NON-BANKRUPTCY ALTERNATIVES TO RESTRUCTURING AND ASSET SALES

Committee on Bankruptcy & Corporate Reorganization

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I. GENERAL OVERVIEW

This paper addresses four procedures available for dealing with a distressed business: UCC Foreclosure; Assignment for the Benefit of Creditors; Composition; and Receivership. Each is explored as a potential alternative to a restructuring or the sale of substantially all assets in a bankruptcy proceeding and the intention is to provide restructuring lawyers, debtor and creditor representatives alike, with a practical overview of those alternatives.

Before discussing the alternatives, it is worth explaining the most prevalent restructuring approach—a bankruptcy filing. As restructuring practitioners know, whatever may have been the particular catalyst that preceded a financial crisis, each commercial reorganization must address the imbalance between the resources of the business and the financial obligations to its creditors. The most powerful and well-developed tool for dealing with this imbalance is bankruptcy, or, more precisely, a proceeding for relief under Title 11 of the United States Code (the “Bankruptcy Code”).

Moreover, not only are the tools available in a bankruptcy proceeding powerful, case law interpreting the Bankruptcy Code is extensive, providing a reasonably predictable environment through which debtor and creditor lawyers can guide their clients. For example, bankruptcy practice has a well-developed body of law addressing the status of liens and the rights and remedies available to secured creditors and how value may be apportioned between secured and unsecured creditors. Similarly, the Bankruptcy Code provides for the disposition of assets either directly, in what is known as a “363 sale” (after the relevant section of the Bankruptcy Code) or through a plan of reorganization for the debtor. Most importantly, a bankruptcy proceeding also can effect a reorganization of a debtor’s financial obligations, including, if sufficient consents are obtained and the proper standards are met, against the will of certain holdout creditors. And even if novel issues have a way of presenting themselves at the margins, the general case law on these subjects is quite robust. As a result, bankruptcy is an environment in which restructuring lawyers are quite comfortable and clients can be assured of more predictable outcomes.

Nevertheless, bankruptcy proceedings do not always provide simple solutions to often complex problems. While the extensive body of law provides some guidance to debtors and creditors, a bankruptcy proceeding can be fraught with practical and legal issues that complicate matters. For example, issues relating to the valuation of collateral or the secured status or relative priority of certain creditors can be very significant in the direction (and length and expense) of a case. Similarly, the need for a borrower to operate under bankruptcy protection while continuing to use its creditors’ collateral or even borrowing additional money to fund its operations might dictate the course of a restructuring. And when credit markets are tight and old lenders are unwilling to be patient while new lenders are less willing to take a chance, the pressure on a debtor to find an immediate solution to its financial difficulties (like liquidate and sell its assets) becomes all the more acute. One need only look at the recent cases of Chrysler, GM and
Lehman Brothers to see how the pressure of the restructuring process can drive parties to a relatively quick sale of assets.

While the inability to access credit markets can make the restructuring environment difficult, it is not the only reason why lawyers should consider whether a bankruptcy restructuring is the only option to address debtor/creditor problems. For one, because of the large number of professionals involved, bankruptcy proceedings are expensive. In addition, some of the more powerful tools available to debtors have eroded over time, making a successful reorganization, as opposed to a sale of assets, more difficult. For example, the time a debtor has to decide whether to assume or reject non-residential real property leases has been limited to 210 days by changes in the Bankruptcy Code in 2005. Additionally, the Bankruptcy Code limits the time during which a debtor has the exclusive right to file and solicit acceptances with respect to a plan of reorganization.

Despite the high costs and potential complexity of a bankruptcy proceeding, it remains a fairly comprehensive framework with powerful tools for reorganizing a struggling enterprise. Nonetheless, creditors and debtors should be aware that there are other options available to them. Specifically, and as discussed in more detail below, there are alternative schemes that can accomplish some of the same things that are effected through a bankruptcy proceeding, though sometimes in a simpler and more efficient manner. Specifically:

a. UCC-Foreclosure: A state law remedy available to secured creditors who wish to take or sell the collateral securing their debt, analogous in many ways to a 363 sale;

b. Assignment for Benefit of Creditors: A state law proceeding similar to a chapter 7 bankruptcy liquidation effected for the benefit of creditors;

c. Composition: A negotiated contractual settlement between a debtor and its creditors, usually unsecured, which can be analogized to a consensual and contractual plan of reorganization; and

d. Receivership: Covers a variety of formats and applications, where a responsible party is appointed to take control over a business or asset and operate and/or liquidate it for the benefit of creditors.

This paper aims to cover each of these alternative schemes in order to provide lawyers with an understanding of the situations in which they can be useful and the advantages and disadvantages each scheme provides, both on its own terms, and as an alternative to a bankruptcy proceeding.

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3 11 U.S.C. § 1121(b), (c)(3).
I. **UCC FORECLOSURE**

A. **Introduction: What is a Foreclosure?**

While the threat of foreclosure may precipitate a bankruptcy filing, a foreclosure sale under the Uniform Commercial Code (“UCC”) is a tool, valuable in its own right, available to a secured creditor hoping to realize upon the value of its collateral. A foreclosure can, in the right circumstances, provide a secured creditor with the opportunity to take control of or realize value for collateral with far greater speed and at much less expense than a bankruptcy sale. On the other hand, foreclosure sales have significant limitations that partially explain the relative prevalence of bankruptcy sales and the relative infrequency of foreclosure sales in large business reorganizations. As a result, the mechanics of a foreclosure sale are often unfamiliar to many creditors’ rights attorneys. The purpose of this section, therefore, is to explain the foreclosure process in a broad outline and to highlight some of its relative advantages and disadvantages.

Viewed in isolation, foreclosure is roughly akin to a sale under Section 363 of the Bankruptcy Code. In other words, in a foreclosure sale, assets are disposed of, the secured creditor may, generally, participate in the sale as a bidder, certain liens on the asset being sold can be cleared and a deficiency claim may be fixed. While in those respects a foreclosure sale is similar to a bankruptcy sale, there are also important differences. For example:

- start to finish, a foreclosure sale can be faster than a bankruptcy sale and certainly faster than the entire bankruptcy process;
- a foreclosure sale typically carries lower professional expenses;
- a foreclosure sale is somewhat limited in scope—it deals with the secured party’s collateral and junior liens on the collateral, but not unsecured claims; and
- there is usually no court order approving the sale or any deficiency claim and, as a result, the sale may spawn litigation with the borrower or any guarantors.4

B. **Foreclosure and Sale of Collateral**

In New York, foreclosure on personal property5 is governed by the Uniform Commercial Code and by Article Nine in particular, which contains a Subpart on default and on the enforcement of security interests.

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4 There is the possibility of a judicial foreclosure, but that is a different subject and process from what is described herein.

5 The Real Property Law of New York covers Real Property, and UCC 9-604 addresses the application of the UCC when both real and personal property are involved. For the sake of simplicity, this section will deal only with the UCC as applied to non-consumer goods personal property.
Generally speaking, foreclosure is the process by which a secured creditor, after a default, sells its collateral to realize value and apply it against the debt it is holding. While the term “foreclose” is, surprisingly, not defined in the UCC, the UCC does detail the process by which the collateral is sold pursuant to a foreclosure.

As a starting point, the disposition of collateral is governed by Section 9-610 of the UCC, which provides that the secured party may sell or otherwise dispose of collateral.

C. Commercial Reasonableness

Section 9-610(a) introduces the requirement that a foreclosure be commercially reasonable. Section 9-610(b) elaborates on that concept, highlighting the importance placed on the conduct of the sale, and specifically requiring that “every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.” Such section further clarifies that so long as it would be commercially reasonable to do so, “a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.”

The requirement of commercial reasonableness is one of the most critical elements of a foreclosure sale and one to which a secured creditor must pay close attention. As a threshold matter, failure to comply with the commercial reasonableness standard may result in judicial interference with the sale under Section 9-625(a) or liability for damages under 9-625(b) (e.g., for the elimination of surplus or an improperly calculated deficiency claim). Further, and perhaps of greater concern, is that a lack of commercial reasonableness in the sale procedures increases the risk of a fraudulent transfer avoidance action in a subsequent bankruptcy proceeding (or similar state law proceeding) to set aside the sale.

Unlike in the case of a 363 sale, a foreclosure sale may not have the benefit of a court order approving the conduct of the sale and its results. Thus, the secured creditor is exposed to parties challenging the result of the sale by claiming, at some future date and with the benefit of hindsight, that the sale did not obtain reasonably equivalent value for fraudulent transfer purposes. While secured creditors cannot escape all risk, in 1994, the United States Supreme Court held that for purposes of an avoidance action brought under the federal bankruptcy laws, “reasonably equivalent value” for foreclosed real property is the price in fact received at the foreclosure sale, so long as all the requirements of the State’s foreclosure law have been complied with. In other words, creditors can take some comfort from the fact that scrupulously adhering to the prescribed process should eliminate or at least limit a challenge based on the fraudulent conveyance laws. But that means carefully complying with the standard of commercial reasonableness.

The UCC provides some, though scant, guidance on what is considered commercially reasonable. Section 9-627 provides that the mere fact that a greater amount could have been obtained by a different method of disposition “is not of itself sufficient to preclude the secured

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party from establishing that the collection, enforcement, disposition, or acceptance was made in a
commercially reasonable manner.” Furthermore, although inapplicable to most UCC sales, as a
practical matter:

A disposition of collateral is made in a commercially reasonable manner if the disposition is made:
(1) in the usual manner on any recognized market;
(2) at the price current in any recognized market at the time of the disposition; or
(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

Section 9-627 also provides that:

A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:
(1) in a judicial proceeding;
(2) by a bona fide creditors' committee;
(3) by a representative of creditors; or
(4) by an assignee for the benefit of creditors.

Thus, while a bankruptcy sale carries with it the certainty of a federal court order approving the sale procedures, the purchaser and the price, a UCC sale typically does not, leaving those issues open to the possibility of subsequent review (and challenge).

Accordingly, secured creditors may be left with some measure of uncertainty remaining after a UCC sale and will therefore want to address commercial reasonableness carefully on a case-by-case basis with attention to the nature of the asset and the facts and circumstances of the transaction as well as to applicable case law. While no generalized assurances can be given as to what, if anything, is required to make a sale “commercially reasonable”, courts have found the following factors can contribute to such a finding: hiring an investment bank;8 preparing a sales memorandum;9 directly contacting potentially interested parties;10 and publishing notices of the sale in a variety of newspapers and trade publications.

D. Public v. Private Sales

Purchase by Secured Party

In discussing the concept of commercial reasonableness, Section 9-610(b) of the UCC also contemplates that the secured party’s collateral may be sold by either a public or a private sale, with either method permitted so long as it is commercially reasonable. While the UCC does not explicitly demarcate the difference between a private and public sale, the essential difference is that a public sale is one in which the public is invited to participate whereas in a private sale, the buyers are limited.11

Even when either option would be commercially reasonable, the UCC is not indifferent between a public and a private sale. The right of the creditor to purchase at the sale differs between the two sale forms. Specifically, as described in Section 9-610(c), a secured creditor may purchase its collateral at the public sale, but in the case of a private sale, only if the collateral is of a specific type:

(c) Purchase by secured party. A secured party may purchase collateral:
   (1) at a public disposition; or
   (2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

In other words, unless the collateral is of the kind sold on a recognized market or subject to a widely-distributed price quotation, the secured creditor may not purchase its collateral at a private sale. If the creditor wishes to purchase its non-market quoted collateral, it must conduct the foreclosure by public sale. By restricting a secured creditor’s right to purchase its collateral to either a public sale, or a private sale of property with a readily ascertainable market price, the UCC is attempting to protect debtors from creditors who might use the foreclosure sale to seize collateral worth more than their debt or at a depressed valuation.

Contrast this UCC restriction with the Bankruptcy Code which, rather than restricting when a creditor may purchase its collateral, explicitly provides that at a 363 sale, “unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.”12 Perhaps the judicial oversight of the bankruptcy sale, absent in a foreclosure, provides adequate protection to debtors from the risks addressed by the UCC and explains the significant limitation on the secured creditor’s right to purchase its collateral at a private sale. In any event, this remains a significant substantive difference between a bankruptcy and a foreclosure sale and may very well prove to be a significant factor in the secured creditor’s choice of remedies.

E. **Realizing Value**

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11 See, e.g., *Ford Motor Credit Co. v. Solway*, 825 F.2d 1213 (7th Cir. 1987).

While it is easy to generalize about the differences between a foreclosure sale and a 363 sale, there is one area where it is apparent that foreclosure sales are designed to provide an expedient creditor remedy whereas bankruptcy sales are intended for use as a bankruptcy debtor’s tool to realize value. This difference is the area of warranty and the buyer’s protection from claims.

Section 363 of the Bankruptcy Code provides a great benefit for buyers, and therefore to sellers, by allowing a court to strip assets sold by a debtor of the claims that might otherwise attach to them – “The trustee may sell property under subsection (b) or (c) of this section [363] free and clear of any interest in such property of an entity other than the estate . . .” 11 U.S.C. § 363(f). This power makes the assets more attractive to a buyer and thus able to attract a higher price.

The UCC on the other hand has a much more limited provision when it comes to claims against the assets subject to the sale. Rather than providing for a sale completely free and clear, a UCC disposition transfers to a transferee for value all of the debtor's rights in the collateral and discharges the foreclosing secured creditor’s lien and any subordinate security interest (other than liens created under state law that are not to be discharged). Nonetheless, the UCC does expressly permit the selling secured party to market the assets without any meaningful representations or warranties. Specifically, Sections 9-610(d), (e) and (f) of the UCC provide:

(d) **Warranties on disposition.** A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) **Disclaimer of warranties.** A secured party may disclaim or modify warranties under subsection (d):

1. in a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or
2. by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) **Record sufficient to disclaim warranties.** A record is sufficient to disclaim warranties under subsection (e) if it indicates “There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition” or uses words of similar import.13

Thus, the UCC allows for a quick sale on an as-is, where-is basis if the seller so desires, though perhaps at the expense of maximizing price.

F. **Notice**

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13 UCC 9-610.
Perhaps because a foreclosure sale typically takes place without court supervision, but has the ability to affect not just the rights of the debtor, but also those of junior creditors, and also because it is usually initiated by the secured party rather than the debtor, the UCC provides for fairly detailed notice provisions. The notice provisions are intended to ensure that the debtor, junior lien holders and certain other parties are made aware of the foreclosure sale and provided with at least a minimum opportunity to participate or exercise rights.\textsuperscript{14}

Section 9-612(b) of the UCC provides that outside of consumer transactions, 10 days or more before the earliest disposition is considered a reasonable time for notice. While this is certainly shorter than the 21 days notice required for a sale of assets under Rule 2002 of the Federal Rules of Bankruptcy Procedure, this minimum statutory period is misleading. First, under UCC 9-611(c)(3)(B) and (e), a secured party will likely need to take specific steps, like requesting lien searches to compile its notice list, at least ten days before \textit{giving} the notice. Second, the ten-day period is only the minimum required to satisfy the notice provisions of UCC 9-611. It does not address the minimum period to conduct a commercially reasonable sale of the collateral. That requirement, depending on the specific collateral, may be significantly longer than ten days.

G. \textbf{Deficiency Claims, Surplus and Application of Proceeds}

Just as the UCC compensates for the lack of judicial process by providing detailed notice requirements so that the non-creditor parties affected by the foreclosure are able to participate in the process, it also specifies how the proceeds of the sale are to be allocated and how any deficiency or surplus is addressed. For example, the UCC accommodates not just the application of the proceeds to the secured creditor’s expenses and claim, but also, in certain circumstances, to discharge junior liens. Most significantly, and in contrast to many bankruptcy sales, the proceeds are available immediately and distribution need not wait until the confirmation of a bankruptcy plan of reorganization.

The basic provisions are contained in Section 9-615 of the UCC.\textsuperscript{15} Under UCC 9-615(a), the secured party has the right to be reimbursed from sale proceeds for the reasonable expenses of the foreclosure sale as well as reasonable attorney’s fees and legal expenses. UCC 9-615(d) provides, generally, for the obligor to receive any surplus and to be liable for any remaining deficiency. UCC 9-615(f) guards against self-dealing by providing that in the event the disposition is to a person related to the secured party, the deficiency must be calculated as if the disposition was to an unrelated party.

H. \textbf{Strict Foreclosure}

\textsuperscript{14} UCC 9-611, which requires, in subsection (c), notice to the debtor, any secondary obligor and certain parties claiming an interest in the collateral.

\textsuperscript{15} Section 9-627 of the UCC addresses actions in which the amount of the deficiency or surplus, calculated in accordance with UCC 9-615(f), is at issue.
In addition to the sale of collateral discussed above, the UCC also provides for the secured party to take possession of the collateral directly. Though not identified as such in the statute, this process is called “Strict Foreclosure” and it is governed primarily by UCC 9-620 and UCC 9-621. If the secured party takes possession of the collateral but still has a deficiency claim, it is called “Partial Strict Foreclosure” and if there is no deficiency claim, it is called “Complete Strict Foreclosure.” While there are several specific requirements for effecting both complete and partial strict foreclosure, the debtor’s consent is needed for Partial Strict Foreclosure and its non-objection is required for Complete Strict Foreclosure, as well as non-objection after notice being required from a variety of affected parties, including other lienholders in the collateral. UCC 9-620 and UCC 9-621. Generally, the objection period is 20 days from the notice being sent. Because partial foreclosure results not only in the loss of the collateral, but also in a deficiency claim against the debtor, the requirements for partial strict foreclosure are a bit more stringent, e.g., the debtor’s consent must be in writing, UCC 9-620(c)(1), and the debt obligation cannot be the result of a consumer transaction, UCC 9-620(g). Presumably, both these requirement reflect a heightened concern about the possibility of a debtor not fully understanding the process and being saddled with liability for the deficiency claim even after losing the asset.

I. Conclusion

While the typical UCC foreclosure sale will not always be the best solution, or even an available option, it does offer certain advantages over a bankruptcy sale: it is quick and cheap and able to address many junior liens. It also provides the secured creditor with a great deal of control. For the latter reason, and because a foreclosure interferes with the debtor’s prospects for reorganization, foreclosures are often pre-empted by a petition for relief in bankruptcy, eliminating the option. But when debtors recognize that their pledged assets must be sold, that the prospects for a reorganization are dim, that the variety of potential secured claims against the subject assets are known and simple and that a court order selling the assets free and clear is not needed by prospective buyers, a foreclosure sale may be the best and most efficient and cost-effective process for all parties. Certainly, it is an option that ought to be considered by secured lenders before assuming that a 363 sale in a bankruptcy is their only option.

II. ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

A. Introduction: What is an ABC?

An assignment for the benefit of creditors (“ABC”) is a state law insolvency proceeding designed to effect a quicker, less expensive liquidation than a chapter 7 bankruptcy. In an ABC, the debtor transfers all of the property it owns at the time of the assignment to an assignee. The ABC is a liquidation proceeding that does not allow the company to continue to operate its business, or seek rehabilitation.

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16 15A Fletcher Cyc. Corp. § 7388 (2010).
17 15A Fletcher Cyc. Corp. § 7381 (2010).
Laws governing ABCs vary from state to state. They can either be rooted in common law or statute.\textsuperscript{18} Whether or not the assignment process requires court supervision also varies from state to state.\textsuperscript{19} While the debtor is required to hand over all of its assets to the assignee, in general, a company does not dissolve when an ABC is made.\textsuperscript{20}

B. \textbf{What Type of Debtors Can Make an ABC?}

Because of the limitations in the ABC process, there are very few debtors who may find ABCs a useful tool. Since ABCs do not provide for the discharge of debts, individuals and partnerships generally do not use them.\textsuperscript{21} Therefore, typically corporations use the ABC process.\textsuperscript{22}

However, sometimes corporations are prohibited from making an ABC. In some states, an ABC may not be a viable proceeding for a corporation due to statutes that declare transfers or assignments by corporations when they are insolvent or in the “zone of insolvency” to be void.\textsuperscript{23} This may be especially true of banking, insurance and railroad corporations.\textsuperscript{24}

ABCs also may not be practical for publicly-held corporations because an ABC involves the transfer of substantially all of the corporation’s assets. Under the law of most states, a sale, lease, exchange or other disposition of all, or substantially all, the property and assets of a corporation not in the usual and regular course of business must be approved by shareholders.\textsuperscript{25} Generally speaking, however, when an ABC is prohibited by law or by the articles of incorporation or bylaws of a corporation, the board of directors or trustees, but not the officers, of a corporation typically have the power to authorize an ABC.\textsuperscript{26}


\textsuperscript{22} Id.

\textsuperscript{23} Fletchers, pg. 72.

\textsuperscript{24} Id.

\textsuperscript{25} MBCA (1984) § 12.02.

\textsuperscript{26} 15A Fletcher Cyc. Corp. § 7381 (2010).
ABCs also lack practicality insofar as the making of an ABC is typically an event of default under most contracts.27

C. **Role of the Assignee**

“The assignee is generally someone who is not related to or directly involved in the management or day-to-day operations of the debtor (i.e., a disinterested third party).”28 Usually the assignee is a lawyer or accountant with experience in liquidating businesses, but can also be a corporate entity with such experience.29 The troubled company must find an experienced assignee who does not “fall asleep at the wheel” because courts may not be familiar with an ABC or have limited resources and may not monitor the proceedings extensively.

The assignee is a fiduciary to all of the creditors, and the guideline for the carrying out his or her fiduciary duties is the maximization of property for the estate.30 The assignee “acts as the advocate for the estate, selling off assets while optimizing the timing and value of the sales.”31

Especially in states where ABCs are not court-supervised procedures, there is a certain lack of oversight with respect to the assignee. There is no equivalent to the U.S. Trustee who would monitor a bankruptcy proceeding. To that end, many states require that the assignee post a bond in order to protect the creditors against the assignee’s potential misconduct.32 Further, assignee fees are commonly contingent upon sale proceeds, a practice which generally results in greater recovery for creditors and aligns the assignee’s interests in the proper direction.33

The assignee is a fiduciary to the creditors. However, to the extent that there is surplus in the estate, the assignee may then be accountable to the debtor.34

D. **Selected States - How it Works**

1. **California**


29 Id.


34 See Linton v. Schmidt, 88 Wis. 2d 183 (1979); Admanco, Inc. v. 700 Stanton Drive, LLC, 2010 WI 76 (2010); 15A Fletcher Cyc. Corp. § 7389 (2010).
California companies use ABCs most frequently, and recent use was spurred by the burst of the dot.com bubble. Private equity and venture capital companies used ABCs as a quick and effective exit option—one that “minimized negative publicity for management.”35 Those PE and VC companies occasionally even purchased certain assets back from the assignee in the hope that a second generation of the same technology would prove more profitable.36 A professional considering the use of an ABC in California should consider the following statutes:

- Cal. Civ. Pro. Code § 493.020, which states simply that “notwithstanding any other provision of this title, the defendant may make a general assignment for the benefit of creditors.”

- Cal. Civ. Pro. Code §§ 493.030-493.060, which terminate any lien of a temporary protective order or attachment if the lien was created within 90 days prior to the making of the ABC, and set out detailed instructions for the release of said property to the assignee. Such liens, however, are reinstated under certain circumstances, including if the ABC is set aside other than by the filing of a bankruptcy petition.

- Cal. Civ. Pro. Code §§ 1204-1204.5, which set forth the order of priority in which creditors in a California ABC should be paid.

- Cal. Civ. Pro. Code § 1800, which discusses the right of the assignee to recover transferred property, and is discussed in detail infra.

- Cal. Civ. Pro. Code § 1802, which requires that the assignee give written notice of the assignment to the assignor’s creditors, equityholders, and other parties of interest within 30 days after the assignment has been accepted in writing. The assignee is also required to set a bar date for filing claims with the assignee between 150 and 180 days after the date of the first written notice to the creditors and parties in interest.

Depending upon the factual circumstances, attention should also be paid to:

- Cal. Com. Code § 6103 (Bulk Sales, Application of Provisions);

- Cal. Civ. Code § 3439.07 (Creditor’s remedies);

- Cal. Civ. Code § 3340 (Transfer without delivery is void as to transferor’s creditors).


It is worthwhile to note that California does not require a public court filing to commence an ABC.  

2.  **New York**

New York entities use ABCs less frequently and the ABC law in New York is more antiquated. A professional in New York considering the use of an ABC should give attention to NY Debt. & Cred. Law §§ 1-24, which are the general New York provisions dealing with ABCs. Such statutes require that the assignment be in writing and recorded, and that the debtor file schedules with the clerk of the county that the assignment was recorded in, including “full and true inventory of all such debtor’s estate at the date of such assignment.”

In New York, the ABC is supervised by the court, which has broad powers of administration over the proceeding. The assignee is required to post a bond. Parties interested in the estate, if directed by the judge, must receive at least ten days notice of all proposed sales of the property, the declaration of time and payment of dividends, the filing of the interim account and the filing of the final account of the assignee and the hearing thereon, and the proposed compromise of any controversy. Unless otherwise ordered by the judge, sales of the debtor’s property are by public auction.

The New York statutes do not create preferences for certain creditors in ABCs, except for the wages or salaries of money held in trust for employees and cash deposits upon purchases for future delivery of merchandise or services.

Depending on the factual circumstances, attention should also be paid to:

- NY UCC LAW § 9-102(a)(52)(B) (definition of lien creditor);
- NY Labor Law § 574 (priority of employee wages in an ABC).

3.  **Delaware**

In Delaware, the relevant statutes are Del. Code. Ann. tit. 10 §§ 7381-7387. Similar to New York, schedules of the debtor’s estate must be filed with the Registrar in Chancery of the county where the assignor is located. The assignee needs to give a bond with sufficient surety, which needs to be approved by the Court of Chancery. The assignee also needs to render an account of his or her trusteeship annually before the Register in Chancery of the proper county. Particular attention should be paid to Del. Code. Ann. tit. 10 § 7387, which voids all preferential payments to creditors in an ABC.

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38 Schedules are required to be filed, but according to Fletcher § 7386, failure to file such schedules will not invalidate the assignment; Metro Burak Inc. v. Rosenthal & Rosenthal, Inc., 372 N.Y.S.2d 781 (N.Y. Sup. Ct. 1975).

E. **Order of Priority**

The transfer of the assets to the assignee is, at the outset, “subject to any and all existing liens and the assignee is bound to honor all valid, i.e., perfected and enforceable, liens. . . . Thereafter, sales of assets and the administration of the assignment estate are subject to state-specific rules and will generally require a hearing and court approval before any significant event can take place.”

The order of priority of creditors may vary, to some extent, state to state, but in all cases the government must be paid first. Pursuant to 31 U.S.C. § 3713, when any person indebted to the government is insolvent, is without enough property to pay all debts, and makes a voluntary assignment of property, the government shall be paid first.

Thereafter, while the rules of distribution vary, no distribution to general unsecured creditors should take place until secured claims, taxes and priority wage claims have been paid. Interestingly, it may be possible for the priorities of creditors to be modified based on principles of equity, which is only available in rare circumstances in a bankruptcy proceeding.

F. **State Law on ABCs - Certain Actions Preempted by Bankruptcy Code**

There are certain things that an ABC may not be able to accomplish due to preemption by federal bankruptcy law. For example, if an ABC statute were to attempt to discharge a debt, it would be an invasion of the field of bankruptcy. The Ninth Circuit found this to be the case in Sherwood v. Lycos, 394 F.3d 1198 (9th Cir. 2005). In Sherwood, the court noted “[t]hat the state discharge statute may be compatible with (or even identical to) the federal discharge statute makes no difference. Nor does it matter that a creditor may be able to opt out of the state insolvency proceeding by commencing an involuntary federal bankruptcy proceeding; indeed, according to Stellwagen, it does not even matter whether a federal bankruptcy act is in effect.” Hence, ABCs do not provide for a discharge of debts.

The avoidance of preferential transfers may also be preempted by bankruptcy law, but it is a matter upon which courts are split. As of 2008, twenty-two states had adopted statutes that allowed the assignee to recover preferences, including California. Much of the controversy over preemption centers around Ca. Civ. Proc. Code § 1800.

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42 Luo, 24 BNK. DEV. J. at 523 (citing Fansler v. Fansler, 253 Cal. Rptr. 186, 188-89 (Ct. App. 1988)).

43 15A Fletcher Cyc. Corp. § 7381 (2010); see, e.g., Stellwagen v. Clum, 245 U.S. 605, 615 (1918); Boese v. King, 108 U.S. 379, 385 (1883).

44 Sherwood v. Lycos, 394 F.3d at 1203.

45 Luo, 24 BNK. DEV. J. at 516.
Ca. Civ. Proc. Code § 1800 allows, in certain circumstances, the assignee of an ABC to recover certain transfers of the property of the assignor made within 90 days before the date of the assignment. However, in Sherwood, the Ninth Circuit Court of Appeals declared the exercise of preference avoidance powers under § 1800 to be “inconsistent with the enactment and operation of the federal bankruptcy system and . . . therefore preempted.” The court reasoned that if an assignee were to recover a preferential transfer under § 1800 and distributed the proceeds to creditors, it would preclude a federal trustee from recovering the same sum under a federal preference statute if a federal bankruptcy proceeding were to begin. The court also reasoned that upholding § 1800 would affect the incentives of the various parties to enter into a bankruptcy proceeding.

However, other California courts disagree with the ruling in Sherwood, as do several states with laws similar to Cal. Civ. Proc. § 1800. In Haberbush v. Charles & Dorothy Cummins Family Ltd. P’ship, 43 Cal. Rptr. 3d 814 (2006), the California Court of Appeals disagreed with Sherwood and found it “impossible to conclude that Code of Civil Procedure section 1800 is inconsistent with ‘the essential goals and purposes of federal bankruptcy law[.]’” Haberbush, 43 Cal. Rptr. 3d at 817. The court in Haberbush concludes that § 1800 is not preempted by the Bankruptcy Code.

This has left the validity of ABCs in California in a state of uncertainty.

G. **State Jurisdiction and Conflicts of Law**

The validity of ABCs is generally governed by the law of the state in which the ABC is made, but there is some authority that holds that the law of the debtor’s domicile governs. It is also important to note that when a state has a statutory, as opposed to common law ABC system, an ABC in that state will “only operate upon property in the jurisdiction in which the assignment is made, and with respect to property in other jurisdictions, the law there is controlling as to the rights of creditors generally.” This is due to the principle of comity, which does not require one state to give effect to an ABC in another state when doing so would impair remedies or lessen securities of its own citizens.

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46 Sherwood v. Lycos, 394 F.3d at 1207.
47 Id. at 1206.
48 Id. at 1205.
49 15A Fletcher Cyc. Corp. § 7396 (2010).
H. **ABCs v. Bankruptcy Code**

There are many differences between a dissolution conducted via an ABC and a dissolution conducted via a chapter 7 proceeding. ABCs are much less expensive than a chapter 7 filing, and they can therefore potentially allow for a comparatively larger payout to creditors. In addition, in a situation wherein assets are being sold off, an ABC can provide for a faster closing on a sale than a 363 sale would.

On the other hand, the expense of a bankruptcy proceeding is tied to certain bankruptcy benefits that an ABC simply cannot provide. A bankruptcy, for example, offers greater transparency. Also, an ABC does not permit creditors to investigate the honesty of the debtor’s financial statements the way a bankruptcy would.52

Moreover, because ABCs are used infrequently, the ABC lacks the institutional formality and widespread familiarity of a formal bankruptcy proceeding. Consequently, in states where ABCs require court supervision, court clerks and other judicial support staff may be unfamiliar with the documents involved and the procedures for docketing those documents. Filing properly may require extensive coordination with the clerk’s offices. Additionally, the judges themselves may not be familiar with ABCs or the process involved in an ABC proceeding.

A restructuring professional attempting an ABC would likely have to spend time not only making sure that the court proceedings went smoothly, but also would need to monitor the parties involved. An ABC does not provide for any sort of equivalent to a U.S. Trustee. It therefore may fall to the lawyers to oversee the proceedings and ensure compliance with fiduciary duties on the part of all of the parties involved.

In many states, an ABC does not give rise to an automatic stay, although an assignee can often block judgment creditors from attaching assets due to the fact that the assignee holds the property of the debtor in trust for the creditors and not for its own account.53 However, the lack of automatic stay leaves the debtor open to any judgments from lawsuits that were pending at the time of the ABC.54

Other differences between an ABC and bankruptcy include:

- ABCs do not have the capacity for handling complexity. They are a simple procedure. Bankruptcy proceedings provide a more “effective and efficient means of liquidating a complicated estate involving disputed claims.”55 As mentioned earlier, they may not be suitable for certain types of creditors.

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52 Fletcher, pg. 72.


54 Luo, 24 BNK. DEV. J. at 524.

55 15A Fletcher Cyc. Corp. § 7382 (2010).
• ABC statutes generally do not have a provision similar to Section 503(b)(9) of the Bankruptcy Code, so there is generally no analogy to the administrative claim priority given to vendors who sold goods to the debtor during the 20 days prior to a bankruptcy.  

• An ABC typically requires that an officer of the company has to “stay on board” to ensure the ABC is properly executed and carried through.

• In an ABC, there is generally no cap imposed on claims for certain liabilities, such as damages stemming from the rejection of a real property lease and certain severance obligations.

• A potential buyer of assets may not be as comfortable purchasing assets from the assignee as they might be purchasing assets via a sale consummated under Section 363 of the Bankruptcy Code.

• Creditors who are unsatisfied with the ABC may be able to challenge the transaction as a fraudulent conveyance and could try to force the buyer to pay more or to unwind the deal.

Finally, one further point to consider in deciding between a bankruptcy proceeding and an ABC: in many instances, a debtor can be pushed into an involuntary chapter 7 proceeding after an ABC is commenced. It is possible that the bankruptcy court could exercise its right to abstention at that point and force the creditors to continue with the state proceeding. However, it is also possible that the debtor could wind up in an involuntary chapter 7.

In conclusion, while an assignment for the benefit of creditors can only be effectively used in more limited circumstances and is less powerful than federal bankruptcy law, it can provide a more expeditious and less expensive alternative to bankruptcy. Despite their limitations, ABCs are being used with increasing frequency, and it behooves professionals dealing with insolvency matters to familiarize themselves with the option.

III. COMPOSITIONS

A. Introduction: What is a Composition?

A “composition,” also known as the “common-law composition of creditors,” is an out-of-court contractual arrangement between a debtor and its creditors whereby creditors agree to the discharge of their respective claims against a debtor upon more favorable terms than those that

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57 Id.

58 Id.

59 Luo, 24 BNK. DEV. J. at 524.
originally governed the claims. Compositions are most often entered into between a debtor and unsecured trade creditors. The agreement is not, however, dissimilar to the types of restructuring agreements commonly used to modify the terms of a secured creditor’s indebtedness.

Compositions provided the inspiration for Chapter XI of the Bankruptcy Act of 1898, which was modeled after common law compositions. Chapter XI of the Bankruptcy Act eventually led us to the modern day Chapter 11 of the Bankruptcy Code of 1978, as amended, and proceedings under the Bankruptcy Code have certainly been more widely-used and well-known than compositions. However, out-of-court common law compositions remain available and are a viable restructuring alternative, especially for smaller debtors. While compositions are typically used in situations where the debtor’s obligations are primarily unsecured trade debt, there is no reason a composition cannot involve other creditors such as landlords and equipment lessors, or be used in conjunction with the restructuring of secured debt held by institutional lenders.

Compositions are generally inexpensive. It avoids the expensive requirements of trustees, committees, and their professional representatives which, with other costs of administration, push junior interests “under water” and potentially diminish prospects for a successful reorganization. Should all of a debtor’s creditors come to agreement, a composition can also provide for a discharge of the debtor’s obligations in their entirety. In addition, commentators have noted the composition “is sensible in that it avoids litigation and places the debtor's financial problems in the hands of those equipped by resources and training to make the needed business judgments.”

Notably, to be successful, compositions require the “near universal agreement of business’s creditors” and require “good faith, conciliation and candor.”

A composition arrangement typically involves an effort to reorganize a debtor’s capital structure through the reduction in debt, but it could involve other cost-cutting and capital raising tools often associated with a reorganization, including reducing leased space, selling assets or obtaining new financing.

Because a composition is wholly contractual and voluntary, the more complicated the arrangement is the less likely the debtor or a group of unsecured creditors can obtain the agreement of the requisite number of creditors to the arrangement. The requisite number is usually stated as a percentage, which is often 90% of the creditor’s holding claims subject to compromise. The requisite percentage in any given situation is determined by the scope of debt relief needed to provide effective relief to the debtor.

60 7 J. WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER THE SEC. ACT OF 1933 § 3:26, n.3 (2009).


62 1 BANKR. DESK GUIDE § 1:35 (2009).

63 10 Norton, Supra, Note 53.

64 Bankr. Desk Guide, Supra, Note 54.
B. **What Type of Debtor Can Make a Composition?**

Since compositions are contractual in nature, they can be used for any type of debtor, including individuals, partnerships, limited liability companies and corporations. In practice, compositions are more likely to be implemented by entities whose creditors (a) are limited in number, (b) know the entity and its principals, (c) have a certain level of trust, and (d) have a vested interest in seeing the entity survive as a continuing customer.

One possible reason for the decline in use of compositions during the last two decades is the vast increase in the size of the market for distressed debt. As it became easier for creditors to sell distressed debt, debtors generally became more estranged from their creditors.

A composition is more likely to succeed if it is explored early in the distressed situation, when no particular creditor’s collection efforts have advanced far enough to give it an advantage over other creditors in the race to judgment or judgment enforcement (or where creditors have sold their positions). Obviously, the debtor’s business would be paralyzed if its bank accounts were restrained or other assets were seized by an aggressive creditor.

Credibility, trust and commitment of management are also keys to a successful composition arrangement. Chances of success are increased if the debtor retains reputable and competent restructuring professionals.

The viability of the debtor’s operations after the implementation of a composition is also critical. Like any reorganization, in court or out, if there is no core business that can become and remain cash flow positive, there is nothing to reorganize.

Compositions will not work if the tools available in a bankruptcy proceeding are required or deemed desirable by creditors. Examples of such tools include the automatic stay (to stop a judgment creditor from seizing assets), rejection of executory contracts with limitations on resulting damage claims, use of cash collateral upon a showing of adequate protection, avoidance actions and the ability to sell assets free and clear of liens.

If these statutory and court-enforced tools are not required, however, a composition may serve as an effective low-cost alternative to a chapter 11 proceeding.

Conversely, there may be situations in which bankruptcy is not only unnecessary, but cannot be used to restructure an entity’s debts. An out-of-court restructuring, pursuant to a composition agreement, may present a better alternative. For example, certain types of transactions, such as derivative contracts, are not always subject to the Bankruptcy Code’s automatic stay and may be terminated at the non-debtor counterparty’s option. In transactions where a significant portion of the value is contained within derivative contracts, such as mortgage securitization pools or power or other commodity traders, a bankruptcy filing could be unavailing—or even chaotic. Similarly, a bankruptcy court can not effect relief as against non-debtors—for example the release of guarantees—which may be essential for an overall restructuring. In circumstances such as these, because consent of certain key constituencies is needed, a bankruptcy can not be used to force a result and contractual composition may represent the superior approach.
In sum, in situations where a composition might work and be beneficial for a debtor and its creditors, the keys to success include:

- an early dialogue between debtor and creditors;
- involvement of nearly all creditors in the workout discussions;
- a means of regular communications with creditors;
- formation of a committee of creditors to negotiate with the debtor and make recommendations to the creditor body; and
- retention of competent professionals, both for the debtor and the creditors’ committee.

C. **The Composition Agreement**

The composition agreement, like any contract, should contain the appropriate terms and conditions for the particular situation, and is limited primarily by the creativity of the parties and their professionals. One debtor may be able to pay its creditors in full (often called an extension agreement), but just needs time. Another debtor may need its creditors to take a “haircut” (often called a compromise settlement). Composition agreements can include options for creditors to cash out early by selling their claims to investors. Such agreements may also contemplate convenience classes as such classes are used in bankruptcy plans, which can reduce the number of creditors who have to sign the agreement (analogous to the manner in which Section 1122 of the Bankruptcy Code provides for the designation of separate classes of similar claims, or separate classes of unsecured claims so small that it is necessary and reasonable to group them together for the sake of administrative convenience).

A relatively simple composition agreement might contain some or all of the following provisions:

- recitals regarding the debtor’s financial woes and the background on how the agreement was reached;
- an extension on the due dates of payments or the permanent reduction of debt;
- an acceptance condition tied to a percentage of creditors signing on to the agreement;
- an escrow agent to receive and distribute payments from the debtor (the creditors’ committee counsel often fills this role);
- a provision for dealing with disputed claims (usually distributions for such creditors are set aside until the matter is resolved in litigation, arbitration, mediation or negotiations between the parties);
- agreement of creditors not to file a bankruptcy petition absent specified defaults under the agreement;
• designation of a creditors’ committee, with limitations on liability and granting of certain discretionary powers (such as to file a petition based on certain subjective criteria, like a material change in the debtor’s financial condition or discovery of facts indicating fraud) and the right to direct the actions of committee counsel;

• covenants, including as to asset transfers and sales, salaries of officers, incurrence of debt, financial reporting, etc.;

• default provisions, including payment and covenant defaults, a bankruptcy filing, failure to pay taxes, etc.;

• remedies upon default, including creditor release from the constraints of the agreement;

• a clawback provision that allows the creditors to assert their full claims upon a default or in a bankruptcy;

• subordination of insider loans; and

• typical provisions regarding choice of law, venue, integration, counterparts, etc.

The agreement will typically include as an exhibit a consent form for creditors to agree to be bound by the agreement, often serving also as a “proof of claim” form.

The composition agreement will often be achieved by the committee’s solicitation, through a letter similar to those sent by official creditors’ committees in support of bankruptcy plans. The solicitation letter is often short, enclosing the agreement and providing a very brief (one or two paragraphs) summary of the gist of the agreement, together with a recommendation and brief explanation as to why the agreement is better than the alternatives, such as the fact that the secured creditor would likely get all the assets in a liquidation.

Finally, it should be noted that a composition agreement can be used in conjunction with the aforementioned assignment for the benefit of creditors. A composition agreement is typically used in an instance where the debtor plans on restructuring with a goal towards continued existence, whereas an assignment for the benefit of creditors is typically used in a situation where liquidation of the debtor is the goal. However, unlike composition agreements, assignments for the benefit of creditors do not provide a debtor with a discharge of their debts. Theoretically, a composition agreement could be entered into between a debtor and its creditors to provide a discharge to the debtor. Thereafter, an assignment for the benefit of those creditors could be undertaken, allowing the logistics of an orderly dissolution to be handled by a third-party assignee as opposed to the debtor. Essentially, the combination of an assignment for the benefit of creditors combined with a composition agreement could provide for the discharge of debts in an out-of-court liquidation scenario.

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D.  **Sample Agreements**

A sample composition agreement may be found attached to the following article: Thomas Lindahl, Alternatives to Bankr.: A Primer on Composition Agreements, 28.3 MICH. BUS. L.J. 43 (2008), available online at: http://www.michbar.org/business/BLJ/Fall%202008/lindahl.pdf

IV.  **RECEIVERSHIP**

A.  **Introduction: What is a Receivership?**

In general, a receiver is a disinterested person appointed to collect and protect property that is the subject of diverse claims (for example, because it belongs to an insolvent entity or is otherwise subject to litigation). A receiver’s powers and responsibilities are proscribed by the documents that underlie his appointment. Such appointment can be made by a court order, regulatory department action, or private agreement. Though a receiver’s powers may vary, as discussed below, a receiver is generally empowered to make major decisions and acts as a custodian of the company’s property, including its funds.

Receiverships are usually appointed after an entity fails to pay debts as they come due, or fails to meet legal obligations. Receivers typically are appointed to liquidate or wind up the affairs of an entity, but appointment of a receiver alone does not technically effect a dissolution of an entity. A receiver may be empowered to continue to operate the business as a going concern. Notably, the appointment of a receiver is generally seen as a drastic remedy, and commentators have counseled that receivers should only be appointed where insolvency is shown and it appears that there is danger that the assets will be misappropriated or wasted.

One of the primary distinctions between a receivership and a bankruptcy proceeding is the party that usually seeks to implement such a restructuring approach. Receivers are not appointed in the interest of the corporation. Rather, they are appointed in the interests of the creditors or stockholders, and only a creditor or stockholder may ask a court to appoint a receiver. A receiver is a fiduciary to all creditors of the controlled entity—not just the entity that sought its appointment. While there is “no objection to a board of directors, with the approval of a majority of the stockholders, procuring a bona fide creditor to sue for a receiver, where they act

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67  See In re Di Bona, 357 N.Y.S. 2d 71, 71 (1st Dep’t 1974).
70  15A Fletcher Cyc. Corp. § 7687 (2010).
in good faith,” the nature of a receivership makes it virtually impossible to implement without the knowledge of creditors.

Simply put, receivership is an option that may be difficult for a company to implement voluntarily, and if it is available, is more likely to function as an alternative to a Chapter 7 liquidation rather than a Chapter 11 reorganization.

B. Types of Receiverships

There are numerous types of receiverships—many of which will not be discussed in this article. This article will focus on consent receiverships and equity receiverships.

The first type of receivership discussed is a “consent” or “friendly” receivership. A friendly receiver is one appointed at the request of friendly creditors and the corporation joins in the prayer for relief. The purpose of such a receivership is generally “to hold off the more urgent and burdensome creditors and give the corporation, its major creditors, and stockholders a chance to work out a way to reorganize or rehabilitate the company.” Friendly receiverships have been condemned by courts, based on the premise that “a receiver is an officer of the court, and should be as free from ‘friendliness’ to a party as should the court itself.” In spite of such concerns, consent receiverships are still employed.

The second type of receivership discussed is an “equitable” receivership, in which a receiver is appointed by a court through the exercise of its equitable power, usually upon request by a party to a litigation. Such a receiver’s power is defined and limited by the court’s order. Frequently, there is no defined test under applicable state law for the appointment of a receiver; rather the court refers to the facts and circumstances of the instant situation to determine whether a receivership appointment would be equitable. The appointment of an equitable receiver is reviewed using an abuse of discretion standard.

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71 15A Fletcher Cyc. Corp. § 7694 (2010).

72 The following receiverships will not be explored in this article: (1) federal regulatory receiverships—receivers appointed in government enforcement actions, such as fraud cases brought by the Securities Exchange Commission; and (2) statutory receiverships—most states have statutes conferring authority to place companies in receivership, either generally, or in specific situations other than for dissolution. These types of receiverships may also be industry specific, e.g., insurance companies or health care providers. Additionally, a receiver may be appointed based on a contract. Typically, a security agreement may provide for the ability to appoint a receiver in certain circumstances. These types of receiverships are more common in Europe and Canada. These “contractual” receivers typically only have authority over property that constitutes collateral, so the scope of security interest is very important.

73 15A Fletcher Cyc. Corp. § 7666 (2010).


Federal courts employ a test similar to that used in preliminary injunction inquiries to determine whether a receiver should be appointed. Such a test counsels that the following factors should be weighed: the existence of a valid claim by the movant; fraudulent conduct on the part of the defendant; imminent danger that property would be lost, concealed, injured, diminished in value, or squandered; inadequacy of other remedies; balance of harms; plaintiff’s probable success in the underlying action; and possibility of irreparable injury to plaintiff’s interest in property. If a secured party is properly pursuing its claim in federal court, the court has ancillary jurisdiction to appoint a receiver. Furthermore, a district court may appoint a receiver, even for property located outside its geographical jurisdiction, although minimum contacts are still required for the district court to exercise jurisdiction.\textsuperscript{76}

C. **General Responsibilities of a Receiver**

A receiver is an officer of the appointing court. A receiver has those powers conferred by statute, if any, including those reasonably or necessarily implied from such statute, those expressly conferred by the court’s appointment order, and those reasonably or necessarily implied from such order.

Typically, a receiver will be tasked with identifying the assets and liabilities of the entity, taking possession of assets and property, marshaling assets, and sometimes serving as management of a debtor’s business. Generally, the receiver will be required by an appointing order to issue regular reports as to the state of the assets. Because receivers may exercise great control over a company’s entire operations, receivers typically must post a bond.

A receiver is generally compensated from the property over which he acts as receiver. Compensation structure varies and can be based on an hourly rate, a flat monthly fee, or percentage of funds managed or distributed. A receiver is typically given discretion to retain and compensate employees and professionals from estate assets to assist in his duties.

D. **Key Attributes of a Receivership**

There are key aspects to a receivership that are similar to the powers of a debtor and benefits inherent in a Bankruptcy Code proceeding.

- First, all defendants and their assets, including affiliated entities, may be dealt with in a single action in a single location, and the receiver may bring suit in the receivership court against anyone, anywhere. This feature of receiverships is similar to “related to” jurisdiction of a bankruptcy court; however, the receivership court’s power does have jurisdictional limitations.

- Summary procedures may be utilized in resolving various claims, both against and on behalf of the receivership entities, so long as basic principles of due process are honored. This is similar to the procedure of filing proofs of claim in a bankruptcy court in order to determine creditors’ claims in that it provides an efficient method for resolving claims against the debtor.

\textsuperscript{76} 28 U.S.C. § 754.
• The court appointing a receiver may enjoin actions against the receivership estate to assist in the efficient administration of the receivership estate (similar to an automatic stay). The injunction is not, however, automatic, as is the case for the stay under the Bankruptcy Code.

• Whereas a receiver usually sells the entity’s property subject to all existing liens, encumbrances, and obligations, a court does have the power to order the sale of property free and clear if the need is apparent and the proceeds of the sale will be sufficient to pay lien claimants. In a receivership, this process may require joining all secured creditors to the proceeding.

• Similar to sales under Section 363 of the Bankruptcy Code, both public sales and private sales are authorized in federal receiverships.77 While a bankruptcy court has broad discretion in determining whether a private sale is appropriate, a federal court presiding over a receivership action must appoint three disinterested appraisers, and may not approve a sale that is less than 75% of the appraised value. Further, the court may not approve a private sale if there is a competing offer that is at least 10% greater.78 These requirements are dispensed with only in rare circumstances.79

• The receivership court is not bound to follow the priorities among claims set out in the Bankruptcy Code, nor in the particular state insolvency laws, though courts may look to those priority rules for guidance. Priority rules may, however, be created by statute, by an agreement among the interested parties, or by common law. Also, as compared to a bankruptcy proceeding, an equitable receiver may have much greater flexibility in developing distribution plans, particularly in SEC proceedings when disgorgement has been ordered. A court need only find the receiver’s plan in such circumstances to be rational.

• Similar to the avoidance powers provided for in Chapter 5 of the Bankruptcy Code, a receiver may sue on behalf of an entity to recover assets that were involved in fraudulent transactions. The receiver may sue even if the entity participated in a fraud, so long as the entity is no longer under the control of the individual(s) who perpetrated the fraud.

79 See Tanzer v. Huffins, 412 F.2d 221 (3d Cir. 1969) (upholding an expedited sale of corporate property because of extraordinary circumstances and dire financial condition of the corporation).
E. Termination of Receivership

While receiverships are frequently portrayed as inevitably leading to liquidation, receiverships can have a rehabilitative aspect. Going concerns do emerge from receivership. Both Universal Studios and the Long Island Rail Road were in receivership for extended periods of time, for instance. Receivership can also be a bridge to a bankruptcy proceeding.\footnote{See Gilchrist v. General Electric Capital Corp., 262 F.3d 295 (4th Cir. 2001) (despite a district court receivership order directing no action against debtor assets, fifty creditors filed an involuntary bankruptcy petition against the debtor. The district court’s attempt to hold the creditors in contempt was unsuccessful, as the commencement of the bankruptcy case granted exclusive jurisdiction over the property of the estate, and the automatic stay prevented continuance of the receivership proceeding).}

Accordingly, though a receivership may not allow a company to employ all of the tools of a bankruptcy filing, and can be difficult to implement without a “friendly” creditor, it can be seen as one restructuring tool in a multi-pronged approach. For creditors, it may allow them to usurp unfriendly (or worse, destructive) management until a restructuring plan can be formulated and sold to all creditors. For debtors, they can potentially take advantage of a “friendly” receivership to stem certain creditor action without incurring the cost and time of a bankruptcy, as well as the requirements of prompt plan formulation.

VI. Conclusion

As examined above, alternatives to a bankruptcy procedure are available to, and should be considered by, restructuring professionals when facing a distressed business. These supplementary approaches include UCC Foreclosure, Assignment for the Benefit of Creditors, Composition and Receivership. While each of these options contain their own disadvantages, they serve as unique tools in an arsenal of restructuring options.

In general, UCC Foreclosures provide secured creditors with a state law remedy to take control of or sell the collateral securing their debt. Although similar to a 363 sale, a restructuring lawyer may prefer foreclosure because of its expediency and lower costs. Foreclosure, however, lacks the predictability and certainty of a bankruptcy proceeding since it is generally not accompanied by a court order approving the sale. This absence creates the risk of future litigation and second-guessing, but such risks may not always be material to certain debtors, creditors or buyers. A UCC Foreclosure might therefore be an appropriate solution when debtors recognize that the prospects for a reorganization are dim and that their assets must be sold, where the universe of secured claims against the subject assets are known and simple and where a court order selling the assets free and clear is not needed by prospective buyers.

Another alternative procedure is an ABC, which is comparable to a bankruptcy liquidation process. An ABC entails a transfer of all of the debtor’s assets to an assignee, who in turn, liquidates the assets and distributes the proceeds to the creditors. ABCs are less expensive than a chapter 7 bankruptcy proceeding, so they can provide potentially bigger returns for creditors. An ABC also offers a faster sale process than a 363 sale. Despite these advantages, however, the
ABC process is hampered by certain limitations, including the lack of transparency and the lack of widespread familiarity among practitioners and the courts with the process. In addition, an ABC is usually deemed a contractual default for which there is no protective automatic stay. For that and other reasons, ABC proceedings do not preclude an involuntary bankruptcy liquidation. Despite these limitations, ABCs are becoming a more frequently-used approach and provide another tool for restructuring lawyers.

A third option is a composition, which is an out-of-court contractual arrangement between a debtor and its creditors (usually unsecured) whereby the creditors agree to discharge their claims. Such an agreement will, among other things, allow a debtor to reduce its debt. Compositions are generally an efficient and inexpensive process and, when widespread creditor consent can be obtained, can provide for practically a complete resolution of the debtor’s obligations.

Finally, a receivership is also a procedure that can be implemented in place of a bankruptcy proceeding. A receiver is a person appointed, either by a court order, regulatory department action or private agreement, to liquidate or wind up the affairs of an entity or to continue the operations of a business to the benefit of the creditors. Some of the advantages of a receivership include the flexibility to usurp an unfriendly management until a restructuring plan is formulated as well as the ability to avoid the cost and time incurred during the bankruptcy process.

While a bankruptcy proceeding is a powerful and comprehensive mechanism, under certain circumstances, these four alternatives can provide a less complex and cheaper solution. Under other circumstances, however, these procedures are outweighed by the advantages provided by a formal bankruptcy process. At the very least, these alternatives serve as options that ought to be considered by a restructuring professional before commencing a bankruptcy proceeding.

November, 2010