

# Journal

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## Delaware as a Venue for ABCs: Some Pros and Cons<sup>1</sup>

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Much has been said about the use of non-bankruptcy alternatives over the past few years, as the number of Chapter 11 filings has decreased, costs of bankruptcy proceedings have risen and uncertainty as to outcomes once again becomes a critical factor in deciding how to address distressed debtor issues. In addition, there is the slowly increasing interest rate environment, with the Federal Reserve having raised the base rate by 25 basis points in March and strongly hinting at two more rate increases before year end. Borrowers who were barely covering cash flow requirements, including debt service, will now have a more difficult time making debt service payments. Couple this environment with the sheer volume of debt placed on businesses when capital sources were plentiful and it is no wonder that businesses are facing ever-increasing demands for resolving needs for new capital or debt without a good deal of success. With this backdrop, the use of Assignments for the Benefit of Creditors (ABCs) is an alternative that is garnering more and more attention.

An ABC is a state law governed liquidation process that in many respects follows the process in a Chapter 7 bankruptcy proceeding. But as the prior sentence reflects, applicable state law versus federal bankruptcy law controls. The assets of the debtor (or "assignor") are assigned to an individual (including a company that acts in the fiduciary capacity as an assignee) for the purpose of liquidating the assigned assets. All assets of the debtor must be assigned to make the assignment a general assignment and enable the assignee to take advantage of the protections provided under the applicable sections of the UCC.<sup>2</sup>

ABCs differ from receiverships and Article 9 sales in a number of respects. First, ABCs are not "a creditor remedy" in that creditors cannot force a debtor to make a general assignment. Secured creditors can push a distressed debtor to this alternative, but the decision to make an ABC belongs solely to the debtor's Board of Directors and shareholders. Second, some states do not have court supervision of an assignee in their role in liquidating a debtor; however, there are a number of states that do have judicial supervision of the ABC process.

<sup>1</sup> This article accompanies other articles focusing on receiverships and Article 9 sales published in this edition of *AIRA Journal*, Vol. 31: No. 2 (2017).

<sup>2</sup> See Article 9-309(12) for an assignee to have the rights of a lien creditor upon the making of the general assignment.



Receiverships are however a creditor remedy, typically sought by a creditor with some form of lien rights against collateral it wishes to protect. Be it by consent from a debtor (through the loan documents or otherwise) or the creditor seeking the appointment of a receiver on an expedited basis, the debtor is not the party usually agreeing to the appointment of the receiver. Receivers are officers of the court that appointed them, but their duty generally runs to the creditor that sought the receiver's appointment.

Article 9 sales are also a secured creditor remedy, again usually initiated by the secured lender through a foreclosure process on its collateral and after having declared the underlying debt in default. A debtor may "consent" as part of a negotiated resolution of its debt, but as with receiverships, the debtor does not control the use of the alternative or the choice of the fiduciary.<sup>3</sup>

Generally, state laws governing ABCs do not provide for an automatic stay stopping any litigation against the debtor. That type of relief is solely within the purview of bankruptcy. But state law will enable the assignee to sell assets, prosecute claims against third parties to recover from those third parties, including choses in action, for example claims for breach of contract, claims against directors and officers and in some states even the recovery of preference-type claims.<sup>4</sup>

A number of states are undertaking review of ABC laws including Missouri and Maryland who are currently working on new statutory schemes for ABCs. With the increasing use of ABCs, there is a growing trend to employ the assistance of the Delaware Courts of Chancery for the supervision of these cases. The corporate friendly backdrop of Delaware law generally and the familiarity of the Courts

<sup>3</sup> Readers are again referred to companion articles in this edition of *AIRA Journal* for more specific information on these alternatives.

<sup>4</sup> Such actions are subject to both state law and any applicable appellate decisions. For example, see *Sherwood Partners V. Lycos*, 394 F.3d 1198 (9<sup>th</sup> Cir. 2005) which invalidated California Code of Civil Procedure Section 1800; but compare *Credit Managers Association v. Countrywide Home Loans*, 144 Cal. App.4th 590 (2006).

of Chancery (and of course the bankruptcy court) with the ABC alternative make the use of Delaware a logical choice where one is dealing with a Delaware corporation whose principal place of business might be in a state that is less “user friendly” for the ABC process. Having a Delaware corporation as the assignor will generally give the Court of Chancery jurisdiction over the assets and enable the Court to “accept” the petition and Trust Agreement. Having an Assignee that is a Delaware entity does not hurt either.

With this in mind, there are a few considerations counsel to a distressed debtor will want to take into account when looking at the Delaware alternative. First, on the “pro” side is the use of a jurisdiction that understands the ABC alternative and is not quick to suggest the case belongs down the street at the Bankruptcy Court. Creditors recognize the authority of the Court of Chancery and orders from the Court carry a gravamen that creditors respect. This gives creditors a comfort that there is a good basis for the proceeding, competent judicial oversight, etc.<sup>5</sup>

There are processes in place for the Assignee to post a bond, requirements for appraising inventory assets, notice requirements and accounting of the activity undertaken in connection with the assignment process. Delaware courts have upheld arbitration clauses in contracts between an assignor and a third party, enabling an assignee to use arbitration as a means of avoiding the costs and time delays attendant with court trials.<sup>6</sup> Additionally, the Delaware Courts and Bar Association provide a wealth of restructuring experience.

There are, of course, drawbacks. As noted, the Assignee bond requirement, inventory appraisals and the need for counsel that participates in court proceedings makes the process more expensive than those states that do not have a judicial oversight component. The author has seen cases where the bond requirement has been waived, though that will usually require the consent of the secured creditor. The same is true with the appraisal requirement.<sup>7</sup>

ABCs provide a sale alternative to bankruptcy 363 sales processes. As with 363 sales, selling assets in a Court of Chancery proceeding requires notice of the sale process, a reasonable marketing effort pre- or post-assignment that the Court finds acceptable and maybe, most importantly, giving creditors sufficient notice of any hearing to approve a sale so as to satisfy the Court’s concerns about due

process. This means that a quick sale is almost impossible. Further, the Court of Chancery has no statutory basis for entering an order selling the assets “free and clear”; that of course is a bankruptcy concept and any state court order providing for such relief would be subject to an argument of being preempted by the Bankruptcy Code or a violation of the Contracts Clause of Article I of the U.S. Constitution.<sup>8</sup>

Such sales take planning, appropriate pleadings and supporting declarations or affidavits and counsel time. Counsel time means costs. So parties going into a Delaware ABC need to take these additional factors into account when planning and budgeting for using Delaware for an ABC.

What does all this mean? A Delaware ABC is a very viable alternative to states where the ABC process is less “user-friendly.” The process requires more planning, good counsel for all parties and an understanding of the timing and process to make the ABC case run smoothly. Knowing the process, relying on good counsel and the credibility of the Court of Chancery with creditors make Delaware a good choice for ABCs.<sup>9</sup>

#### ABOUT THE AUTHOR



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Mr. Berman is a Senior Managing Director of Development Specialists, Inc. He is a former President and Chairman of the Board of the American Bankruptcy Institute, Alexandria, VA and ex-officio member of the ABI’s Commission to Study the Reform of Chapter 11. He is also the author of *General Assignments for the Benefit of Creditors: The ABCs of ABCs, Third Edition* (edited by David Gould; American Bankruptcy Institute (2015)), along with other articles and treatises on ABCs. Mr. Berman would like to thank John Knight and Paul Heath of Richards Layton & Finger for their review and comments to this article.

<sup>5</sup> This is not to say other states with judicial oversight of ABC cases do not have competent judges handling the cases; however, ABC cases in many states are small in number or are assigned to trial courts with little commercial liquidation or even probate case experience.

<sup>6</sup> See *CVD Equipment Corp. v. Development Specialists Inc.*, No. CV 11062-VCG, 2015 WL 4506052, 2015 Del. Ch. LEXIS 193 (Del. Ch. July 23, 2015) (unpublished).

<sup>7</sup> The waiver of the inventory appraisal is becoming more prevalent where the secured creditor is significantly under-collateralized and has a recent appraisal, thereby reducing, if not eliminating, the need for additional appraisals or, as in a recent case, where the assignor was a drop ship e-tailer with no inventory.

<sup>8</sup> The taking of a property right without providing the creditor with due process to protect their property right.

<sup>9</sup> Additional information on ABCs generally can be found across the Web. See also, *General Assignments for the Benefit of Creditors: The ABCs of ABCs, Third Edition*, by Geoffrey L. Berman, edited by David Gould (American Bankruptcy Institute (2015)); available at [www.bookstore.abi.org](http://www.bookstore.abi.org)