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Schools Facing Financial Difficulties Should Know the ABC Process is an Alternative to Bankruptcy

By Geoffrey L. Berman and Steven L. Victor, Senior Managing Directors, Development Specialists, Inc.

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Readers of this publication are undoubtedly familiar with how DOE Title IV funding works, so we will not make this article about funding. Rather, this article provides school administrators and board members with an alternative to address financial difficulties they may face when funding is in peril and likely to be withdrawn by the DOE. To state the obvious, the immediate decisions administrators face include how to let students know their school is facing immediate closure, how to deal with existing payroll to faculty, administrative and support staff, dealing with creditor and investor issues, and record retention to help students migrate to new schools. First and foremost, the authors assume the administration principals have good counsel on board for dealing with the DOE, and now, insolvency issues.

It is important to have the right advisor assisting you in your decision-making process. The fiduciary responsibilities of the board of

directors should be revisited as soon as the school is notified of a DOE audit and the potential withdrawal of funding. Insolvency counsel will

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only addressing ABCs is in this article.

What is an ABC?

An ABC is a state law process to liquidate the assets of a business. It is not a bankruptcy, as bankruptcy is governed by federal law. Each state has rules or statutes that govern the process. ABCs can be done under court supervision in states such as Delaware, Florida, or Michigan; turned into a receivership action in Minnesota, North Carolina or Washington state; or be an out-of-court process in states such as California or Illinois. No matter what rules govern, the process itself is straightforward. A person or firm experienced in administering ABCs is chosen by the company's board of directors (or members per the operating agreement of an LLC). The board's action needs to be ratified by a majority of the shareholders. The board, in making the decision to liquidate, will want advice from

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outside counsel to protect exercising its business judgment to make the ABC the choice of the assignee.

Once the ABC has been authorized and shareholders consent, the company will execute a form of trust agreement, usually called a General Assignment or Trust Agreement (this is based on applicable state law and a distinction without a difference). The Agreement is the contract that transfers all rights, titles and interest in the company's assets to the assignee. The assignee is a fiduciary, responsible for liquidating and distributing the assets to the company's creditors. If the school has a loan that is secured by some or all the school's assets, the assignee will want the secured lender's "consent" to liquidate the lender's collateral and be paid for its service as assignee. The assignee will have to validate the lender's security interest to be able to affirm to creditors and an applicable court that the lender's lien has been properly documented.

An alternative for career colleges

An assignee is required to give creditors notice of the making of the



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general assignment. This includes the DOE, students, employees, teachers, vendors and any other source of student funding. There may be a need for the assignee to obtain a bond to protect creditors from the assignee not fulfilling its fiduciary duties as it liquidates the assets, resolves creditor claims and addresses potential claims against third parties.

The immediate and most valuable important initial actions will be to communicate with students, the state and postsecondary government agencies; to marshal and protect all student records; and to develop a student migration plan.

The assignee will have to deal with any owned or leased real properties. Included in that is what to do with the school's furniture, fixtures and equipment. The school's name, trademarks, website(s), social media sites or other intellectual property may also have value. The assignee will want to review the intellectual property to determine if another school has an interest in acquiring the school's assets.

Let's assume that two parties express interest in using the intellectual property portfolio to provide displaced students with an immediate resumption of their studies. This will generally result in the assignee conducting an auction-type sale where the parties can bid against each other, on terms that are similar for both, so no "credit bidding" will be allowed. The bids are all cash. At the conclusion of the sale, the high bidder is declared, the money is paid to the assignee, a bill of sale is executed along with the necessary transfer of documents and a release of the lenders' liens is granted. The assignee will use the proceeds to complete the liquidation and pay the creditors according to a "waterfall" based on the priorities established by law.

One of the biggest issues the assignee will face is how to preserve student records. Many current students and former students will need to have access to their transcripts to be able to continue their education at a new school. They'll need to obtain proof of completing their course of studies and certification of basic knowledge in their area of learning. The longer

the school has been in existence, the more records that need to be preserved. Today, with the ability to store records in

electronic form, the need for hard copy records is greatly reduced, but there is a hefty cost to convert hard-copy records to electronic data. Additionally, the electronic records need to be in searchable form, as students will ask for transcripts for years after the school closes. This cost is one of the largest expenses of the liquidation process.

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Considerations for career colleges

One critical issue for the school's board or administration is whether the DOE is actually a creditor based on the Title IV funding audit. If DOE is in fact a creditor, its claim has priority over all unsecured creditors. This priority is a result of a federal statute, 31 U.S.C. §3713. The statute is not limited to DOE claims. Rather, the statute provides that a claim of any agency of the federal government has priority over all other unsecured claims. Examples of agencies that one might find in these situations include the Veterans Affairs through the GI Bill and scholarships or grants provided by a Native American nation. The exceptions to this priority are secured creditor claims and the administrative expenses of the assignee, including its fees. Note that failure to honor this

priority exposes the assignee to personal liability.

Creditors are generally amenable to the ABC process because the assignee provides creditors with “Notice of the ABC” and a place to file claims. A good assignee will make sure to tend to creditors’ concerns and respond in a timely manner to questions. Most accounting departments are familiar with claim forms either from a bankruptcy court or from an assignee for the benefit of creditors. The fact

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An assignee is not liable for the debts of the assignor company, but the assignee must use its business judgment to try to maximize the asset value for creditors. The assignee must also not allow creditors to assert claims not otherwise supported by the school’s books and records.

One other point of interest for decision makers reviewing their options is to address the loss of

funding and likely closure of the school. Bankruptcies are reportable by board members who serve on a public company board. ABCs have generally been deemed not reportable as they are not a bankruptcy. This is a key advantage to the alternative, especially where the board includes private equity and/or venture capital representatives who may have investments in other large or publicly traded enterprises.

For those interested in learning more about ABCs, there are several options available. These include resources from the American Bankruptcy Institute, trade journal articles or connections with professionals who have served as assignees.

Most importantly, just knowing that the ABC process exists as an alternative to bankruptcy, will help decision makers, with advice from counsel, choose the best path for addressing specific issues as they arise.