

ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

By Howard R. Korenthal, Principal



HOWARD R. KORENTHAL
PRINCIPAL
HKORENTHAL@MORRIS-ANDERSON.COM

Since the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) made bankruptcy much more expensive, assignments for the benefit of creditors have become increasingly popular vehicles to liquidate business assets.

An assignment for the benefit of creditors is not a vehicle to reorganize a business. It is a non-bankruptcy process for asset liquidation that is conducted under state law, either under court supervision or out of court. Several states, including Illinois, California, and Alabama, provide for common-law, out-of-court assignments. Assignments tend to be quicker and less expensive than Chapter 7 or Chapter 11 liquidations because the administrative process is more streamlined than it would be under a bankruptcy.

In general, an assignee-trustee (assignee) is selected by the debtor's shareholders, directors, members, or partners to handle the liquidation. This differs from a bankruptcy proceeding, where the trustee is typically selected randomly from a pool of approved trustees, and the debtor has no control over who handles the liquidation. The assignee has a fiduciary obligation to all creditors, not just the secured creditors, and must treat all creditors equally within the priority groups.

The debtor drafts a trust and assignment for the benefit of creditors agreement. When it has been accepted by the assignee, the debtor's assets are transferred to a trust created for the purpose of liquidating the assets. The assignee sends a notice of assignment to the creditors as soon as possible, and regularly communicates with the creditors to keep them informed of the progress of the liquidation.

The benefit of the automatic stay granted in a bankruptcy is not available in an assignment. However, the assets that have been transferred to the trust are insulated from the creditors. As a practical matter, this deters creditors from pursuing judgment actions because they would essentially get a judgment against an entity that has no assets.

The assignee has a fiduciary obligation to liquidate the assets, and to distribute the proceeds to the creditors in accordance with the priorities established under law. The order of priorities is: the expenses of the liquidation, secured debt, taxes, wage claims and then general unsecured claims. The priorities differ from those in bankruptcy law, where wage claims take precedence over tax claims.

In an out-of-court assignment such as seen in Illinois, the assignee is held to the prudent man standard, and has broad powers to act in the liquidation of the estate. In court-supervised assignments, the assignee reports to the court on his activities, and generally is required to receive court approval to take actions such as sale or abandonment of assets, or distribution of proceeds to creditors.

Assignees have the power to operate a business to preserve value while a buyer for the assets is sought. To do so, the assignee must have the consent of the secured lender, who would allow the assignee to use the lender's collateral to fund the expenses of the liquidation. In general, this process will bring a higher net recovery to the creditors than would a straight liquidation.

An assignee will typically sell assets at a public auction, advertised in a major newspaper such as the *Chicago Tribune* for at least 10 business days. This demonstrates that the assignee took the proper steps to achieve the highest and best recovery for the estate.

It is common for an assignee to receive a stalking horse offer for the assets at the

commencement of the assignment. In this situation, the prospective buyer would be offered bid protection as an incentive to be the stalking horse bidder, and have the advantage of setting the terms of sale that other bidders would have to abide by.

The size of liquidations conducted as assignments for the benefit of creditors since BAPCPA has increased tremendously. Recently, we liquidated a company that had approximately \$20 million of secured debt, and \$35 million of sub-debt.

MorrisAnderson operated the business to convert work-in-progress inventory into finished goods that were then sold to the company's customers, including Wal-Mart and Kmart, and we solicited potential buyers for the business. A buyer was found, and the transaction was closed about 45 days after the assignment commenced.

We initially estimated that the secured lender would have a shortfall of approximately \$4 million in a straight liquidation. By converting the inventory to finished goods and servicing the customer base to protect the receivables, we were able to reduce that loss to approximately \$1 million at the conclusion of the liquidation—an improvement of more than \$3 million from initial expectations.

The cost and time consumption in bankruptcies have made it somewhat impractical to wind down or sell many companies in a bankruptcy, especially when it appears that the secured creditor is likely impaired. In the states with active assignment for the benefit of creditor (ABC) statutes, this means an increase in the use of ABCs. In other states, receiverships are being increasingly used for the same reason.