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Even though the markets took a much-needed tick upwards in mid-March, those of us in private equity with an eye on the IPO window know not only that it remains substantially closed, but that its reopening will trail a broad turnaround in stocks by many months, or even years. So we are forced today to build for a better tomorrow. For those of us involved in equity buyouts in this sideways economy, the prospect of purchasing a turnaround situation is more likely than ever. Herewith we present some ideas on managing your companies through the turnaround process, and some ideas on the vital difference in value between private and public company values. For those of you patiently waiting for the IPO scene to take off, we present views on how the process may be able to be improved. For those having difficulties inside their current VC partnership, some tips; for those thinking of getting involved with a franchise business, a study of returns; and for those wondering where the entire segment of "private equity" belongs, a comment on what private equity represents amongst and against other investment classes.

William Fetterman leads off our issue with a look at the general concept of a professionally managed turnaround. Just what is there that is different when bringing in outsiders to either review or lead your company's turnaround? What are the key issues they concentrate on? William takes us through the five stages of a turnaround with specific financial and operational actions to be taken at each stage. Anyone looking at a turnaround situation, either in your portfolio or as an acquisition, will find this outline a useful way to organize your plan.

Earnings before interest, taxes, depreciation, and amortization: how meaningful is EBITDA to your business? Is it the best way to look at earning power? I have long been of the opinion that this measure, while useful in some cases, can also hide from view critical components of the financial and operational progress of a business. Calabrese and Rafferty take us through a Cook's tour of how EB ITDA can be used and abused as you look at your troubled businesses and think about a turnaround plan.

David Kupetz takes us through one of the less well known but very powerful techniques of moving assets from a troubled company into a better one: an ABC. The assignment for the benefit of creditors gives both owners and creditors a useful way to wind

up operations or transfer assets without the lengthy, expensive, intrusive, public, and often capricious court process of a bankruptcy. Understand the way an ABC works and you may be surprised at how much better it is in many situations than a bankruptcy.

Things get messy inside a private equity partnership when the companies are going through "down rounds," that difficult time when new money enters at a value less than previous valuations. Just what obligations do directors owe to the stockholders in this special situation? Hill and Gambaccini take us through the general and special duties owed, and how best to discharge them.

And what to do if you are having problems in general with the general partners of your firm? Ah, yes, as so many firms struggle over smaller sets of limited partner funds and reduced levels of returns, hidden problems often surface. Allen Weingarten covers such topics as non-competes for departing partners, limited partner revolts when general partners depart, partners that are construed also as employees ... and many other vital issues. These are the times that try men's (and women's) souls, and when that happens, can the legal community be far behind? Read this piece to stay just a bit ahead.

The IPO market is like the weather: very hard to predict and constantly changing. When times are good, the sun shines and seems that it will never end. Yet when the clouds roll in, we wonder if the sun will ever come back. Giant waves of good IPO weather are driven by industry upheaval, yet some academic studies show those who sell on the first day do better than everyone else. What in the heck can we do about this situation that seems almost too wild even for Wall Street? Bartlett and Shulman offer a thought-provoking look at what is being discussed throughout financial and government circles on how to tame this wild beast. Forewarned is forearmed; you will find this interesting reading.

What does the idealized rational and diversified investor have to look forward with when investing in private equities as a class? Varun Sood takes a broad look at this question and posits a number of ways to think about the issues. Should general partners be positioned to take risks or to insure the longevity of their partnership? How many of us have watched the fantastically successful VC firm morph with later- and later-stage investments into a conservative source of pre-IPO capital, far away from the seed-stage investments that were the source of their success? Why does this happen?

Thinking more about the line dividing private and public companies, Kooli, Kortas, and U Her present their findings about the differences in value between private and public companies. Each of us forming a private company with the expectation of taking it public someday is counting on erasing this discount the day we hit the public market. Just how big has the discount been? Has it changed over time? What has caused it to change? What will it look like next year? All fascinating questions.

Our final piece takes us into an area that has had more attention since the implosion of the tech sector: franchising. There was a day when franchising was the growth engine for small businesses. How have these companies done in the decade of the roaring 1990s? Are they more or less risky than the market as a whole? Do certain characteristics of the franchisor predict success or failure? Spinelli, Birley, and Leleux tackle this interesting topic and develop a good overview of the area.

James E. Schrager
Chicago, Illinois

Assignment for the Benefit of Creditors

Advantageous Vehicle for Selling and Acquiring Distressed Enterprises

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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. Further, 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 1 1 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) slaking 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. An assignment for the benefit of creditors can serve as a very useful and efficient means of 1) accomplishing a wind down and the liquidation or going concern sale of a troubled business unable to reorganize, 2) maximizing a secured creditor's recovery from the assets of a distressed debtor, and/or 3) facilitating a buyer's acquisition of a troubled business or assets from an entity burdened with unsecured debt (and, with the cooperation of secured creditors, secured debt).

The assignment process. XYZ Corp. ("XYZ") is a wireless technology company which was formed three years ago. Since that time, more than $200,000,000 in equity investments have poured into XYZ. Additionally, XYZ has incurred more than $25,000,000 in unsecured debt that it is now unable to pay While XYZ has developed some exciting products, it continues to operate on a negative cash flow basis, and is unable to obtain further funding through either equity investment or debt placement. The Board of Directors of XYZ has considered the realistic alternatives available to XYZ. At this point, XYZ is insolvent (XYZ's debts exceed the value of its assets). The Board recognizes that, under the circumstances, it has fiduciary obligations running to XYZ's creditors and that it is required to act in a manner reasonably designed to maximize creditor recovery.

Among the alternatives considered by the Board are the following: 1) merging with or being acquired by a qualified candidate; 2) commencing aa formal bankruptcy proceeding (chapter 11 reorganization or a chapter 7 liq-

uidation); 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. The Board has determined that a going concern sale of XYZ's business is in the best interests of the company and its creditors and has identified two potential purchasers who have expressed interest in the acquisition. However, neither purchaser will acquire the business if the assumption of XYZ's unsecured debt is involved. Further, the situation is deteriorating rapidly. XYZ is burning through its cash reserves. Its key employees are aware of its financial difficulties and creditors of XYZ are pressing for payment. XYZ's Board has been advised and has now concluded that an assignment for the benefit of creditors ("ABC") is the most appropriate course of action.

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 ABC. An assignment for the benefit of creditors can serve as a very useful and efficient means of 1) accomplishing a wind down and the liquidation or going concern sale of a troubled business unable to reorganize, 2) maximizing a secured creditor's recovery from the assets of a distressed debtor, and/or 3) facilitating a buyer's acquisition of a troubled business or assets from an entity burdened with unsecured debt (and, with the cooperation of secured creditors, secured debt).

The process of an ABC is commenced by the distressed entity (the "Assignor") entering an agreement with the party which will be responsible for conducting the wind down and/or liquidation or going concern sale (the "Assignee") in a fiduciary capacity for the benefit of the Assignor's creditors. The assignment agreement is a contract 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 liquidates the property and distributes the proceeds to the Assignor's creditors. In an ABC, unsecured creditors of the Assignor have no right to pursue the assets assigned to the Assignee, but rather trust submit a proof of claim to the Assignee and, if the claim is allowed, will ultimately participate in the Assignee's distribution of funds from the assignment estate.

"An assignment for the benefit of creditors is a business liquidation device available to an insolvent debtor as an alternative to formal bankruptcy proceedings." *Credit Managers Association of Southern California v. National Independent Business Alliance*, 162 Cal. App. 3d 1166, 1169 (1984). Unlike federal bankruptcy proceedings, assignments for the benefit of creditors are governed by state law.

> *Assignments originated at common law, but now are governed by statutes in most states. The statutes may be mandatory, replacing common law assignments entirely, or permissive, allowing common law assignments to continue. In addition to specifying applicable procedures in detail, state assignment statutes usually prohibit preferences to creditors and award priority to favored creditors (e.g. for taxes or wages). State laws may not provide for the discharge of debts, however, or condition a creditor's participation in a distribution upon the granting of the discharge. Such laws are preempted by the federal government'_c exercise of its power to enact a uniform bankruptcy law.* (Citing International Shoe *Co.* v. Pinkus, 278 U.S. 261 (1929)).
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> -Tabb, *The Law of Bankruptcy, p. 27* (Foundation Press, *1997)*

In order to commence the ABC process, a distressed corporation will generally need to obtain both Board of Director authorization and shareholder approval. While this requirement is dictated by applicable state law, the ABC constitutes a transfer of all of the Assignor's assets to the Assignee and the law of most states provides that the transfer of all of a corporation's assets is subject to shareholder approval (although this approval may be obtained, in some instances, retroactively). In contrast, shareholder approval is not required in order for a corporation to file a petition commencing a federal bankruptcy case. In some instances, the shareholder approval requirement for an ABC can be an impediment to the quick action ordinarily available in the context of an ABC, especially when a public company is involved as the Assignor. However, ABCs have been successfully implemented by public companies (e.g., the ABC made by iPrint Technologies, Inc., in October, 2002).

California is the capital of ABCs. Assignments for the benefit of creditors in California are governed by common law and are subject to various specific statutory provisions. In states, like California, where common law (with specific statutory supplements) governs the ABC process, the process is non judicial. The basis for appli-

cability of common law in California is set forth in California Civil Code § 22.2 which provides that "[t]he common law of England, so far as it is not repugnant to or inconsistent with the Constitution of thg United States, or the Constitution or laws of this State, is the rule of decision in all the courts of this State." An Assignee in an assignment for the benefit of creditors serves in a capacity that is analogous to a bankruptcy trustee and is responsible for liquidating the assets of the assignment estate and distributing the net proceeds, if any, to the assignor's creditors. *See Credit Managers Association of Southern California v. National Independent Business Alliance,* 162 Cal. App. 3d at 1170-72 ("Under the common law of assignment, the assignee stands in the place of the assignor.... [A]s trustee for all the creditors, [assignee] was charged with the duty to defend the property in its hands against all unjust adverse claims."); *see also In re A&B Liquidating, Inc.,* 18 B.R. 922, 924-26 (Bankr. E.D. Va. 1982).

Among the statutory provisions under California law applicable to assignments for the benefit of creditors are the following: 1) Cal. Code Civ. Proc. §493.010 (defining a "general assignment for the benefit of creditors"); 2) Cal. Code Civ. Proc. 5 1802 (requiring a notice to creditors of the assignment, the setting of a deadline-on 150 to 180 days' notice-for submission of claims to the Assignee, and setting forth the Assignor's obligation to provide the Assignee with a list of creditors, shareholders, and other parties in interest); 3) Cal. Code Civ. Proc. § 493.030 (providing for termination of attachment and temporary protective order liens obtained within 90 days prior to the making of the assignment for the benefit of creditors); 4) Cal. Code Civ. Proc. § 1204 (providing for priority treatment of claims for wages, salaries, commissions, and employee benefit contributions); 5) Cal. Code Civ. Proc. § 1204.5 (priority for consumer deposit claims); 6) Cal. Code Civ. Proc. § 1800 (right of Assignee to recover preferential transfers-this statute parallels Bankruptcy Code section 547 and allows Assignee to bring a preference action within one year of the date of the assignment); 7) Cal. Civ. Code § 1954.1 (right of Assignee to occupy business premises); 8) Cal. Civ. Code c 3439.07(d) (authorizing Assignee to exercise any and all of the rights and remedies available to any one or more creditors of the Assignor in connection with bringing a fraudulent transfer action); and 9) Cal. Com. Code §~ 9102(a)(52)(A)(ii) and 9317(a)(2) (providing that an Assignee for the benefit of creditors and a bankruptcy trustee are each a "lien creditor" who has priority over an unperfected security interest).

Advantages of an ABC. 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 an 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 prepackaged ABCs where an immediate going concern sale will be implemented, the Assignee will be involved prior to the ABC going effective. Further, in states that have adopted the common law ABC process, court procedures, requirements, and oversight are not involved. In contrast, in bankruptcy cases, the judicial process is invoked and brings with it additional uncertainty and complications, including players whose identity is unknown at the time the bankruptcy petition is filed, expense, and likely delay.

In situations where a company is burdened with debt that makes a merger or acquisition infeasible, an ABC 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 Oldco acquired by Newco," Instead of "Oldco files bankruptcy" or "Oldco 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).

From a buyer's perspective, acquiring a going concern business or the specific assets of a distressed entity from an Assignee, in an ABC sale transaction, provides some important advantages. Most sophisticated buyers will not acquire an ongoing business or substantial assets from a

financially distressed entity with outstanding unsecured debt, unless the assets are cleansed either through an ABC or bankruptcy process. Such buyers are generally simply unwilling to subject themselves to potential contentions that the assets were acquired as part off a fraudulent transfer and/or that they are a successor to or subject to successor liability for claims against the distressed entity. Buying a going concern or specified assets from an Assignee allows the purchaser to avoid these types of contentions and issues and to obtain the assets free of the Assignor's unsecured debt. Creditors of the Assignor simply must submit proofs of claim to the Assignee and will ultimately receive payment by the Assignee from the proceeds of the assignment estate. Moreover, compared to a bankruptcy case, where numerous unknown parties (i.e., the bankruptcy trustee, the bankruptcy judge, the United States trustee, an unsecured creditors' committee, and possibly others) will become part of the process and where court procedures and legal requirements come into play, a common law ABC allows for flexibility and quick action.

From the perspective of a secured creditor, in certain circumstances, instead of being responsible for conducting a foreclosure proceeding, the secured creditor may prefer to have an independent, objective third party with expertise and experience liquidating businesses of the type of the distressed entity act as an Assignee. There is nothing wrong with an Assignee entering into appropriate subordination agreements with the secured creditor and liquidating the Assignor's assets and turning the proceeds over to the secured creditor to the extent that the secured creditor holds valid, perfected liens on the assets that are sold.

In many instances involving distressed enterprises, 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. Additionally, the ABC process allows buyers of going concerns and specific assets to acquire those assets in an expeditious and efficient manner and at the same time minimize risks associated with the acquisition. Finally, in certain circumstances, the secured creditors may determine that using the ABC process provides the most significant advantages compared to pursuing a foreclosure.

ABCs in action. As a common law liquidation vehicle that has been around for a very long time, ABCs have been used over the years for all different types of businesses. In recent years, in particular, ABCs have become a particularly popular method for liquidating troubled dot-corn, technology, and healthcare companies. In large part, this is simply a reflection of the distressed nature of those industries. At the same time, ABCs allow for quick and flexible action that frequently is necessary in order to maximize the value that might be obtained for a business that is largely dependent on the know-how and expertise of key personnel. An ABC may provide a vehicle for the implementation of a quick transaction which can be implemented before key employees jump from the sinking ship.

The liquidation process in an ABC can take many different forms. In some instances, negotiations between the buyer and the Assignee commence before the assignment is made and a prepackaged transaction is agreed on and implemented contemporaneously with the execution of the assignment. This type of turnkey sale can effectively allow the purchaser of a business to acquire the business without assuming the former owner's unsecured debt in a manner where the business operations continue uninterrupted.

In some instances, the Assignee may operate the Assignor's business post-ABC with the intent ofselling the business as a going concern even if an agreement has not been reached with a purchaser. However, the Assignee must weigh the risks and costs of continuing to operate the business against the anticipated benefits to be received from a going concern sale.

In many cases, the distressed enterprise has already ceased operations prior to making the assignment or will cease its business operations at the time the ABC is entered. In these cases, the Assignee may be selling the assets in bulk or may sell or license certain key assets and liquidate the other assets through auctions or other private or public liquidation sale methods. At all times, the Assignee is guided by its responsibility to act in a reasonable manner designed to maximize value obtained for the assets and ultimate creditor recovery under the circumstances.

The alternative of voluntary federal bankruptcy cases. Chapter 7 bankruptcy provides a procedure for the orderly liquidation of the assets of the debtor and the ultimate payment of creditors in the order of priority set forth in the Bankruptcy Code. Upon the filing of a chapter 7 petition, a trustee is appointed who is charged with marshalling all of the assets of the debtor, liquidating the assets, and eventually distributing the proceeds of the liquidation to the debtor's creditors. The process can take years and

is governed by detailed statutory requirements.

Chapter 11 of the Bankruptcy Code provides a framework for a formal, court-supervised business reorganization. While the primary goals of chapter 11 are rehabilitation of the debtor, equality of treatment of creditors holding claims of the same priority, and maximization of the value of the bankruptcy estate, chapter 11 can be used to implement a liquidation of the debtor. Unlike the traditional common law assignment for the benefit of creditors (assignments are governed by state law and may differ from state to state), chapter 7 and chapter l 1 bankruptcy cases are presided over by a federal bankruptcy judge and are governed by a detailed federal statute (the Bankruptcy Code).

Involuntary bankruptcy. Any time that an entity is failing to pay its obligations on a timely basis, there is the risk that an involuntary bankruptcy petition may be filed against it. The involuntary bankruptcy petition must be signed by three or more creditors (unless there are less than 12 total creditors, in which case, the involuntary petition may be signed by one or more creditors) who hold unsecured claims against the debtor that are not contingent as to liability or the subject of a bona fide dispute and which amount, in aggregate, to at least $11,625. 11 U.S.C. § 303(b). Upon the filing of an involuntary bankruptcy petition, a summons is issued, requiring the debtor to answer the petition within 20 days of service of the summons. Fed. R. Bankr. P 1011(b). If the petition is riot timely controverted by the debtor (or by another party with standing to respond), the court will enter an order for relief against the debtor. Otherwise, after trial, the court will enter an order for relief against the debtor if the debtor is generally not paying its debts as they become due (unless such debts are the subject of a bona fide dispute) or within 120 days before the date of the filing of the bankruptcy petition, a custodian (including an Assignee for the benefit of creditors), other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession. 11 U.S.C. 5 303(h).

In the context of a out-of-court workout or liquidation, there is always risk that an involuntary bankruptcy petition may be filed against the debtor. Such a risk is substantially less, however, in connection with an assignment for the benefit of creditors because the bankruptcy court is likely to abstain when a process (the assignment) is already in place to facilitate liquidation of the debtor's assets and distribution to creditors. There is a policy favoring allowing general assignments for the benefit of creditors to stand. *See Brainard v. Fitzgerald,* 3 Cal. 2d 157, 163 (1935) ("Experience has shown that this practice [general assignment for the benefit of creditors made in good faith] has much to commend it."); *Muller v. Norton,* 132 U.S. 501, 506, 10 S. Ct. 147, 148 (1889) (assignments are favored in the law and construed so that they may stand rather than fill). Accordingly, as discussed in greater detail below, when a general assignment for the benefit of creditors made in good faith is in process, it is appropriate for a bankruptcy court faced with an involuntary bankruptcy petition against the assignor to abstain from accepting jurisdiction and dismiss the case. *See In re Egan Co., Inc.,* 24 B.R. 189 (Bankr. WD.N.Y. 1982); *In re Artists' Outlet, Inc.,* 25 B.R. 231 (Bankr. D. Mass. 1982); and *In re Bailey's Beauticians Supply Company,* 671 E2d 1063 (7th Cir. 1982).

While ABCs are not free from risk of being thrown into bankruptcy, substantial authority supports the bankruptcy court's abstention from exercising jurisdiction and dismissal of involuntary bankruptcy cases filed when a proper assignment proceeding is in process. The primary risk associated with a distressed company electing to do an ABC is that the company might end up being forced into bankruptcy. Generally, this risk is relatively small and, even if an involuntary bankruptcy petition is filed against an entity that has done an ABC, the bankruptcy petition will usually be dismissed. Bankruptcy Code § 305(a), entitled "Abstention," provides in relevant part that:

> *The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time i-*
>
> *(1) The interests of creditors and the debtor would be better served by such dismissal or suspension ... .*

11 U.S.C. 5 305(a).

"Section 305 of the Bankruptcy Code recognizes that there are situations under title 11 where it would be proper for the Bankruptcy Court to decline jurisdiction." *In re Fitzgerald Group,* 38 B.R. 16, 17 (Bankr. S.D.N.Y. 1983); *International House of Pancakes, Inc. v. The American Druggists' Insurance Co.,* 22 B.R. 926, 928 (Bankr. N.D. Ill. 1982) ("The adoption of the Abstention doctrine by § 305 of the Bankruptcy Code is a codification of the well-recognized fact that there are instances where it appears to be proper for the Court to decline jurisdic-

tion."). Moreover, courts have held that section 305 is designed to enhance the Bankruptcy Court's power to abstain from accepting jurisdiction. *See In re Fast Food Properties, Ltd.,* 5 B.R. 539, 540 (Bankr. C.D. Ca. 1980) (the enactment of the Bankruptcy Reform Act of 1978 and, specifically, 5 305 reflect that § 305 is designed to enlarge the Court's power to abstain from accepting jurisdiction and dismiss a case, rather than restricting the Court's power to dismiss); *Swift v. Bellucci (In re Bellucci),* 119 B.R. 763, n. 18 (Bankr. E.D. Cal. 1990) (Stating with regard section 305 that the "[1]egislative history clarifies that Congress was deliberately rejecting the general rule that courts with jurisdiction over a matter must take jurisdiction. S. Rep. No. 95-989, 95th Cong. 2d Sess. 35 (1978); H. Rep. No. 95-595, 95th Cong., 1st Sess. 325 (1977) U.S. Code Cong. & Admin. News 1978 p. 5787."); *see also In re Spade,* 258 B.R. 221, n. 4 (Bankr. D. Colo. 2001) ("The legislative history of § 305 is an untrustworthy indicator of Congress' intent regarding the scope of a court's discretion in § 305 matters as courts have interpreted the Committee's report differently." The Court in *Spade,* after engaging in an extensive survey of the cases addressing g 305, held that a bankruptcy court has broad discretion to consider a wide variety of factors in determining whether to abstain under § 305.).

In context of an involuntary bankruptcy, "[e]ven though the basis for an involuntary case has been established, it must be determined whether an order for relief should be entered or the case should be dismissed under 11 U.S.C. § 305." *In re Tarletz,* 27 B.R. 787, 793 (Bankr. D. Colo. 1983); *see also In re Willianisburg Suites, Ltd.,* 117 B.R. 216, 218 (Bankr. E.D. Va. 1990) ("Dismissal pursuant to § 305 is appropriate even when petitioning creditors have established a case for an involuntary bankruptcy."). Broadly speaking, the question to be addressed, in determining whether abstention from jurisdiction and dismissal of the case is appropriate, is whether the interests of creditors and the debtor would be better served by dismissal. *See 11 U.S.C. §* 305(a); *In re O'Neil Village Personal Care Corp., 88* B.R. 76, 79-80 (Bankr. WD. Pa. 1988); *In re Starbuck, Inc.,* 14 B.R. 134, 135 (Bankr. S.D.N.Y. 1981). "The decision to dismiss under § 305 is discretionary, and must be made on a case-by-case basis." *In re O'Neil Village Personal Care Corp.,* 88 B.R. at 79; *see also In re Fitzgerald Group,* 38 B.R. at *17; In re Artists' Outlet, Inc.,* 25 B.R. 231, 232-33 (Bankr. D. Mass. 1982); *In re Spade,* 258 B.R. at 231.

In determining whether to abstain from exercising jurisdiction and dismiss a case under Section 305, courts consider a wide variety of frequently overlapping factors, including: 1) efficiency and economy of administration and avoiding an unnecessary duplication of efforts and a waste of time and resources; 2) whether an alternative means is available for achieving an equitable distribution of the assets; 3) whether a non-federal insolvency has advanced so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; 4) whether federal proceedings are necessary to reach a just and equitable solution; 5) the lack of any advantage to creditors by invoking federal bankruptcy jurisdiction and/or the lack of prejudice to parties resulting from abstention and dismissal; 6) the existence of minimal assets to administer; and 7) the motivation and/or purpose of the parties seeking to invoke federal bankruptcy jurisdiction. *See In re Spade,* 258 B.R. at 231, and *see 230-* 238 ("Clearly, the historical and contemporary trend in § 305 case law permits courts to consider a wide variety of factors relevant to the facts of the particular case in determining whether to abstain under § 305."); *In re Artists' Outlet, Inc.,* 25 B.R. 231, 232-34 (Bankr. D. Mass. 1982); *O'Neil Village Personal Care Corp.,* 88 B.R. at 79-80; *In re Mazzocone,* 200 B.R. 568, 575 (E.D. Pa. 1996); *In re Fax Station, Inc.,* 118 B.R. 176, 177 (Bankr. D. R.I. 1990); *In re Fitzgerald Group,* 38 BR_ at 18; *In re Trina Assocs.,* 128 BR. 858, 867 (Bankr. E.D.N.Y. 1991).

Generally, courts will abstain from exercising jurisdiction and dismiss involuntary bankruptcy petitions filed after the debtor has made an assignment for the benefit of creditors. A pending assignment proceeding constitutes an alternative means available for achieving an equitable distribution of the Assignor's assets. *See Credit Managers Association of Southern California versus National Independent Business Alliance,* 162 Cal. App. 3d at 1169 (an assignment for the benefit of creditors is a liquidation alternative to a federal bankruptcy case). "Dismissal or a suspension would ordinarily be warranted under this section [11 U.S.C. 5 305(a)(1)] if another forum is available to protect the interests of both parties or there is already a pending proceeding in a state court (e.g_, assignment for the benefit of creditors)." *In re Mineral Hill Corp.,* 16 B.R. 687, 688 (Bankr. D. Md. 1982); *see also In re Egan Co., Inc.,* 24 B.R. 189, 191-92 (Bankr. WD.N.Y. 1982); *In re Artists' Outlet, Inc.,* 25 B.R. 231, 233 (Bankr. D. Mass. 1982).

It should be kept in mind that when the current Bankruptcy Code was initially enacted, section 305(c) prohibited any appeal from a bankruptcy court's decision to abstain from jurisdiction and dismiss the case. This has

been changed. Pursuant to the Judicial Improvements Act of 1990, Pub. L. 101650, section 305(c) now permits District Court and Bankruptcy Appellate Panel review of a bankruptcy court's section 305 dismissai order, while specifically prohibiting further appellate review by courts of appeal and the United States Supreme Court. 11 U.S.C. 5 305(c); *see Chemical Bank v. Togut (In re Axona International Credit & Commerce Ltd.),* 924 E2d 31, *32, 35* (2nd Cir. 1991). Accordingly, certain decisions made prior to the amendment of Section 305(c) adopting a more restrictive view of the use of section 305 based on a lack of any ability to appeal should be considered in light of the amendment.

Under 11 U.S.C. § 707(a) and 1112(b), the court may dismiss an involuntary bankruptcy case for "cause." The court's power to dismiss for cause is not limited to those examples specifically set forth in section 707(a). Section 707(a) (in a chapter 7 case) and § 1112(b) (in a chapter 11 case) may be used to dismiss an involuntary bankruptcy petition. *See In re MacFarlane Webster Assocs.,* 121 B.R. 694 (Bankr. S.D.N.Y 1990); *In re ABQ-MCB Joint Venture,* 155 B.R. 338 (Bankr. D.N.M. 1993) (In this case, the court considered dismissal under both section 305(a)(1) and section 707(a) and elected to rely only on section 305(a) in dismissing the involuntary petition).

The Assignee has standing to respond to an involuntary bankruptcy petition by bringing a motion for abstention and dismissal. Under the common law of assignments governing assignments in California, the Assignee stands in the place of the Assignor, holds all of the Assignor's former assets, should be considered the "legal representative" of the Assignor and trustee for all Assignor's creditors, and is charged with the duty to defend the property in its hands against all unjust adverse claims. *See Credit Managers Association of Southern California v. National Independent Business Alliance,* 162 Cal. App. 3d at 1170-73, *citing Francisco v. Aguirre,* 94 Cal. 180, 183 (1892). In *In re A & B Liquidating, Inc.,* the court held that "[i]n light of an assignee's responsibilities and interests.... absent the filing of an answer by the Debtor, the assignee for the benefit of creditors has standing to file an answer [in response to an involuntary petition]." *In re A & B Liquidating, Inc.,* 18 B.R. 922, 925 (Bankr. E.D. Va. 1982), *citing Wood v. Natural Soda Products Co.,* 31 E2d 110 (9th Cir. 1929) and *In re Morosco Holding Co., Inc.,* 296 E 516 (S.D.N.Y 1924).

Recovery of preferences in assignment proceedings. The California preference statute, Cal. Civ. Proc. Code 5 1800, is entitled "Right of Assignee of General Assignment for Benefit of Creditors to Recover Transfer of Property." A comparison of this statute with the bankruptcy preference statute, Bankruptcy Code 5 547, indicates that the state law was patterned upon and is substantially the same as the federal statute.

The California preference statute is not unique. While a majority of states do not prohibit preferences, Professor David A. Skeet, in his article *Rethinking the Line Between Corporate Law and Corporate Bankruptcy,* 72 Tex. L.Rev. 471 at 556 (1994) lists twenty-two states with provisions for avoidance of preferences, many of them going back more than 100 years. Not all of these statutes are consistent with the provisions of the Bankruptcy Code, and many have different "reach back" periods for avoidance from that provided in California or in the Bankruptcy Code. In addition to the state preference laws, Section 5(b) of the Uniform Fraudulent Transfer Act provides for the avoidance of preferences to insiders. California and a number of other states which have enacted the Uniform Fraudulent Transfer Act have deleted Section 5(b) as unnecessary since they already have a separate preference law.

Preference laws, like fraudulent transfer laws, are not unique to bankruptcy law and are not in conflict with the provisions or purposes of the bankruptcy law. Preference avoidance is no more a distinctive feature of bankruptcy law than is fraudulent transfer avoidance, judicial lien avoidance, unperfected security interest avoidance, or other provisions which are designed to achieve equality of distribution among creditors of the same class. Since state preference statutes like state fraudulent transfer statutes are designed to achieve equality of distribution among creditors, they are not, in principle, in conflict with the bankruptcy law and are not to be invalidated without a clear and definite expression of such intent by Congress. State preference and fraudulent transfer laws may co-exist with the Bankruptcy Code and may be utilized by trustees in bankruptcy when they are more advantageous to the bankruptcy estate than the Bankruptcy Code's preference or fraudulent transfer provisions. *See Miller v. New Orleans Acid and Fertilizer Company,* 211 U.S. 496, 29 S. Ct. 176 (1909); *Perkins v. Metro Supply Company (In re Rexplore Drilling, Inc.),* 971 E2d 1219 (6th Cir. 1992); *Zimmerman v. Frem Corporation (In re Kenval Marketing Corporation),* 69 B.R. 922 (Bankr. E.D. Pa. 1987).

The bankruptcy code recognizes the viability of state statutes regulating liquidation of insolvent debtor estates. Bankruptcy Code § 101(11) defines the term "custodian" as including a receiver or a trustee or an Assignee

under a general assignment for benefit of creditors. Bankruptcy Code § 303(h) provides that the bankruptcy court shall enter an order for relief in an involuntary case if, within 120 days before the date of the filing of the involuntary petition, the custodian was appointed or took possession of substantially all of the debtor's assets.

Bankruptcy Code 5 543(b) provides that a custodian appointed within 120 days prior to the filing of a bankruptcy petition must turn over the property of the debtor and make an accounting to the bankruptcy trustee, unless, under § 543(d) the bankruptcy court, "if the interests of creditors" would be better served by permitting a custodian to continue in possession of such property, excuses compliance with the turnover and accounting requirements. Bankruptcy Code § 305 provides that the bankruptcy court may dismiss or suspend any proceeding under the Bankruptcy Code if the interests of creditors and the debtor would be better served by such dismissal or suspension.

These bankruptcy provisions reflect a congressional intent generally to preserve the validity of state's receivership statutes as well as less intrusive state statutes regulating and governing voluntary assignments for benefit of creditors.

Distribution scheme in ABCs. Under California la,.s; an Assignee for the benefit of creditors must set a deadline for the submission of claims. Notice of the deadline must be disseminated within 30 days of the commencement of the ABC and must provide not less than 150 and not more than 180 days' notice of the bar date. CCP § 1802. Once the Assignee has liquidated the assets, evaluated the claims submitted, resolved any pending litigation to the extent necessary prior to making distribution, and is otherwise ready to make distribution to creditors, pertinent statutory provisions must be followed in the distribution process. Generally, California law ensures that taxes (both state and municipal), certain unpaid wages and other employee benefits, and customer deposits are paid before general unsecured claims. *See CCP* 55 1204 and 1204.5; *See also* Cal. Rev. & Tax Code § 6756.

Particular care must be taken by an Assignee in dealing with claims of the federal government. These claims are entitled to priority by reason of a catch-all type statute, which entitles any agency of the federal government to enjoy a priority status for its claims over the claims of general unsecured creditors. 31 U.S.C. 55 3713. In fact, the federal statute provides that an Assignee "paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government." 31 U.S.C. § 3713. As a practical result, these payments must be prioritized above those owed to all state and local taxing agencies.

In the state of California, there is no *comprehensive* priority scheme for distributions from an assignment estate like the priority scheme in bankruptcy or priority schemes under assignment laws in certain other states. Instead, California has various statutes which provide that certain claims should receive priority status over general unsecured claims, such as taxes, priority labor wages, lease deposits, etc. (discussed below). However, the order of priority amongst the various priority claims is not clear. (Note that determining the order of priority amongst priority claims becomes merely an academic exercise if there are sufficient funds to pay all priority claims.)

Secured creditors retain their liens on the collateral and are entitled to receive the proceeds from the sale of their collateral up to the extent of the amount of their claim. Thereafter, distribution in California assignments for the benefit of creditors is generally made in accordance with the following priorities: 1) obligations owing to the U.S. (31 USC 5 3713); 2) the costs and expenses of the assignment, including the Assignee's fees, legal expenses, and costs of administration; 3) priority wage and benefit claims' (CCP 5 1204); 4) state tax claims, including interest and penalties for sales and use taxes, income taxes, and bank and corporate taxes (Cal. Rev. & Tax Code § 19253 and 26312,); 5) security deposits up to $900 for the lease or rental of property, or purchase of services not provided (CCP § 1204.5); 6) unpaid unemployment insurance contribution, including interest and penalties (Cal. Unemp. Ins. Code § 1701); 7) State of California, Department of Fish and Game, for all monies owing the State for the sale of licenses and license tags (Cal. Fish & Game Code 5 1058); and 8) general unsecured claims.' Interest is paid on general unsecured claims only after the principal is paid for all unsecured claims submitted and allowed and only to the extent that a particular creditor is entitled under contract or judgment to assert such claim for interest.

If there are insufficient funds to pay the unsecured claims in full, then these claims will be paid pro rata. If unsecured claims are paid in full, equityholders will receive distribution in accordance with their liquidation rights. No distribution to general unsecured creditors should take place until the Assignee is satisfied that all priority claims have been paid in frill.

Conclusion. 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 ABC process may allow the parties to avoid the delay and uncertainty of formal federal bankruptcy,court proceedings. In many instances involving deteriorating business, 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, among other things, key employees leave. Moreover, the parties interested in acquiring the business and/or assets generally will only move forward under circumstances where they will not be taking on the unsecured debt of the distressed entity along with its assets. In such instances, an assignment for the benefit of creditors can be a viable solution.

ENDNOTES

[1]This section includes all of the following, only to the extent of $4,300, earned within 90 days before the making of the assignment: Wages, salaries, or conunissions, including vacation, severance, and sick leave pay earned by an individual, sales commissions, unsecured claims for contributions to employee benefit plans. CCP § 1204.

[2]These tax code sections specifically state that they do not give a preference over any recorded lien which attached prior to the date when the State records or files its lien.

[3]The claim of a tenant to any payment or deposit of money the primary function of which is to secure the performance ofa rental agreement for other than residential property shall be prior to the claim of any creditor of the landlord, except a trustee in bankruptcy. Ca. Civ. Code c 1950.7.

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