before effectuating one.

This article explains the ABC process, including advantages and disadvantages, to assist boards and their advisors in assessing whether it may be the appropriate process for their situation. It also describes the ABC sale process for buyers and the distribution process for creditors.

An ABC is a business liquidation device governed by state law that is available to an insolvent debtor. The ABC procedure has long existed in law and is sometimes addressed in state statutes.<sup>1</sup> In an ABC, a company, referred to as the assignor, transfers all of its rights, title, and interest in its assets to an independent fiduciary known as the assignee, who liquidates the assets and distributes the net proceeds to the company's creditors. The assignee in an ABC serves in a capacity analogous to a bankruptcy trustee in a Chapter 7 or a liquidating trustee in a Chapter 11.

Board and shareholder consent is typically required to effectuate an ABC. The necessary percentage of shareholders who must consent is governed by a company's corporate governance documents. An assignee generally relies on the corporate counsel of the assignor to clarify the required shareholder percentages as part of the vetting process to confirm proper effectuation of an ABC. If a company is venture-backed, it may be required to seek specific consent from both preferred and common shareholders. It is possible to enter publicly traded companies into an ABC; however, the shareholder proxy process increases the difficulty of effectuating the ABC and results in a much longer pre-ABC planning process.

Once the necessary consents have been secured, an officer of the company executes the general assignment agreement, which initiates the ABC and transfers title of the assets from the assignor to the assignee. The state law under which an ABC occurs should generally be the state of the company's incorporation, the state in which it is domiciled, or the state where it has a substantial portion of its assets or business.

### Key Drivers for ABC Consideration

An ABC is a liquidation vehicle. It is not a process by which a company can reorganize, obtain a discharge, or otherwise emerge from insolvency. Thus, the company's board of directors, officers, and investors need to accept that their control over the company and its assets will cease following commencement of an ABC. In addition, shareholder equity will have

no value unless there is money left to distribute after the costs of the ABC are funded and all creditors have been paid in full.

The following are examples of fact patterns involving companies that could be a good fit for an ABC:

- A software company with a history of material cash burn, no financing options, and no further support from its venture investors. The continued maintenance and support for key customers is necessary for a purchaser of the company's intellectual property to offer a meaningful purchase price. The continued support also keeps key engineers and developers associated with the product on board, allowing the purchaser to quickly relaunch the product when the sale closes. A sale process must occur quickly, and the ABC budget needs to be minimal and funded from collateral. Little money is available for administrative or winddown costs.
- A brick-and-mortar company for which continued servicing of customers helps liquidate inventory in an organized manner while incentivizing customers to pay outstanding accounts receivable within normal terms. Continued operations provide customers with some runway to seek alternatives for continuity in their businesses.

As in most insolvency proceedings, a lack of liquidity and an increasingly upside-down balance sheet eventually force a company to confront the reality of its financial condition. Key factors that drive a company to consider an ABC typically include:

- Negative cash burn coupled with an inability to raise additional debt financing or equity investment
- An unwillingness by current lenders to extend loan/forbearance periods and confirmation that no further loan advances will be made
- Increasing risk for board members and officers that cash will be insufficient to handle key fiduciary items at winddown (*i.e.*, accrued payroll, vacation, taxes, etc.)
- A more realistic assessment of the lack of value of the company and/or its assets, particularly relative to its debt or ability to continue to function as an operating entity (*i.e.*, an unsuccessful M&A process has occurred)

There are many other potential causes that may drive an ABC, but a lack of liquidity and strategic options is the overarching theme.

## Benefits and Limitations

While every situation must be evaluated independently, an ABC offers many strategic benefits to companies, boards, and other stakeholders. For one thing, it allows the company to select an assignee with appropriate industry expertise to conduct the liquidation process, resulting in a greater opportunity to maximize the value of the assets.

Second, the assignee is responsible for the sales process and any risks associated with it. Board members and officers are not parties to the sale of the assets from an ABC. Any such sale or liquidation is conducted by the assignee, an independent fiduciary for the benefit of creditors who takes no direction from the assignor's board or officers. Therefore, any attempted attack or claim by a creditor of the assignor or other interested stakeholder concerning the process or ultimate terms should lack merit and be dismissed by the court.

Third, ABCs tend to have lower administrative costs than Chapter 11 filings due to less extensive court filings (or no filings, depending on the venue) and the lack of a creditors' committee.<sup>2</sup> Fourth, certain investor groups or board members may prefer an ABC to a federal bankruptcy filing due to the lower visibility of an ABC.

Finally, secured creditors generally support an ABC if they believe that the budget for the process is reasonable (less than alternatives) and that the assignee will return proceeds in a timely manner post-ABC after investigating and validating the creditors' secured position.

In sum, the increased value of the monetization of the assets coupled with lower costs will hopefully result in a distribution to unsecured creditors at a higher rate in an ABC process as compared to other alternatives, such as a bankruptcy liquidation.

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**Once a company enters into an ABC, the marketplace understands that value expectations have changed and that a completely motivated seller who is an independent fiduciary for the benefit of creditors is in charge of the sale process.**

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An ABC does have challenges and limitations that should be understood by the board of directors and officers of a company as they consider the most appropriate insolvency process to undertake. While ABC law varies from state to state, there are a few common limitations.

First, an assignee cannot use the collateral of secured creditors without their consent. Therefore, secured creditors have significant leverage in an ABC in regards to the budgeting process. While the budgeting process may be similar to a Chapter 11 cash collateral process, there may be no judge to hear disputes in an ABC. Therefore, the assignee may be more accommodating to secured creditors in an ABC than a debtor might be in a Chapter 11.

Second, a buyer cannot assume any of the secured debt in an ABC sale without the consent of the secured creditor. Similarly, there is no cramdown opportunity (or forced loan extension) of secured debt in an ABC, as is possible in a confirmed plan of reorganization in Chapter 11.

Third, with limited exceptions, there is no automatic stay in an ABC. While the ABC transfers the assets out of the assignor and therefore post-ABC judgments may have no practical value or impact, litigation can continue against the assignor, and the assignee typically has neither the funding nor the economic motivation to defend the assignor against any litigation. In addition, hostile creditors may decide to shift their focus to other stakeholders (*i.e.*, board members or officers in their capacity as guarantors or fiduciaries) if they believe there will likely be no return for them from the ABC estate.

Fourth, an assignee has no rights to assign executory contracts or leases beyond those granted by the contract terms, as is possible in bankruptcy, and seeking consents of counterparties to assign contracts or leases to a buyer of assets from an ABC estate can be a laborious process. If such contracts are numerous or favorable to the assignor, the assignee may be unable to obtain the required consents. That, in turn, may reduce the purchase price or prevent a sale from closing because an ABC does not provide a mechanism to capture the above-market value of any executory contract or lease for the benefit of creditors, absent consent of the counterparties, as Chapter 11 does.

Finally, assignees in most states cannot provide free-and-clear sale orders. What a buyer of assets in an ABC typically obtains, along with the sale documents, is a bill of sale from the assignee. A bill of sale, particularly from an assignee who is a well-known and well-regarded fiduciary, is a very powerful document from the perspective of creditor protection, successor liability, etc., but it does not have the same force and effect as a free-and-clear sale order from a bankruptcy court.

### Sales Process

Most ABCs conclude with a sale of assets. An ABC sales process tends to be faster than even an expedited Chapter 11 sales process conducted under Section 363 of the Bankruptcy Code (*i.e.*, 30-45 days as opposed to 45-60 days), though specific circumstances of any matter can result in a longer process. Typically, the length of the process is directly correlated to available liquidity and runway.

If an assignee accepts assignment of the assets and then conducts its sale process, the time frame is likely somewhat similar to that of a bankruptcy sale process because both are designed to obtain the highest and best price under the circumstances—recognizing that the ABC sale does not require the prior consent of the court.

However, if a sale process was conducted beforehand and is ready to close at the time of the commencement of the ABC, then it is possible—and, in fact, is frequently the case—that the assignee consummates the asset sale to the buyer immediately following commencement of the ABC. A similar sale process in bankruptcy cannot close as quickly and efficiently, which is one of the primary reasons that buyers of assets from insolvent companies frequently require as a condition of the purchase that the sale occur through an ABC rather than through a bankruptcy case.

Many ABCs occur after an unsuccessful M&A process that targeted a much higher valuation, one intended to return money to equity. An assignee runs a similar process, albeit with different terms and conditions. The assets are sold on a “where-is, as-is” basis, with limited or no representations or warranties. The assignee focuses interested parties solely on the asset side of the balance sheet. It is the assignee’s responsibility to seek required consents from known secured lienholders for releases of their liens on the assets in connection with the closing of any sale.

Once a company enters into an ABC, the marketplace understands that value expectations have changed and that a completely motivated seller who is an independent fiduciary for the benefit of creditors is in charge of the sale process. This seller does not have to answer to a board of directors or satisfy the desires of shareholders, which may be unrealistic in an insolvency situation. This typically results in buyers that had previously passed on the buying opportunity to reconsider their interest in the assets.

The assignee bears responsibility for the sales process and choosing the winning bidder (in conjunction with the secured creditor if there are insufficient funds to pay the secured creditor in full). The assignee also must be prepared to defend both the process and its outcome to creditors of the ABC estate.

An assignee’s sale process should include:

- Clear terms and conditions of the sale and deadlines in a sale memorandum
- A robust target list of potentially interested buyers, including competitors of the assignor and other companies and investors in the industry
- A data room providing similar diligence information to all interested parties that have executed a nondisclosure agreement<sup>3</sup>

- An asset purchase agreement form that requires that minimal and nonmaterial changes accompany submission of an offer
- A requirement that an interested buyer supply evidence of financial wherewithal to support any offer

An assignee can operate a business post-ABC to maximize the value of the assets. Similar to a Chapter 11 estate, the ABC must have sufficient liquidity to pay post-ABC expenses to avoid administrative insolvency. An assignee may retain key employees of the assignor as temporary employees of the ABC estate to assist with the sales process or otherwise maintain value through operations.

In certain states, such as California, there is no court supervision in an ABC, which places an increased burden on the assignee to defend against any challenges to the sales process and its outcome. In states with court supervision, such as Minnesota, the assignee seeks court approval of the sale process and a sale order approving the winning bidder's purchase, free and clear of liens.

### **Distribution and Administrative Duties**

The goal of every ABC process is to maximize distributions to creditors. An assignee handles the administrative tasks associated with:

- Noticing creditors of the commencement of the ABC and the deadline for filing claims against the ABC estate
- Distributing funds to creditors
- Winding down the assignor

Shortly after the commencement of the ABC, the assignee sends a notice of the ABC to all creditors, shareholders, and other interested parties, accompanied by a proof of claim form that allows any person or entity to submit a claim to the assignee. The assignee is responsible for reviewing submitted claims and verifying their validity, and may also object to unsupported claims.

If funds are available for distribution to creditors, the assignee is required to distribute them in accordance with the priority schedule established under applicable state law, which is a similar concept to the creditor priorities in a bankruptcy proceeding. If disputes arise between two creditor classes or within a single creditor class, then the assignee attempts to resolve them in a manner that is cost efficient for the ABC or through a declaratory relief lawsuit in state court. Certain state laws may impact the distribution priority scheme and should be reviewed as part of the distribution process.

The assignee generally handles winddown tasks, such as retention of accountants to prepare final tax returns of the assignor, closing 401(k) plans, storage of books and records, cleanup and return of facilities to landlords, and return of leased equipment. These are tasks that the company's officers and board are often not well-suited to handle.

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1. CA Civ Pro Code Section 493.010 (California ABC statute); Minn. Stat. Section 577.11 (Minnesota ABC statute); Fla. Stat. Section 727.01 (Florida ABC statute).

2. However, an assignee may decide that it is prudent and appropriate in certain larger ABCs to support the formation of an ad hoc committee that serves a similar role.
3. The assignee may have additional requirements for the company's most sensitive information, such as submission of an offer for a minimum purchase price.

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## About The Author



**Andrew De Camara** is a senior managing director of Sherwood Partners Inc. and is based in the firm's Los Angeles office. He joined Sherwood in 2001 and has successfully restructured companies through out-of-court restructurings and Chapter 11 reorganizations. De Camara has served as a receiver in both state and federal courts and has helped maximize the value of assets through assignments for the benefit of creditors (ABCs) under various state laws.



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