

Assignment for the Benefit of Creditors: Salvaging Value From a Sinking Ship

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It is inevitable that a significant portion of companies in new or emerging industries will come to a point where they are no longer viable and must pursue an ultimate disposition strategy. Of course, businesses in mature industries may also reach a point where they are no longer viable going concerns. Many businesses face hard choices when the economy slows down and debt builds up. Not infrequently, the stark reality is that these companies' realistic alternatives are limited to the following: (1) merging with or being acquired by a qualified candidate; (2) commencing a formal bankruptcy proceeding (Chapter 11 reorganization or a Chapter 7 liquidation); (3) engaging in an out-of-court debt restructuring or workout; (4) shutting down their business and simply closing their doors (an informal death); (5) streamlining the company and focusing on a core business or technology; or (6) making an assignment for the benefit of creditors. Depending on the circumstances, any one of the above alternatives may be the best choice. However, in many instances, where the goal is to transfer the assets of the troubled business to an acquiring entity free of the unsecured debt incurred by the transferor, and wind down the company in a manner designed to minimize negative publicity and potential liability for directors and management, the most advantageous and graceful exit strategy can be an assignment for the benefit of creditors.

The assignment is a contract under which the assignor (the debtor) transfers all of its right, title, interest in, custody and control of its property to a third-party assignee in trust. The assignee liquidates the property and distributes the proceeds to the assignor's creditors. The common law assignment by simple transfer in trust, in many cases, is a superior liquidation mechanism when compared to using the more cumbersome statutory procedures governing a formal Chapter 7 bankruptcy liquidation case or a liquidating Chapter 11 case. Compared to bankruptcy liquidation, assignments may involve less administrative expense and are a substantially faster and more flexible liquidation process. In addition, unlike a Chapter 7 liquidation, where generally an unknown trustee will be appointed to administer the liquidation process, in a common law assignment for the benefit of creditors, the assignor can select an assignee with appropriate experience and expertise to conduct the wind-down of its business and liquidation of its assets.

In situations where a company is burdened with debt that makes a merger or acquisition infeasible, an assignment for the benefit of creditors can be the most efficient, effective and desirable means of effectuating a favorable transaction and addressing the debt. The assignment process enables the assignee to sell the assignor's assets free of the unsecured debt that burdened the company. Unlike bankruptcy, where the publicity for the company and its officers and directors will be negative, in an assignment, the press generally reads "assets of ABC Company acquired by XYZ Company", instead of "ABC Company files bankruptcy" or "ABC Company shuts its doors". Moreover, the assignment process removes from the board of directors and management of the troubled company the responsibility for and burden of winding down the business and disposing of the assets. Further, SEC requirements obliging directors to disclose their involvement with companies that previously filed bankruptcy may not be triggered by an

assignment for the benefit of creditors (however, this issue requires evaluation by counsel with securities law expertise).

In many instances involving troubled companies, an assignment for the benefit of creditors may be the best means for exiting a business that has reached the end of its lifecycle by minimizing negative publicity, limiting the potential liability of officers and directors, and relieving the officers and directors of responsibility for winding down the business and disposing of its assets by entrusting that responsibility to qualified, independent professionals.

Assignments for the benefit of creditors can be particularly useful when fast action and/or industry expertise is needed in order to capture value from the liquidation of the assets of a troubled enterprise. The assignment process may allow the parties to avoid the delay and uncertainty of formal federal bankruptcy court proceedings. In many instances involving deteriorating businesses, management engages in last-ditch efforts to sell the business in the face of mounting debt. However, frequently the value of the business is diminishing rapidly as key employees, such as necessary engineering personnel in the case of a technology business, leave. Moreover, the parties interested in acquiring the business and/or assets of the company generally will only move forward under circumstances where they will not be taking on the unsecured debt of the company along with its assets. In such instances, an assignment for the benefit of creditors can be a viable solution.

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