NONBANKRUPTCY ALTERNATIVES

ASSIGNMENTS FOR BENEFIT OF CREDITORS; UCC SALES, AND VOLUNTARY LIQUIDATIONS,

by
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I. Assignment for Benefit of Creditors

Colorado and Utah statutes provide for the making of an assignment for the benefit of creditors, or a general assignment, as a means for conducting an orderly liquidation of a debtor's assets.[1] While assignments for the benefit of creditors have not commonly been used in either state (Colorado since at least the 1940's, Utah since the 1970's, based on published decisions regarding interpretation of the statutory provisions), general assignments are enjoying a resurgence in other states as a less expensive alternative to a sale as a going concern or complete liquidation in bankruptcy.[2] "In contrast to a Chapter 7 liquidation under the Bankruptcy Code, an assignment is generally more efficient, less costly, of shorter duration, more successful in terms of the value received for the assets and amounts paid to creditors and more tailored to the needs of debtors and their creditors."[3]

Colorado and Utah's statutes contain substantially similar provisions, though Colorado's are more detailed. Under both states' statutes, a debtor which has decided to liquidate its business operations may make a general assignment for the benefit of all of its creditors. The assignment is accomplished by the execution of a deed in favor of the assignee, chosen by the debtor, which is filed with the clerk and recorder of the county of the debtor's residence or principal place of business.[4] Upon the recordation of the assignment, the assignee holds the assigned property in trust for the benefit of the debtor's creditors. The debtor retains only those

assets exempt under applicable law. The debtor must deliver to the assignee a complete inventory of the property assigned; the estimated value thereof; and a list of all creditors and the amounts due.

After receipt of the assignment, the assignee must file a complete inventory and valuation of the property assigned with the clerk of the district court in the county where the deed of assignment has been recorded. The assignee must also post a bond to the state, for the benefit of the creditors, in an amount twice the value of the inventory. Where real property is involved, the assignee must file a notice of the assignment with the clerk and recorder of each county in which the debtor owned real property.

The district court has full power and complete jurisdiction over all the property of the assignment, regardless of its location. All sales of real estate, and all sales of personal property, not in the ordinary course of business of the debtor, must be approved by the court before they are valid. If no market exists for a particular asset of the estate, the property may be distributed in kind to creditors willing to receive property in lieu of cash distributions. The assignee also has the power to bring suit to collect obligations due the debtor.

Upon receipt of the assignment, the assignee must publish notice of the assignment in a newspaper located in the county of the assignment. In addition, the assignee must send actual notice to each listed creditor, informing each creditor of the assignment, and directing each creditor to submit a claim within three months of the notice. After the three months have expired, the assignee must file a report with the clerk of the court containing a complete list of all of the creditors that filed claims, the amount of their claims, and the collateral, if any, for their claims. The assignee must also file a statement summarizing his disposition of assigned assets,

and showing the funds he has received, and the disbursements he has made. Any party in interest may challenge the claim asserted by any creditor, by filing an objection with the clerk of the court. The court will then conduct a hearing to determine the legitimacy of the claim. Once all claims a re resolved, and all assets have been disposed of, the assignee makes distributions to creditors based on their priority or class. The debtor does not receive a discharge as a result of the assignment. Utah's statute expressly provides that nothing in the ABC statute prohibits a debtor from making a preferential transfer to a legitimate creditor.

Colorado's statute has a number of interesting provisions. First, creditors may appoint an attorney to represent the interests of creditors in the estate. The attorney may examine all the reports of the assignee and inquire into the conduct of the assignee in performing his duties. The attorney's fees may be paid from the proceeds of the estate.[5] In addition, the assignor, the creditors, and the assignee all may agree in writing that all proceedings before the court be waived. Upon the filing of such an agreement with the court, the court ceases to have further jurisdiction over the proceedings.[6] Finally, the making of an assignment stays all pending foreclosure actions on real and personal property for a period of one year, unless the court orders otherwise. Further, the statute requires that any foreclosure proceed judicially (no public trustee or UCC foreclosure process), unless the secured creditor has proven its claim and the claim has been allowed by court order.[7]

Because of the lack of a discharge provision, use of an assignment for the benefit of creditors, rather than a Chapter 7 bankruptcy filing, will appeal only to business entities. While certainly uncommon at this time, there are several potential advantages to a debtor to use of an

assignment for the benefit of creditors rather than a bankruptcy filing. Perhaps the most significant is the debtor's ability to choose the assignee, rather than having a randomly appointed panel trustee. In addition, the debtor can negotiate an agreeable compensation structure with the proposed assignee, rather than being bound by the statutory commissions due trustees. While the agreed compensation may exceed a trustee's commission, the added expense may be offset by the added value a chosen assignee may bring to the process. Further, the chosen assignee may commence work immediately, contrasted with many panel trustees who take little or no action until after the first meeting of creditors, when inventory and accounts receivable may have become stale.

In addition, the assignee has greater flexibility in liquidating assets or selling as a going concern. Nothing in the statute prohibits the assignee from continuing to operate the business for a limited period of time to complete work in process and collect receivables in the ordinary course. In addition, the assignee is authorized to distribute assets in kind to creditors willing to accept them. The assignee may also accomplish a sale as a going concern, either to a completely independent third party, or to a new corporation created by the existing shareholders to acquire the business. Because the assignee owes a fiduciary duty to the creditors to assure that the best price is received for the business, the purchaser of the business has a higher comfort level that the sale will survive a subsequent challenge by creditors over the legitimacy of the transaction than may exist in a completely unsupervised transaction. Such a sale may be accomplished more quickly, and at less legal expense, than a comparable sale through bankruptcy.

Of course, there are disadvantages to a general assignment, as well. In particular, cooperation of a secured creditor cannot be coerced, and there is no provision authorizing the use of cash collateral, for the recovery of liquidation costs from the proceeds received, or authorizing a sale free and clear of liens and encumbrances. Thus, an assignment will work best, either when significant assets are unencumbered, or where the secured creditor consents. Liquidation through an assignee may benefit a secured creditor which is unable to liquidate its collateral effectively, or is concerned about the risk of lender liability claims if it forces a liquidation. Similarly, a going concern sale can be structured consensually with a lender to preserve the going concern value, while eliminating burdensome unsecured debt.

II. UCC Foreclosure Sales

The Uniform Commercial Code, adopted in essentially identical form in all fifty states, provides an inexpensive procedure for the recovery and liquidation of personal property by a secured lender. After providing ten days' notice of an intended disposition of collateral to the debtor, guarantors, and any other creditors with a record security interest in the collateral, the secured creditor may dispose of its collateral in a public or private sale, free of all junior liens. Secured creditors may also take title to the collateral, in full or partial satisfaction of their claims, absent objection from interested parties.

The use of these statutory procedures to liquidate collateral in a public or private auction is common. Perhaps less familiar may be the use of the UCC to conduct the sale of a business as a going concern. Where no real property is involved, and with a cooperative borrower, a going concern sale of all of the assets of a business may be achieved, relatively simply and inexpensively, through the UCC sale process. The lender, borrower, and purchaser may enter

into an asset purchase agreement, conditioned upon the lender's completion of foreclosure through a private sale notice. The lender then sends the requisite UCC private sale notice, waits the minimum ten days, and then closes on the sale pursuant to the asset purchase agreement. Attached to this article are sample purchase agreements and bill of sales reflecting one potential structure to achieve a successful sale.

III. Voluntary Liquidations

Finally, of course, nothing prevents a debtor from conducting its own orderly liquidation, paying secured creditors from the proceeds, and distributing any remaining funds on a *pro rata* basis to general unsecured creditors. This may be the most commonly implemented method of shutting down a failing business. So long as any secured creditors are cooperative, an orderly shutdown can frequently be accomplished simply and inexpensively.

Within reason, debtors may make preferential transfers to certain creditors, most commonly when principals have personal guaranties at stake. Under limited circumstances, such transfers may be avoided under the Uniform Fraudulent Conveyances Act, but, from the author's experience, rarely are such remedies pursued. Once the orderly shutdown and asset liquidation has been completed, it is common for either the debtor, or debtor's counsel, to send a letter to all creditors, informing them of the cessation of operations, and either that the trade creditors will receive nothing, or that there is some prospect that creditors will receive something from the liquidation, and any proceeds will be distributed on a *pro rata* basis when the liquidation process is complete. A subsequent Chapter 7 bankruptcy filing remains an option, if disgruntled creditors persist in litigation and Rule 69 discovery.

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1. C.R.S. §§ 6-10-101, *et seq.* ; Utah §6-1-101, *et seq.* The Colorado statute has been upheld as not in conflict with federal bankruptcy laws. *In re Carlson's for Music, Inc. v. Gould*, 176 Colo. 172, 489 P.2d 1038 (1971).

2. *See*, e.g., Berman, *Common Law Assignments for the Benefit of Creditors: The Reemergence of the Nonbankruptcy Alternative*, 21 Cal. Bankr. J. 357 (1993); Cohen and Challacombe, *Assignment for Benefit of Creditors -- A Contemporary Alternative for Corporations*, 2 DePaul Bus. L.J. 269 (1990).

3. Cohen & Challacombe, 2 DePaul Bus. L. J. at 270.

4. The assignee takes title only to the extent that title in the assigned assets was held by the debtor, but, under the Colorado statute, stands in the shoes of the creditors in avoiding transfers that could be avoided by creditors. *Clark v. Bright*, 30 Colo. 199, 69 P. 506 (1902). Under common law assignments, however, the assignee does not stand in the shoes of the creditors and therefore has no standing to challenge fraudulent transfers. *Wells v. Schuster-Hax Nat'l Bank*, 23 Colo. 534, 48 P. 809 (1897). In Utah, the deed conveys all of the assets of the debtor other than exempt assets and insurance on the life of the debtor. *Peeples v. Wolfe,* 19 Utah 2d 258, 430 P.2d 574 (1967).

5. C.R.S. § 6-10-125.

6. C.R.S. § 6-10-126.

7. C.R.S. 6-10-132.