

Assignment for the Benefit of Creditors (ABC)



A FASTER, LESS EXPENSIVE ALTERNATIVE TO BANKRUPTCY

ABSTRACT

Despite the enormous economic growth in specific sectors of the U.S. economy during recent years, some experts are predicting a downturn in the market and a possible recession due to inflationary conditions.

As insolvency professionals prepare for an uptick in workload and evaluate available options for clients in financial distress, the Assignment for the Benefit of Creditors (ABC) is an alternative to bankruptcy gaining acceptance on the heels of the pandemic.

AN OPTION GAINING POPULARITY NATIONWIDE

In early 2000, small to medium sized companies throughout the United States turned to the Assignment for the Benefit of Creditors as the alternative to filing bankruptcy. The start of the 21st century continues to showcase their increasing popularity, including significant activity in both the technology and healthcare sectors.

As a simpler and less expensive alternative to filing for bankruptcy, secured and unsecured creditors in an ABC will [typically] receive higher payouts than in a bankruptcy case, and also in a more timely fashion.

Continued on next page >>

In recent months, companies that have used ABCs to wind down operations include Theranos, Hired, Fast AF, and Telltale Games.

For local Arizona companies, the use of the ABC is not a favorable alternative to filing for bankruptcy. Universally, Arizona ABC laws are considered impractical and unworkable because the law requires each creditor to execute a consent *and* a release. However, as most companies that do business in Arizona are incorporated in Delaware [and not Arizona], these entities can more easily explore an ABC under Delaware law.

AN OVERVIEW

This white paper will provide an overview of the Delaware ABC laws and make the argument that a Delaware ABC is a viable alternative to a bankruptcy filing for distressed businesses that operate in Arizona.

A Delaware ABC commences with the contractual assignment of the assets of the distressed company, known as the Assignor, to an independent fiduciary, known as the Assignee, in trust for its creditors. Much like a Chapter 7 bankruptcy trustee, the Assignee owes a fiduciary duty to preserve assets for the benefit of the Assignor's creditors.

Initiating a Delaware ABC for a corporation requires board and shareholder approval under both Delaware and Arizona law. See 8 Del. C. § 271(a); ARIZ. REV. STAT. § 10-1202(A); *Stream TV Networks, Inc. v. SeeCubic, Inc.*, No. 360, 2021, 2022 Del. LEXIS 177, 2022 WL 2149437 (Del. June 15, 2022) (confirming sale or assignment of substantially all of a corporation's assets requires board and shareholder approval under Delaware law).

For other business entities, the ABC requires approvals from partners, general partners, managers, or members, as applicable.

The assignment document ("General Assignment") is the primary source used to initiate the ABC. It cannot prefer any creditor to any other creditor, nor can it secure or pay any creditor a greater proportion of the creditor's debt or demand than must be secured or paid to other creditors. See 10 Del. C. § 7387.

It is not uncommon for the Assignor to also contract with the Assignee to formally dissolve the Assignor, shut down any employee benefit plans, and file final tax returns.

Unlike other states such as California, Delaware has court supervision over ABCs. The state requires that within thirty days of the execution of the General Assignment, the Assignee must file a petition (which includes the General Assignment) with Delaware Court of Chancery. The petition requests recognition of the ABC (Chancery Court Rule 3).

The Assignee is also required to file an inventory or schedule of assets within thirty days with the Chancery Court. 10 Del. C. § 7381.

After filing the inventory or schedule of assets, the Assignee must post a bond in an amount and with sufficient surety, as established by the Chancery Court. 10 Del. C. § 7383.

The Chancery Court will not typically set the bond until the Assignee files appraisals by two independent appraisers. Also, a Delaware ABC requires filing a final account or, if not completed within one year of filing the bond, filing an annual accounting until the administration of the ABC is complete.

The Delaware Code does not contain specific procedures on notifying creditors, though the Chancery Court will expect the Assignee to provide creditors notice of major actions in the ABC. It is common practice for Assignees to request an order from the Chancery Court, establishing a claims procedure that approves the form of notice, the proof of claims form, and the claims filing deadline.

It has recently become common practice to seek Chancery Court approval of asset sales, but it is not technically required under the Delaware Code. Many asset purchasers prefer to obtain a court order approving the sale as a condition to purchasing assets from an ABC.



HOW ABCS DIFFER FROM BANKRUPTCIES

At first glance, a Delaware ABC appears to be quite like a Chapter 7 or Chapter 11 bankruptcy case. However, a Delaware ABC benefits from greater savings and a quicker payout to creditors when compared to a bankruptcy filing. Other differences between the two include the following:

1. Significantly fewer court appearances – a normal ABC usually has no more than three court appearances (if any), while bankruptcy cases that have a substantial amount of assets will have multiple court hearings.
2. No meeting of creditors in an ABC.
3. No monthly operating reports.
4. The hiring of professionals does not require the approval of the Chancery Court.
5. No fee applications for professionals, however creditors and the Chancery Court can review professional fees as part of the review of the Assignee's final account.
6. Assignee is selected by the Assignor while a Chapter 7 trustee is almost always selected from the Bankruptcy Court's panel of trustees. This allows the Assignor to select an Assignee who has expertise and experience selling assets of the type of the distressed entity rather than a panel trustee who [typically] has a large caseload and [possibly] limited experience with selling assets in certain industries.
7. Distributions to creditors usually occur within a year from the commencement of the ABC, while creditor distributions in bankruptcy cases will [likely] not occur for at least three years after the commencement of the bankruptcy case.
8. Less publicity, which may be attractive to investors who do not want to broadcast that one of their investments failed.
9. Allows management and board members to resign and move on to their next project.

Distributions to creditors usually occur within a year from the commencement of the ABC, while creditor distributions in bankruptcy cases will [likely] not occur for at least three years after the commencement of the bankruptcy case.



THE ADVANTAGES OF AN ABC

A Delaware ABC is preferable to a bankruptcy filing when the corporation is able to benefit from the following advantages:

- 1.** Assignor's ability to select the assignee rather than a randomly appointed trustee.
- 2.** An experienced Assignee brings the added value of selling distressed assets in various industries, thus resulting in a higher return to creditors.
- 3.** A Delaware ABC has the oversight of the Chancery Court, ensuring that the process is both fair and transparent, but it is not as cumbersome as a bankruptcy.
- 4.** The Chancery Court has substantial experience with ABCs. One criticism of the ABC is its infrequent use in certain states. In such cases, judges, court clerks, and staff may lack the institutional familiarity of an ABC which may lead to delays and cause uncertainties. In the case of the Delaware Chancery Court, however, the vice chancellors and court staff have extensive experience with ABCs.
- 5.** No automatic stay. Bankruptcy may be preferable if the potential Assignor is facing litigation, eviction, or foreclosure.
- 6.** Less protection from successor liability because you do not get the protections of a Bankruptcy Code section 363 order.

AN ARIZONA CASE STUDY

In February 2022, Arizona-based LM Industries Group, Inc. d/b/a Local Motors, commenced a Delaware ABC. Local Motors selected Sherwood Partners, a business advisory and consulting firm with extensive ABC experience. As of December 2022, the ABC is still pending; however, the company's website remains functional, suggesting a sale has occurred and the assets are now either operated by a new entity, or the Assignee is continuing to operate the company, notwithstanding the assignment.

Although ABCs involve liquidation like Chapter 7 bankruptcies, Assignees are permitted to operate the Assignor's business before selling and winding it down. This preserves the going concern value and eases the transition for employees [to the extent the business must cease].

Although Local Motors is based out of Chandler, Arizona, it is a Delaware corporation and therefore able to use the Delaware ABC process. As noted above, while Arizona has an ABC statute, it is impractical in many respects, including the onerous requirement of obtaining express written consent of all creditors. See ARIZ. REV. STAT. §§ 44-1031 – 44-1047.

GEOGRAPHIC CONSIDERATIONS

Technology has become paramount to aiding a company through difficult financial times as well as eliminating geography as a precursor to retaining assistance. However, in order to access the Delaware Chancery Court, local Delaware counsel is required. Thus, while a Delaware corporation can operate wherever it desires, it must retain local Delaware counsel to prosecute its ABC.

It is also true that to the extent a creditor wants to voice an objection in a Delaware ABC through counsel, such counsel must be admitted in Delaware as well. This raises a potentially high barrier to entry.



For more information:

If your business is facing financial difficulties and you wish to discuss the best option (ABC, bankruptcy, or restructuring), schedule a free and confidential consultation by calling **(480) 947-3321** or sending an email to info@resolutecommercial.com.

Visit resolutecommercial.com for information regarding our portfolio of services.

RESOLUTE

problems solved.

 @Resolute_PS

 /resolute-commercial-services