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The Receivership Alternative - A Response

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Journal Article:

In the February 2001 issue of the *ABI Journal,* Paul Lucey discussed "The Receivership Alternative" to a chapter 11. Unfortunately, Mr. Lucey's reference to voluntary receiverships as state law processes initiated by an assignment for the benefit of creditors is not giving the assignment alternative its proper due.

To begin with, under most state statutes and the common-law governing assignments, a general assignment is not a receivership, as the assignee is a fiduciary to all creditors, unlike receivers, whose interests are generally aligned with the creditor who sought the receiver's appointment. Second, the receiver is chosen by the creditor, subject to court appointment and/or approval. Assignees are usually selected by the debtor and in most instances must be a disinterested party not otherwise affiliated with the debtor or a creditor.[1]

Mr. Lucey also suggests that general assignments are then subject to state court supervision and that state law may enjoin creditor collection efforts. This is not always the case. In those states where general assignments are not statutory and are not court supervised,[2] enjoining creditors from collection efforts can only be done by the filing of a bankruptcy and triggering the automatic stay provisions of §362.[3] Rather, application of state law will generally result in creditors being unsuccessful in their collection efforts. Section 9-301 of the Uniform Commercial Code, as enacted by each state, gives an assignee the rights of a lien creditor.[4] This enables the assignee to assert the rights a lien creditor would have as of the date of the assignment. Therefore, a creditor whose claim was unsecured on the date the debtor made the assignment would remain an unsecured creditor, and any judgment the creditor obtained post-assignment would only serve to liquidate (fix the amount) of the claim. The post-assignment judgment would not give the claim any greater priority over the other claims of unsecured creditors.

Mr. Lucey suggests the "receiver" will operate the business prior to a sale. An assignee will operate a business after the making of the assignment only if the assignee can be assured that his operation will not cause a loss for the estate and, indeed, if the operation is necessary to preserve value or will likely add value. If this cannot be assured, or the assignee does not receive an indemnification from creditors, the business will be closed and the assets then sold. Anything less may result in the assignee being subject to attack, either in state court or in any subsequent bankruptcy proceeding, as having breached its fiduciary duty to creditors. Similarly, allowing the management team of the debtor to "remain in place" is a decision each assignee makes, depending on the facts of the matter. Management that brought the business to failure may not be the best to maintain the business; some key personnel may of course be necessary to provide continuity to the assignee to help maximize the recovery from the assets.

Mr. Lucey mixes the rights of a receiver and an assignee throughout his article; this description may not pertain to many state law assignments. Under most state laws, creditors can assert their security interests in collateral over the rights of all other creditors, including an assignee. Experienced assignees will generally obtain the secured creditor's consent to the use of the collateral, and the right to liquidate the collateral before they accept the general assignment. That negotiation usually includes the obligation of the assignee to confirm the validity of the secured creditor's security interest once the assignment is accepted.

The points raised by Mr. Lucey as "disadvantages" are generally on point. State law generally will not enable an assignee to avoid *ipso facto* clauses, and counsel advising debtors with executory contracts with value (*i.e.,* under-market leases of real property) need to consider this issue before the decision is made to make the general assignment. In assignments of technology-based companies, the limitations (even in chapter 11) of relating to the debtor's ability to assign license agreements must be considered. Reorganization is not generally effected through general assignments or receiverships. General assignments are a method of liquidating assets and are generally more efficient and yield a greater recovery than bankruptcy proceedings, but both options must be considered in light of all the facts before an assignment is made.

The issues related to the filing of an involuntary bankruptcy case against a debtor that made a general assignment are somewhat complex. While Bankruptcy Code §305 allows the court to dismiss or abstain from asserting jurisdiction over the debtor, as Mr. Lucey points out, a key issue will be the potential recovery of preferences in a bankruptcy proceeding where state law does not provide a means to avoid and recover the preferential transfers. California, for example, has a state-law preference statute.[5] However, many states do not.[6] Therefore, in those states where there is no such state-law power, the assignee should immediately review the debtor's payments to trade and insider creditors to determine what, if any, payments may constitute a recoverable preference. If the amounts in question are considerable, the assignee may be obligated to file (or have creditors file) a bankruptcy proceeding to preserve those claims for creditors; allowing the state law process to proceed is not in the best interests of creditors and could also be considered a breach of the assignee's fiduciary duty to creditors.

In summary, bankruptcy lawyers, whether debtor's or creditors' counsel, should understand the differences between receiverships, general assignments and bankruptcy proceedings. Each has its benefits and its deficiencies, and a failure to understand those nuances can result in significant losses for your clients.

Author's Note: *The ABI publication,* General Assignments for the Benefit of Creditors: A Practical Guide, *is available by calling ABI at (703) 739-0800, or e-mailing info@abiworld.org.*

Footnotes

1 This is not intended to minimize the importance of creditors having input or some form of veto over the choice of the assignee, but the debtor, or sometimes a senior secured creditor, will have the final choice as to the assignee. In those states where assignments are court-supervised, the court has the authority to confirm or approve the selected assignee. Return to article

2 For example, neither California nor Maine require the filing of the general assignment with the state court, nor does the making of the assignment "enjoin" creditor collection efforts against the assignor entity. Return to article

3 11 U.S.C. §362. Return to article

4 In the revised statutes due to become effective July 1, 2001, this right will be found in §9-309. Return to article

5 *See* California Code of Civil Procedure §1800. Return to article

6 Many state versions of the UFTA contain an "insider preference" provision. *See* 14 Me.Rev.Stat.Am. §3576(2). Return to article

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