

BANKRUPTCY

Exit Strategy Gets Right Back to Basics

By Toni Vranjes

Bankruptcy attorneys are busy practicing their ABCs. An out-of-court process known as assignment for the benefit of creditors, or ABC, has gained popularity as an alternative to formal bankruptcy proceedings. The process has become increasingly attractive since the stock market began its nose dive in early 2000, according to insolvency lawyers.

The approach has enticed financially troubled companies because it's considered a relatively quick, inexpensive and quiet way to liquidate assets. It isn't used for reorganization.

"It's a graceful exit strategy that allows for greater flexibility and quick action," bankruptcy partner David Kupetz of Sulmeyer, Kupetz, Baumann & Rothman in Los Angeles says. "And the company's managers and directors may be able to avoid some of the negative publicity that might accompany a bankruptcy."

In the assignment process, the struggling company transfers its assets to a third party, which liquidates the assets and distributes the proceeds to the company's creditors. The proceeds are paid to creditors in a manner similar to the way liquidation proceeds from a bankruptcy are paid.

Although the financially troubled company receives no money in return for its assets, it benefits by getting a neutral third party to administer the assets for the benefit of its creditors, says Los Angeles bankruptcy lawyer Karl Block.

"Hopefully it will benefit the creditor because less money will go to administrative costs, and hopefully there will be more money left over for creditors," says Block, a partner at Greenberg, Glusker, Fields, Claman, Machtinger & Kinsella.

The Third Party, which serves in a role analogous to a bankruptcy trustee, is often a business advisory or consulting firm. In some cases, it's an individual who has served as bankruptcy trustee. The third party often negotiates its fees upfront.

The Technique often is appealing to smaller, private companies.

"Most larger companies are looking to reorganize, and they're looking usually to survive in one form or another," Kupetz notes. "Most larger companies are not going to be considering an assignment."

Kupetz says assignment proceedings are advisable only if companies have assets of "material value."

If the company's assets are worth millions of dollars, the assignment process probably will make sense, he says. But if the assets are worth tens of thousands of dollars, it may not be worthwhile, Kupetz adds.

If it's a gray area, the company should consider several factors, such as the amount of debt and whether any potential buyers for the business have emerged.

Companies that decide to go the ABC route can tailor the process to meet their specific needs.

Some already have shut their doors and need to liquidate their equipment, intellectual property and other assets.

In some situations, a company will cease its operations when it transfers its assets to the third party.

Other times, a financially distressed company may transfer the assets to the third party, which will operate the business for a short period before selling it. The buyer then will operate the busi-

ness.

The dot-com collapse of the past few years has brought a noticeable increase in the use of ABCs.

"This was and continues to be used a lot in connection with technology companies that have basically hit the wall, and are going to do a 'going concern' sale or are going to liquidate," Kupetz explains.

Block also has noticed a dramatic upswing.

"In the early- and mid-1990's, you rarely saw one," he says.

Kupetz says the number of assignments handled by his firm started rising toward the end of 2000 and has remained steady since. Sulmeyer Kupetz has handled 40 of these matters in each of the past two years, compared to only a handful a year in the late 1990s.

The firm often represents third parties, including Los Angeles-based business advisory firm Sherwood Partners Inc., in these assignments. In some instances, it represents the financially distressed company or a creditor.

Similarly, Greenberg Glusker has represented clients, usually creditors or company shareholders, in 20 assignments in the past two years, compared to a handful during the 1990s.

Farther north in the San Francisco Bay area, John Fredericks of Murphy, Sheneman, Julian & Rogers also is busier.

In the late 1990s, the firm generally worked on two or three of these assignments a year. In each of the past two years, the firm has represented creditors or other parties in two dozen assignment proceedings.

It's a particularly attractive technique for tech companies, according to Fredericks.

"The value of their assets generally falls within the range in which bankruptcy is too expensive or not effective, and something less formal—such as just closing the doors—has too much risk or is inappropriate," he says.

But not only dot-coms choose this option.

"There are lots of companies that are not dot-coms that liquidate in ABC," Block emphasizes.

Regardless of the type of company involved, the assignment process has several advantages.

Speed is one factor. The assignment process typically takes nine months to one year to complete, while a Chapter 7 bankruptcy case often drags on for a couple years.

In addition, assignments generally are less expensive than bankruptcy proceedings, although lawyers say the savings will vary greatly depending on the company's specific circumstances.

Although the financially struggling company may pay a greater fee to its counsel in an assignment proceeding than in a Chapter 7 bankruptcy case, the overall expenses of the assignment process are likely to be less, according to Block.

"There are more constraints in bankruptcy, such as the requirement to get court orders for various matters," Block says.

In addition to increased efficiency and lower costs, the parties may avoid the uncertainty of working with a bankruptcy trustee.

"A Chapter 7 trustee is selected at random by the court and won't necessarily have any specific skills or expertise for dealing with a technology company," Fredericks says. "But in an ABC, you can try to pick an assignee who has special skills and is familiar with the specific type of assets and

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Through ABC's, "[a] company's managers and directors may be able to avoid some of the negative publicity that might accompany a bankruptcy," attorney David Kupetz says.

might be better suited to maximize value for the benefit of creditors.

Legal issues and concerns also play a role.

One incentive for doing an assignment is reducing potential liability for the company's officers and directors.

"Often they prefer doing an assignment, because they transfer responsibilities to someone who is a professional in conducting a liquidation," Fredericks says.

Through the process, directors also may be able to avoid Securities and Exchange Commission requirements that they disclose their involvement with companies that have filed for bankruptcy, Kupetz says.

There are potential risks, however.

For one thing, assignments lack the automatic stay on pending litigation that temporarily protects debtors in bankruptcy cases.

"It's a case-by-case basis," Block says. "If there's contentious litigation, it may be that an assignment is not appropriate."

In addition, an asset buyer in an assignment proceeding may have a greater risk of "successor liability claims," in which creditors try to enforce old debt against the new company.

Also, if a creditor is displeased with the way assignment process is proceeding, the creditor could try to throw the company into involuntary bankruptcy.

In terms of the future of the technique, the lawyers have differing views.

Kupetz believes the assignment process will continue to be used often in the tech area and also will become more common in other sectors.

But Fredericks foresees a drop in the number of assignments over the next two years.

"I expect to see a decline in the number of ABCs, attributable to the reduction in the number of remaining tech and other starting companies," he says.

"I think ABCs have become a permanent feature of the landscape and a commonly accepted alternative, but I think the number of companies that fit the profile for ABCs are diminishing."

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