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JUDGMENT CALL

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Easy as ABC

At its best, a general assignment can resolve creditor-debtor problems and offer the possibility of more funding for a company with lots of potential and little cash

by David Haberbush

Wouldn't it be nice if a venture capital firm could secure a second round of funding to bring a cash-strapped but potentially rich company to market divested of its debt baggage? If it could employ an instrument that could morph this company from an old-co to a new-co while still maintaining old company's full cash price and, if appropriate, its royalties and stock kickbacks?

Look no further. Venture capitalists, and others, can use a general assignment, a rarely used but perfectly legal vehicle that can transform an old-co into a new-co, that can mitigate unsavory and unprofitable financial circumstances and that can create a win-win opportunity for all parties concerned.

A general assignment—more often called an assignment for the benefit of creditors, or ABC—offers, in most states, an alternative to court-supervised processes for the resolution of debtor-creditor relationships by contractual agreement.

Here's how it works. Under a general assignment an entity transfers its assets to a third-party fiduciary. This third-party fiduciary receives the assets and then sells them piecemeal or by bulk (turnkey or going-concern) method, depending on what the assignee deems is in the best interest of the creditors.

The purpose of the general assignment is to provide an equitable process for the liquidation of an entity's assets, and the payment of the distribution of the proceeds to the creditors' allowed claims.

A general assignment is a contract between the entity and the assignee that provides for this process. A creditor may chose to participate in the process and thereby have the opportunity to receive distributions of money by filing a claim with the assignee.

If there is a secured creditor, the general assignment does not alter its contractual or other legal rights. Ordinarily, the secured creditor will base its decision whether to permit use/liquidation of its assets after the transfer on the risk of loss it believes will occur through the process. The benefits are entirely subject to negotiation since the secured creditor can exercise its rights to collect and liquidate its collateral at any time.

Usually the secured creditor and the prospective assignee will agree on how the secured debt will be satisfied or resolved through the process before the assignee accepts the general assignment.

The assignee may formally assume the secured debt of the entity entering into the assignment and confirm any existing security interests in exchange for the use of a secured creditors' collateral during the liquidation. Waivers and releases can be negotiated in favor of the secured creditor, provided the assignee does not breach its fiduciary duty.

Any buyer of assets from the assignee does so free and clear of the unsecured claims but not the secured claims. Therefore, the secured debt must be satisfied or assumed by the buyer upon a sale of any assets subject to a lien.

A general assignment requires no court oversight or involvement in most states. An assignee's decisions regarding the conduct of a general assignment are subject to the business judgment of the assignee. When the assets are subject to security interests, however, the manner, method and timing may be subject to negotiation with the secured creditor(s).

Since there is a transfer of all assets, the entity entering into the assignment is "judgment-proof" because it becomes an assetless corporate shell.

The general creditors cannot sue the assignee on contractual or other claims against the assignor because they have no relationship with the assignee on which to base them. Therefore, the general creditors are left with the alternative of filing a claim with the assignee or forgoing any distributions from the assets and pursuing other avenues of recovery, if any.

There is no specific time period within which a general assignment is wound up after all distributions to creditors. But the timing will depend on the nature of the assets and how long it takes to dispose of them.

The shortest period in which a general assignment can result in completing a distribution of all assets—once reduced to cash—is about seven months, which allows sufficient time during which creditors' claims can be filed with the assignee.

A general assignment's benefits often outstrip its liabilities. At its best a general assignment provides for a win-win resolution for creditors and debtors and the potential for a second round of funding for a company that quite conceivably has all the potential in the world.

All in all, then, a general assignment is a capital idea. ■

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