

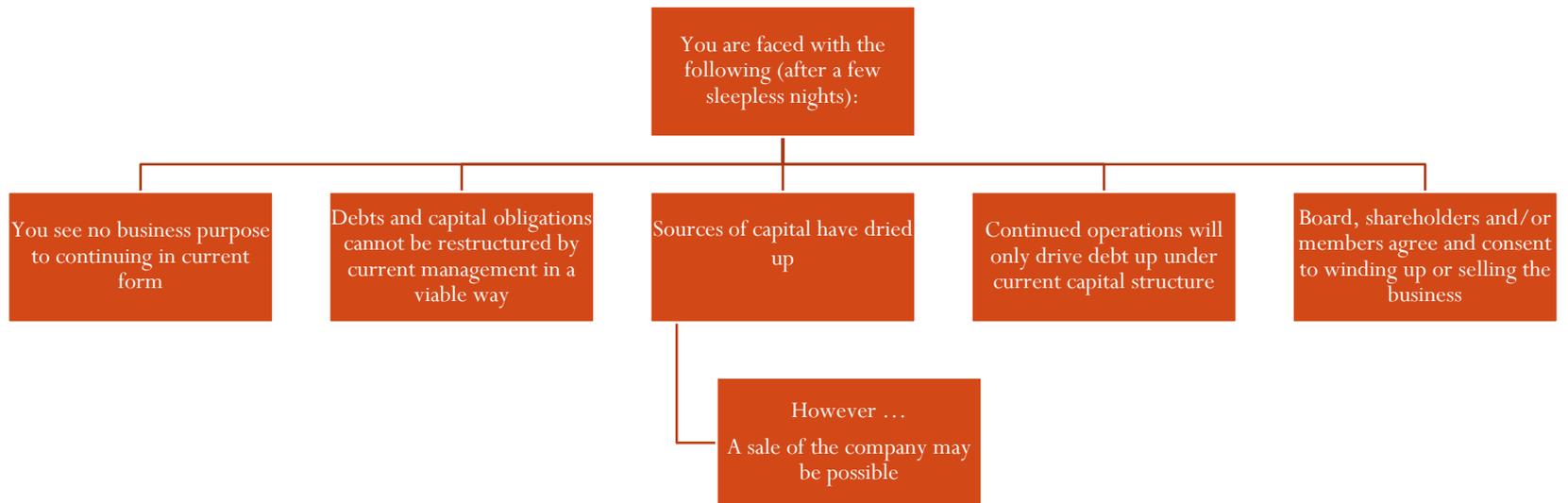
# Options for Businesses Facing Financial Pressure

When to Dissolve, File Bankruptcy, or  
Execute an Assignment for the Benefit of Creditors

Presentation to the  
Northwest Suburban Bar Association of Illinois  
April 2010

Mark S. Melickian, Esq.  
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# The Decision Point



# Options

## Dissolution

Dissolve under state law – statutory mechanisms

Self managed – liquidation of assets, termination of contracts, handling claims

## Assignment for the Benefit of Creditors

Wind up mechanism using trust to liquidate assets and pay creditors

Assignee manages assets, contracts and claims, but owner must still dissolve entity under state law

## Bankruptcy

Chapter 7 liquidation  
Trustee manages estate and controls process (including dissolution)

Chapter 11 liquidation  
Company (debtor in possession) manages estate and controls process

# Dissolution

- A voluntary dissolution is effected by filing articles of dissolution with the Sec of State setting forth:
  - Corporate name and address for service of process
  - Date dissolution was authorized
  - Itemized listing of shares, by class, and of paid-in capital
  - Information necessary to determine unpaid fees or franchise taxes owed by the entity
  - Statements attesting to the validity of director or shareholder consent to the dissolution
    - See 805 ILCS 5/12.20

# Dissolution

- Upon dissolution, the entity can no longer operate except to wind up and liquidate its business and affairs, including:
  - Collecting, liquidating and disposing of assets
  - Giving notice to creditors and parties in interest
  - Making arrangements to discharge its liabilities
  - Distribute any remaining assets (after payment of all liabilities) to shareholders
  - Undertaking such other acts as necessary to wind up
    - See 805 ILCS 5/12.30

# Dissolution

- If you undertake a standard state law dissolution and can't pay all company debts:
  - Certain creditors may not rest and may pursue theories of recovery against corporate insiders
  - Absent setting in place a structure to administer and pay debts in an equitable fashion, you face a heightened risk of fighting multiple litigations in multiple venues and resolution of claims that have no bearing on each other in terms of proportion or fairness

# Assignment for the Benefit of Creditors (ABC)

- What is an ABC?
  - An ABC is a creation of common law – in many states (such as California), ABCs are codified into statute (33 states have statutory regimes). Illinois has no statutory scheme but a significant history of the practice, and ABCs are governed by case law
  - An ABC is an express trust - see *Tribune Co. v. Canger Floral Co.*, 312 Ill.App. 149, 37 N.E.2d 906 (1<sup>st</sup> Dist. 1941).
  - The assignor (company) assigns its assets to an assignee, who acts in a manner similar to a bankruptcy trustee - collecting and monetizing assets, notifying and resolving claims with creditors, and otherwise winding up the business
  - The assignee may operate the business for a limited period as part of a going concern sale

## Assignment for the Benefit of Creditors (ABC)

- In many ways, the process (and the outcome) is similar to a bankruptcy case, with the exception that there no judicial oversight, at least in Illinois. (Certain states, such as Wisconsin, mandate court supervision of ABCs).
- The process is typically far shorter, less expensive, and certainly more flexible than a bankruptcy

# Assignment for the Benefit of Creditors (ABC)

- Factors that may warrant considering an ABC over a bankruptcy proceeding:
  - The company has assets to sell and significant claims to administer
  - The automatic stay is not needed to stop an impending foreclosure or other judicial enforcement action
  - A sale or other disposition of assets and/or contractual obligations has been arranged and needs to close quickly
  - Key parties will consent – secured creditors, key vendors, and/or the purchasing party
  - Insiders or key creditors fear scrutiny of recent payments made to them by the debtor (e.g., recovery as preferential transfers in a bankruptcy proceeding)

# Assignment for the Benefit of Creditors (ABC)

- Key elements of a valid written assignment in Illinois:
  - Sets forth the powers and duties of the assignee
  - Provides for an absolute and unqualified assignment into a trust of all of the debtor's property for the benefit of all creditors
  - Does not condition assignee's use or benefit of the conveyed property
  - Does not waive or compromise claims against debtor
  - Does not exempt the assignee from personal liability, willful misconduct or negligence

# Assignment for the Benefit of Creditors (ABC)

- No automatic stay ...
  - Litigation against the debtor or debtor's property is not stayed (unlike a bankruptcy)

However ...

- An assignment places all of the debtor's property into the hands of the assignee and out of reach of creditors

Caveat ...

- Debtor's receipt of a citation to discover assets from a creditor prevents an assignment (see e.g. *Consolidated Pipe & Supply Co. v. Rovanco Corp.*, 897 F.Supp. 364 (N.D. Ill. 1995))

# Assignment for the Benefit of Creditors (ABC)

- Funding an ABC – typical sources
  - Secured creditor
  - Purchaser (stalking horse bidder)
  - Company principals and guarantors
- Assignee will typically ask for a retainer sufficient to cover pre-assignment work and initial tasks; the balance comes from the proceeds of liquidation as an administrative expense

# Assignment for the Benefit of Creditors (ABC)

- Advantages of an ABC for a sale or disposition of assets
  - No judicial or creditor oversight
  - Flexibility in terms of process and timing
    - A pending sale can close immediately after an assignment is made, compared to minimum of 30 days (and generally not less than 45 days) following a bankruptcy filing

# Assignment for the Benefit of Creditors (ABC)

- Disadvantages of conducting a going-concern sale through an ABC
  - No sale of assets “free and clear” of liens, claims and encumbrances as under Sec. 363 of the Bankruptcy Code
  - No ability to override anti-assignment clauses in contracts
  - No court blessing for the sale process

## Bankruptcy - Liquidation

- A business that anticipates significant resistance from creditors or contract parties to an ABC will generally wind up in bankruptcy, and may want the certainty and closure that a federally-court supervised proceeding can provide
- Bankruptcy provides a built-in venue (federal bankruptcy court) for resolving disputes with creditors and contract parties with judicial finality. Claims and other disputes can be litigated (if necessary) in one setting and are resolved by a federal court order.

# Bankruptcy - Liquidation

## Chapter 7

- Trustee is appointed to manage the estate
- No owner involvement except as a source of information (and potential target of investigation)

## Chapter 11

- Company (owner) remains in possession to manage bankruptcy
- Can result in a liquidation plan that requires post-bankruptcy management
- As a format for liquidation, suited only for larger companies due to cost

# Bankruptcy - Liquidation

- Key benefits:
  - Breathing spell - the automatic stay stops all judicial action in its tracks, including foreclosures and judicial sales
  - Power over executory contracts (e.g., leases) - Burdensome or above-market leases and similar contractual obligations (called executory contracts) can be rejected without opposition by the counterparty, while below-market or otherwise attractive leases and similar contractual obligations can be assigned (with some exceptions) in the face of contractual restrictions on assignment (11 U.S.C. Sec. 365)
  - Value of an asset sale may be enhanced by ability to sell “free and clear” of liens, claims and encumbrances (11 U.S.C. Sec. 363) and to force a sale over objection of lienholders

# Bankruptcy - Liquidation

- Key burdens:
  - Loss of company control – under chapter 7, a trustee controls the process and management's active participation ends (in a chapter 11 liquidation, can retain control but there are other costs)
  - Increased creditor standing - Bankruptcy will give creditors standing to oppose asset sales and the right to investigate (or demand that a trustee investigate) corporate malfeasance
  - Increased risk of investigation of corporate insiders - a chapter 7 trustee is charged with examining all of the debtor's prepetition activities, including those of its management, and in determining whether claims should be brought against management (and, in a chapter 11, a creditors committee may pursue a similar investigation)

# Bankruptcy - Liquidation

- Another burden – cost:
  - Bankruptcy will be more expensive than an ABC - in the case of chapter 11 wind-down, significantly more expensive than an ABC – due to a combination of, among other things
    - Increased administration period – cases may be open for years due, in part, to the additional category of claims that may be investigated and pursued by a trustee or estate representative on behalf of the estate (avoidance actions)
    - Statutory fees due to a chapter 7 trustee or, in a chapter 11, administrative fees paid to the United States Trustee
    - Creditors legal costs that may be born by estate (e.g, the costs of creditors committee counsel)

## ABC versus Bankruptcy - A Scenario

Brand X Inc. is a closely held Illinois corporation in trouble - it cannot survive as a going concern with its existing cash flow and balance sheet and its owners are considering options, including liquidation following a going-concern sale.

- Some facts: Brand X thrived two years ago but is in an untenable cash crunch due to falling revenues and a tapped out credit line (\$8 M) with no additional access to credit or investment. Brand X historically paid its vendors on time but began stretching out payments 9 months ago across the board to preserve cash - the company now owes trade creditors \$6 M and key vendors just put Brand X on COD terms.
- Some additional facts: Believing the company to be flush and the future rosy, Brand X's four shareholders authorized dividends to themselves totaling \$1.5 M in July 2008 and \$1 million in July 2009 (Brand X's fiscal year ends June 30).

## ABC versus Bankruptcy - A Scenario

- Brand X has two potential suitors:
  - Vulturemax Inc.— Vulturemax has tendered a non-binding term sheet for Brand X’s operating assets at a good price on the condition that it is pursued as a “free and clear” sale. Vulturemax wants assignment of its key RE lease and critical equipment leases and licenses (some of which have anti-assignment provisions), and continued relations with key vendors. Vulturemax has conditioned its offer on the sale closing by June 30. Vulturemax’s offer will result in payment of existing trade debt at 40%. Vulturemax has indicated that it intends to replace existing management as soon as practicable following a sale.
  - VC Fund LLC – one of Brand X’s four shareholders is a member of a VC fund which is conducting due diligence and may want to buy Brand X’s operating assets. VC Fund has informally concluded that it will offer enough to pay the trade at 70% but will not close prior to August 15. VC Fund has indicated that it maybe interested in hiring existing management to run operations. VC Fund has not yet tendered a term sheet but the Brand X shareholder has informed his co-owners about the potential interest at the higher price.

## ABC versus Bankruptcy - A Scenario

- What should Brand X do? How should its owners go about determining whether a sale through an ABC or a bankruptcy proceeding is the better choice for the company, its creditors, or them?
- We will work through the options during the seminar ...

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- Bona fide 3<sup>rd</sup> party

### **VC Fund**

- 3<sup>rd</sup> party but with insider (shareholder) connection

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- Term sheet

### **VC Fund**

- No term sheet – informal (nonfinal) decision

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- Quick “free & clear” sale –  
by June 30

### **VC Fund**

- No set format date – no  
sooner than August 15

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- No management continuity

### **VC Fund**

- Probable management continuity

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- Equity is gone

### **VC Fund**

- Equity is gone (maybe)
- One insider definitely continues

# *Brand X Sale*

## *Vulturemax v. VC Fund*

### **Vulturemax**

- 40% to creditors from sale
- If BK filed in time for June sale, debtor/trustee can pursue avoidance actions against insiders and creditors who received favorable treatment

### **VC Fund**

- 70% to creditors from sale
- If by ABC, no pursuit of preferences by anybody or of fraudulent transfers by assignee