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The ABCs of Assignments for the Benefit of Creditors (ABCs)¹

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General assignments for the benefit of creditors (ABCs) have been and continue to be a popular business liquidation device for the orderly wind down of corporations, limited liability companies, and even nonprofit corporations and general partnerships. Just as in bankruptcy, an ABC can also be used to facilitate a going-concern sale of the debtor's assets to a third-party.

An ABC can be the most advantageous and graceful exit strategy, particularly where the goals of the company are (1) to transfer the assets of the troubled business to an acquiring entity free of the unsecured debt incurred by the transferor, and (2) to wind down the company in a manner designed to minimize negative publicity and potential liability for directors and management.

ABCs are available in every state, although specific methods and practices vary. ABCs in eleven states (including the authors' home state of Illinois) are governed by common law. The other states have statutory regimes that vary in complexity and completeness, ranging from the mere mention of the rights of an assignee as a lien creditor pursuant to that state's enactment of the Uniform Commercial Code (UCC) to comprehensive statutory schemes enacted in states such as Washington, Minnesota, and Florida.

How Does an ABC Work?

ABCs are specific to each state and business situation but share a common architecture and principles. An ABC is initiated when a financially distressed entity/debtor enters into an assignment agreement with a neutral third-party that becomes responsible for conducting the orderly wind down and liquidation of the business for the benefit of the assignor's creditors, which may include a sale of assets or going concern sale. The assignment agreement is both a contract that sets forth specific duties of the assignee and a trust agreement under which the assignor transfers all of its right, title, interest in, and custody and control of its property to the third-party assignee in trust. The assignee becomes the trustee of the trust, responsible for liquidating property and distributing proceeds to the assignor's creditors and undertaking such other duties as the trust agreement may designate, such as the wind down of the company, addressing final tax returns, and other related tasks.

State-Supervised vs. Unsupervised ABCs

ABCs can be broken down into two categories: state-supervised and unsupervised. State-supervised ABCs function very similarly to a chapter 7 liquidation (e.g. acts taken by the assignee are subject to judicial oversight and notice to creditors, engagement of counsel, etc.), and assignee fees may be subject to approval. ABCs in states that do not require judicial supervision are not

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subject to the delay and burden of the judicial system, including with respect to retention of professionals.

Step-by-Step Process of ABC

The ABC process will generally function as follows in both statutory and common law states:

1. Upon acceptance of the assignment, the assignee gives notice of the assignment to creditors;
2. Creditors are provided with a reasonable period of time to file proofs of claim with the assignee and therefore to be included in the pool of creditors who can share in the proceeds of the liquidation of the business' assets;
3. The assignee liquidates the assets through a sale process of some design (the assignee determines the best mechanism to accomplish the sale);
4. The liquidation proceeds are applied against creditor claims based on the state's priority scheme;
5. The assignee ends the administration of the assignment estate when all assets are liquidated, and the proceeds distributed.

The majority of states have governing statutes for ABCs, and a few have comprehensive schemes that essentially abolish the common law form and create a new, separate ABC process. In some states, ABC statutes are permissive, allowing common law ABCs to continue alongside their statutory counterpart, essentially codifying the common law format.

In states where ABCs are governed by common law, assignees will still typically approach ABCs in a manner similar to those governed by a statutory scheme. In Illinois, for example, it is common for assignees to provide some preliminary economic data to creditors regarding the value of the assets available for liquidation and distribution and the potential claims on those assets. A common law ABC will typically organize payments to creditors according to a priority scheme that would be familiar in a bankruptcy or receivership. However, because a common law ABC involves no comprehensive statute governing the creation, validity, or administration of ABCs, where a complex issue or dispute arises, the path to resolution (including through litigation) may not be clear.

When is an ABC the Right Tool? Advantages and Disadvantages of an ABC

Advantages

In many cases, ABCs may be a superior liquidation mechanism when compared to using more cumbersome statutory procedures governing chapter 7 or chapter 11 bankruptcy. Cost will be

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factor, certainly – as a rule, ABCs are less time consuming, less expensive, less public, involve less paperwork, and are less subject to judicial oversight, even in states with statutory schemes.

For example, an ABC may be attractive to a secured creditor that wants to avoid the cost of a formal receivership and of taking property through a foreclosure and sale, preferring instead to engage an experienced, independent third party to act as assignee and to liquidate the distressed entity's assets.

Sophisticated buyers are familiar with the ability to purchase assets “free and clear” in a bankruptcy sale. Although the amount of protection can vary depending on the scheme, a buyer seeking to purchase a going concern operation or the specific assets of a distressed business can obtain substantially similar relief in an ABC sale without the cost and process associated with bankruptcy. The assignee can run a notice and auction process for assets that mimics the public nature of an Article 9 or bankruptcy sale. Creditors will be offered the opportunity to lodge claims against the ABC trust. Should a creditor later challenge the sale, it will have a steep climb to additional recovery so long as the sale can be shown to have been done in a commercially reasonable manner.

On the other hand, in states with light statutory or non-statutory common law schemes, an ABC also presents an opportunity to pursue a less public, more discrete transaction tailored more to the needs of the buyer and other parties to the transaction. The value of such an approach needs to be weighed against the risk: The more the going concern or liquidation sale diverges from a notice and auction toward a private sale format, the more risk there is to the buyer and, potentially, the assignee from attacks by creditors.

Disadvantages

One obvious disadvantage to an ABC is the risk that creditors of the business may feel that they will be better served by liquidation under the Bankruptcy Code, band together and file an involuntary bankruptcy proceeding against the company, potentially voiding the ABC and any transactions that may have occurred or be occurring. but there is no automatic stay in ABC, so nothing prohibits creditors from filing an involuntary bankruptcy petition against the business after it has made an assignment, or taking other action in an attempt to stymie the assignee's administration of assets.

Another significant disadvantage is that an assignee, unlike a debtor or bankruptcy trustee, does not have the power to assume and assign executory contracts and leases without the consent of the counterparty to the contract. When considering whether an ABC is the best path to a going concern sale, for example, if the sale would benefit materially from the strategic power offered to the debtor by Section 365 of the Bankruptcy Code, bankruptcy may prove to be the better route.

How is Priority of Payment Determined in an ABC?

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ABCs do not always have a clear priority scheme with respect to allocation of liquidation proceeds. However, some states have passed priority statutes to shed light on this issue. The state statutes generally provide proceeds of the liquidation be distributed in the following order:

1. Properly perfected secured creditors
2. Administrative fees and expenses of the assignee pursuant to the terms of the assignment contract and the assignee's rights as a lien creditor under the state's version of U.C.C. §§ 9-102(a)(52) and 9-309(12)
3. Claims of any agency of the federal government
4. Priority Wages, or those wages and other benefits accrued and unpaid within a specified timeframe, typically 90 days from the date of the assignment, in an amount not to exceed some specified dollar limitation¹
5. Unpaid state and local taxes and contributions to unemployment insurance funds
6. Allowed general unsecured creditor claims
7. Claims of equity holders

An assignee preparing to follow the above-priorities must take into account the federal statute that may conflict with certain state priority laws that parties to an ABC should be made aware of – 31 U.S.C.A. § 3713(a) and (b). Under this federal statute, when an insolvent party makes a voluntary assignment, a “claim of the United States Government shall be paid first.” Otherwise, the party who pays the insolvent debtor’s debt prior to paying the federal government is personally liable to the government for the unpaid claims. As such, an assignee (or any fiduciary under state law) will need to carefully solve any conflict between state priority laws and this federal statute. Note, however, this federal statute does not subordinate properly perfected secured creditors’ interest to this governmental priority under this federal law.

Some creditors may have priority claims – essentially, floating trust claims - pursuant to the Perishable Agricultural Commodities Act (PACA) or the Packers and Stockyards Act (PSA). An assignee of the assets of a restaurant, grocery store, or food distributor must keep these acts in mind when considering the priorities of creditors and whether certain assets of the debtor can be assigned to the ABC trust. Assets subject to PACA or PSA that are deemed trust assets under those statutes are not considered assets that can be transferred by the debtor to an assignee. This is significant distinction particularly relevant in determining whether assets are subject to avoidance actions.

Notice to Creditors & Deadlines to File Proofs of Claim

The required time period between the notice to creditors and the deadline for filing proofs of claims varies from state-to-state - it can range from as little as 60 days to over 180 days. The purpose is to ensure that creditors are given a reasonable opportunity to file their claims with the assignee and protect their right to recover from the proceeds of the liquidation of the company's assets. Generally, assignments may be accomplished without the consent of creditors, though certain states (e.g., Massachusetts) require creditors to assent to an assignment.

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Addressing Disputes in an ABC

To address disputes in court-supervised states, the assignee may bring a state court action. However, in non-state court supervised jurisdictions, disputes are a bit more complicated and generally more expensive. For example, in the event a dispute arises between an assignee and a creditor over a creditor's proof of claim, the assignee must work quickly towards a timely consensual resolution of the issue to avoid delaying distribution to creditors. In the event a consensual resolution cannot be reached, the assignee is likely to look to state court for judicial intervention, by way of declaratory relief or interpleader action, to resolve the dispute.

Application of Bulk Sale Laws to ABC Sales

States with bulk transfer laws in place will typically have an exemption to the reporting requirements of the bulk sales statute for sales by an assignee of an ABC. Generally, the notice provisions of the assignment statutes satisfy the bulk sales statute reporting needs and the fact that the assignee is a fiduciary, presumed to be acting in the best interests of creditors, is generally sufficient to address the need for additional reporting requirements as found in the bulk transfer statutes.

Final ABC Considerations

In a liquidation, the nature of the business's assets may determine whether an ABC is the best path forward. For example, a trustee in bankruptcy with perishable inventory may need to sell such inventory immediately to preserve its value but will face the requirement and delay of seeking court approval to liquidate the inventory. An assignee generally has no such restraints. If speed and flexibility is critical, an ABC will be the better option and perhaps may be the only option.

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