

## ASSIGNMENT FOR THE BENEFIT OF CREDITORS: AN ALTERNATIVE TO BANKRUPTCY

*By Mark Leipold, Partner*

Some businesses cannot continue to operate and must therefore be sold or liquidated and the proceeds distributed to creditors. An Assignment for the Benefit of Creditors (hereinafter an "Assignment") is a well-established common law tool that is an alternative to bankruptcy that provides a benefit to troubled companies and presents an opportunity for potential buyers.

Assignments are structured to save time and expense in concluding the affairs of an insolvent company. Through an Assignment, the insolvent company's assets can be sold quickly and efficiently, and the liquidation proceeds can be distributed to creditors shortly thereafter. In general, after the secured creditors, tax and wage claims are paid next. Secured creditors frequently find an Assignment useful because the secured creditor is relieved of the legal costs and risks associated with the foreclosure and sale of its collateral. Secured creditors may be willing to allow some portion of the proceeds of its collateral to pay the fees and costs of the Assignee, as well as tax and wage claims.

### **Similar to a Chapter 7 Case**

An Assignment is analogous to a Chapter 7 liquidation proceeding under the Bankruptcy Code. 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 of the liquidation of the assets to the Assignor's creditors in accord with priorities established by law. However, unlike a Chapter 7, an Assignee can elect to keep the business operating while it tries to sell the company as an operating business.

An Assignee is generally an individual. The Assignee is charged with the responsibility of gathering all of the Assignor's assets and selling the Assignor's right, title and interest in those assets. The Assignee has a fiduciary duty to all creditors. The Assignor must turn over and assign all right, title, and interest in its assets to the Assignee together with a complete listing of all creditors, their addresses, and the amount of indebtedness shown on the debtor's books and records. The Assignee is required to give notice of the Assignment to the creditors and invite each creditor to file a claim in the Assignment estate. The notice may provide a "bar" date, by which all claims must be filed. After the bar date, the Assignee will reconcile the claims and object to those deemed to be improper.

### **Liquidation of Assets**

As a general rule, the Assignee will assemble the Assignor's assets and advertise an auction sale. The assets will be liquidated either piecemeal or in bulk, whichever will yield the highest price. Circumstances may arise when a buyer exists for the entire asset pool and the Assignee is convinced that the price the buyer is willing to pay reasonably exceeds that which can be obtained at auction or in a bankruptcy trustee's sale. An Assignee will generally obtain at least one liquidation appraisal and if the sale price being offered exceeds the appraised liquidation value by a reasonable amount, the Assignment and immediate sale of the assets will go forward.

### **Fees and Costs of an Assignment**

In general, the fees and costs associated with an assignment are about the same as a Chapter 7 bankruptcy case. In an Assignment, the Assignor pays the fees and costs of its professionals. These include the fees and costs of an attorney experienced in insolvency matters. The Assignor's attorney is retained to evaluate the financial situation of the business and consider the various options available. If an Assignment is to be the course of action, the attorney will assist the Assignor in selecting an independent Assignee and the preparation of the Assignment documents. The Assignee's fees and costs are paid from the proceeds of the sale of the assets. In general, the Assignee will prepare the Assignment documents.

This article appeared in the Summer 2005 issue of the GReview.

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### **Right, Title and Interest**

The buyer of the assets will receive an Assignee's bill of sale establishing that the buyer has received the Assignee's right, title, and interest in the purchased assets on an "AS IS, WHERE IS" basis without any warranties, representations or covenants. The buyer at an Assignee's sale is best advised to obtain a thorough lien search before consummating such a purchase because the sale is free and clear of only known liens, claims, and encumbrances and to determine that there are sufficient assets to satisfy these claims, or the buyer and the claimant can enter into a settlement. This differs from bankruptcy in that the assets can be purchased through a bankruptcy sale free and clear of all liens, claims and encumbrances notwithstanding the purchase price or the agreement of the claimants. Even if the Assignee is willing to give the buyer a warranty, a representation or covenant, the Assignee liability is generally limited to the proceeds of the sale. If the breach of any of the foregoing is not discovered until after the assets are liquidated and disbursed, the Assignee will not have any funds to pay any damages. In some instances, if the Assignee's conduct amounts to gross negligence or willful misconduct, a court may require the Assignee to pay claims from its own resources.

### **Assignment for the Benefit of Creditors: Preservation of Value**

Goodwill may be a significant asset whose value can be realized only through the sale of the business as a going concern. In fact, many potential buyers are located prior to the Assignment. An Assignee may also operate a business for a short period of time in hopes of locating a buyer for purposes of selling the company as a going concern, and/or conduct an orderly liquidation of the debtor's assets that would maximize the value over a straight public auction. A Chapter 7 Trustee has no incentive to undertake this type of extra work or spend the time and money required seeking court approval to pursue this type of turnkey sale.

### **Risk Factors**

One of the risks inherent in an Assignment is that three unsecured creditors of the Assignor might file an involuntary bankruptcy proceeding. However, many bankruptcy courts will abstain from exercising jurisdiction over the case and will dismiss it if the Assignee can establish that the Assignee's administration of the estate is competent and continued administration by the Assignee will best serve the interests of the creditors.

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This article appeared in the Summer 2005 issue of the GReview.