

Assignment for the Benefit of Creditors

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December 2002

The economic downturn of the last two years continues to create record business failures particularly with the demise of the dotcom industry. As the option of bankruptcy becomes more a business tool and less of a social embarrassment, exponential increases in bankruptcy filings are occurring.

Bankruptcy is, however, not always the best solution for a distressed business that has decided to liquidate. Upon filing, the debtor faces a Bankruptcy Court that is already overburdened with its caseload. Equally overburdened Chapter 7 trustees, serving by appointment, rarely are able to devote the attention needed to tailor the liquidation effort to options other than auction sales. The process of liquidating the assets is often slow and costly, and Chapter 7 trustee sales often result in lower recoveries due to bulk sale process, as well as the necessity of following Bankruptcy Court-approved sale procedures.

An Assignment for the Benefit of Creditors (“Assignment”) is an option that can be utilized to help overcome the problems often incurred in Chapter 7 trustee liquidation sales. An Assignment is an old common law tool that could be utilized as an alternative to bankruptcy more often.

An Assignment is analogous to bankruptcy under the United States Code. Unlike a Chapter 7 bankruptcy, however, an Assignment should only be considered if there are assets to liquidate. The significant difference is the ability to avoid following all of the administrative procedures that govern Bankruptcy Court proceedings. Assignments lessen the time required to sell assets, increase the

liquidation options, and keep the costs substantially lower, often resulting in a greater return for creditors.

An Assignment is simply a contract whereby the troubled entity (“assignor”) transfers legal and equitable title, as well as custody and control of its property, to a third party (“assignee”) in trust, to apply the proceeds to the payment of the assignor’s debts. When a corporation makes an assignment, all corporate property, tangible and intangible is transferred including accounts, and rights and credits of all kinds, both in law and equity. The assignee liquidates the property and distributes the proceeds among the assignor’s creditors in accordance with the priorities established by law.

The assignee generally is selected by the assignor, although a court may remove an assignee for violations of the Assignment contract or nonfeasance. The assignee may not give up his duties without liability or a superior court order until creditors receive distribution. The assignee’s duties include protecting the assets of the estate, administering them fairly and representing the estate.

An assignee is often able to pursue causes of action that a Chapter 7 trustee could not or would not. The assignee is free to enter into contracts to recover assets or liquidated claims. Thus, an assignee may hire an attorney on a contingent fee basis to pursue claims that may be theoretically possible but impractical for a Chapter 7 trustee to pursue in a bankruptcy. The assignee has the flexibility to contract with creditors or even shareholders to fund expenses to pursue a valuable cause of action without court approval.

An Assignment is most successful when there is cooperation among the debtor, the secured creditors and the assignor. For example, an assignee of a manufacturing business may, with the cooperation of the secured parties and the principals, operate the business for a limited time to complete work in process and to maximize recovery of accounts receivable. An assignee often will be able to

employ the principal of the assignor who can be invaluable in clarifying business records and liquidating assets at the highest possible price.

While not required to consent to an Assignment, secured creditors often must agree in advance since their cooperation frequently affects the liquidation of the assets. The acceptance of an Assignment by unsecured creditors is not necessary, since under common law the proceedings are deemed to benefit them through equality of treatment.

The costs and expenses of the Assignment, including the assignee's fees, legal expenses and costs of administration, are paid first, just as in a Chapter 7 bankruptcy.

A conditional sale vendor, lessor or secured creditor elects whether to retake its property or collateral or utilize the assignee for purposes of liquidation procedures. Such creditors, in fact, are often the greatest beneficiaries of the Assignment and usually consent to the proceedings since this procedure generally realizes more on their collateral or property than from a Chapter 7 bankruptcy. Furthermore, such secured creditors avoid having to comply with the strict legal requirements mandated by California Commercial Code provisions. It can save time and expenses and is often beneficial to principals who have personally guaranteed company obligations or have personal liability on tax claims.

Assignments can be utilized to sell the assets of a troubled company to a third party as a going concern. The Assignment is made to the Assignor who in turn sells the assets to a buyer without representations or warranties. Generally an assignee will only warrant that the assignee has title to the assets.

Assignments are an effective tool that should be considered by both the debtors and creditors.