An introduction to Assignment for the Benefit of Creditors

by Daniel J. Stermer


D. STERMER

A general assignment or Assignment for the Benefit of Creditors (ABC) provides a means of liquidating the assets of a business organization (assignor) in an orderly, controlled manner under state law. An ABC is a vehicle used for the sale or liquidation of a business. It is not used to financially rehabilitate or "turn the business around."

General assignments are either common law or statutory, and the law varies from state to state as to which rule(s) govern. Generally, states will follow one of two approaches to the assignment process: one approach requires court supervision of the assignment and the assignee (such as Florida, New York, Delaware, Minnesota, Washington and Ohio); the other permits assignments to proceed without court supervision, but require that the assignee follow the common law or statutory structure in that state as applicable and governing the liquidation of a business and its assets (such as California, Illinois and Maine).

It is easy to think of assignments as the state law equivalent to Chapter 7 of the United States Bankruptcy Code. The assignment must be of all assets of the assignor in order to qualify as a general assignment; otherwise, the assignment is a specific assignment, and common law and/or statutory law does not apply. The assignee, like a Chapter 7 trustee, marshals the assets, liquidates the assets and distributes the proceeds pursuant to the state's distribution scheme. The federal priority pursuant to 31 U.S.C. § 3713 is applicable to any state assignment proceeding. That priority, however, does not supersede properly perfected liens on assets.

An assignee may have the power to pursue preferences depending upon the state law in which the assignment takes place. Fraudulent conveyances are subject to that state's Uniform Fraudulent Transfer Act or Uniform Voidable Transfer Act. Distributions are made to creditors according to statutory priority and based on a claim's process, including a claims bar date including use of a Notice and Proof of Claim, similar to those used in a bankruptcy.

The assignee should be someone who is not related to or directly involved in the management or day-to-day operations and affairs of the assignor (debtor) and should not be a creditor of the assignor (i.e., a disinterested third person). The assignee is usually an individual experienced in the process of liquidating businesses; however, an assignee may also be a corporate entity with such experience (depending upon state law). An assignment is consummated when the assignee accepts the assignment trust or "contract" from the assignor, some of which processes are embedded in state law. Upon acceptance of the assignment "contract," all of the contracts, assignor's right, title and interest in all of its assets (including personal and intangible property, including choses in action) are "transferred" to the assignee for the purpose of liquidation. The assignee becomes a fiduciary on behalf of any and all creditors of the assignor. The assignor remains, but as an empty shell, because all of its assets have been assigned to the assignee for the benefit of its creditors.

Where there is a blanket secured creditor, the assignee must get that creditor's consent to use and/or liquidate that creditor's collateral. When liquidating the assignor's assets, the assignee must use his/her professional business judgment. The transfer of assets from assignor to assignee is subject to any and all existing liens, and the assignee must validate any alleged secured claims. General assignments do not give an assignor a discharge of its debts, as a discharge of debts can only be achieved through a bankruptcy filing. State statutes that come close to giving bankruptcy type relief, e.g., including an automatic stay, may be invalidated by reason of the U.S. Constitution's supremacy clause. Further, the assignee generally does not have the authority to dissolve the corporate entity. Employee benefit plans, such as 401(k) plans, are not assets of the assignor; thus, the assignee does not become involved in winding down those plans.

The board of directors' decision to commence an ABC versus a bankruptcy is generally driven by a number of considerations, which should be vetted with the advice from counsel, including insolvency counsel. Considerations when determining whether to commence an ABC include, but are not limited to: (1) board members that sit on boards of public companies do not have to check the box about filing bankruptcy for SEC disclosure purposes; (2) zone of insolvency and shifting of fiduciary duty by members of the BOD from shareholders to creditors; (3) cost – usually less costly than bankruptcy; (4) timing – usually faster than bankruptcy; and (5) not all situations are appropriate for ABCs.

For additional information on assignments for the benefit of creditors, visit *www.dsiassignments.com*. Careful consideration needs to be given, in consultation with appropriate professionals, on deciding whether or not to proceed with an ABC.

Note: *Readers are strongly encouraged to review the state law where they may consider filing an Assignment for the Benefit of Creditors for the applicable law in that jurisdiction.*