Study D-400 March 23, 1997

Memorandum 97-7

Assignment for Benefit of Creditors: Organization of Study

The Commission decided at the November 1996 meeting to study some insolvency issues, including "codifying the law governing assignments for the benefit of creditors, including expansion of the assignment concept to include reorganization." This memorandum gives a brief overview of the issues and considers how the study might be organized.

The following article and letters are attached as exhibits:

The letters in items 2-6 refer to Commissioner Wied's letter which was attached to the Third Supplement to Memorandum 96-58; for reference, the relevant portion of this letter is included here:

Two general issues have been presented: (1) whether the law relating to liquidation through general assignments for the benefit of creditors should be revised and (2) whether the GABC concept could advantageously be extended to permit some form of reorganization, particularly for smaller businesses that are not good candidates for Chapter 11 bankruptcy reorganizations.

(1) Revision of Law Concerning General Assignments

As the Commission knows, this area was the subject of a Commission study around 20 years ago. The project was not abandoned because the Commission (or Legislature) was convinced that the law could not be improved. Then as now, the

issue seems to invite early politicization. We hope to be able to avoid polarization, however, and work with all interested parties toward the best potential solution to the problems that are identified. It is premature to conclude that all legislation is inappropriate.

Viewed in the abstract, it is anomalous that such an important area of the law remains largely uncodified. There are scattered sections and sentences in the law providing special rules or exceptions to general rules (see, e.g., Civ. Code §§ 1954.1, 3439.07, 3440, Code Civ. Proc. §§ 493.010-493.060, 490.060, 1204-1204.5, 1800-1802; Com. Code §§ 6103(c)(6), 9301; Corp. Code § 15642; Rev. & Tax. Code §§ 6756, 18933, 26312; Unemp. Ins. Code §§ 1701-1702). On Commission recommendation, the old statutory scheme was repealed in 1980 as obsolete and unworkable, and the area was left to common law development. See 1980 Cal. Stat. ch. 135; *Recommendation Relating to Assignments for the Benefit of Creditors* , 15 Cal. L. Revision Comm'n Reports 1117 (1980); see also *Recommendation Relating to Attachment Law — Effect of Bankruptcy Proceedings; Effect of General Assignments for the Benefit of Creditors,* 14 Cal. L. Revision Comm'n Reports 61 (1978). While the Commission was in the process of considering a new codification of the GABC law at that time, as reported in the Third Supplement to Memorandum 96-58, the effort was abandoned due to strong opposition to "government regulation." There was substantial opposition to further study at that time and insufficient evidence of abuse. 15 Cal. L. Revision Comm'n Reports at 1121-22.

As evidenced by several of the attached letters, lack of a comprehensive statute is not seen as a defect by the GABC community (the lawyers and organizations who are in the business of handling general assignments) — in fact, it is cited as a virtue, providing flexibility and economy and efficiency. This is consistent with the approach when there was a statutory scheme; since it was not mandatory, the practice developed under the common law assignments.

Commissioner Wied circulated his letter to a number of companies who specialize in turnarounds, workouts, and general assignments. The letters listed in items 2-6 above were received in response. Geoffrey L. Berman, writing on behalf of the Credit Managers Association (see Exhibit pp. 9-11), notes that the "Association was against government regulation of general assignments then and remains opposed today." He notes that various statutory rules have been added over the years to deal with specific problems and generally concludes that "no clarification or codification of the law in this area is necessary."

Frederick Hamer, whose firm has been active in rehabilitative work, GABC, superior court receiverships, and bankruptcy, believes that "the statutes and case law currently in effect with respect to general assignments for the benefit of creditors are more than adequate to cover cases that are typical and which this office has handled. (Exhibit p. 7.) Mr. Hamer also notes: "There are a number of cases where an assignee may consider limited operation of a company to enhance assets such as the receivables, finish work-in-process and the like. As an assignee we do not believe that there is any impediment to such limited operation."

Benjamin S. Seigel, of Katz, Hoyt, Seigel & Kapor, concurs in the remarks of Mr. Berman and Mr. Hamer, and concludes that "to change the entire statutory scheme would, in my humble opinion be a major mistake." (Exhibit p. 12.) Mr. Seigel suggests that the issues raised in Commissioner Wied's letter and the responses received be referred to the Debtor/Creditor Relations and Bankruptcy Committee of the State Bar Business Law Section. (Exhibit pp. 12-13.) This is a good suggestion. The State Bar Committee should be receiving all of these materials in the regular course of our cooperative relationship with the State Bar and we anticipate that the Debtor/Creditor Committee will give us its input. We would also be happy to see a representative of the Committee at any Commission meeting we consider these issues, or any others of interest to the Committee.

David Gould, of McDermott, Will & Emery, joins in the comments of the other writers, and concludes: "I believe that the practice in California is far better than anywhere else in the country and my partners in other offices look with envy to the flexibility of a California common law assignment for the benefit of creditors." (Exhibit p. 14.)

If a conclusion were drawn solely from these letters, there would appear to be nothing to study, or that if there are a few problems that arise from time to time, they have been and will be fixed by the GABC community. This is strongly reminiscent of the situation faced by the Commission in the late 1970s. The staff is impressed, however, by the review of pitfalls and problems in existing law discussed in the article by Howard Kollitz and Scott McNutt, which is reproduced in Exhibit pp. 1-6. Several of the problems listed are the same complaints the Commission received over 20 years ago. (See, e.g., letter from Sandor T. Boxer, Coskey, Coskey & Boxer, Jan. 12, 1978, attached to Memorandum 79-8.)

Kollitz and McNutt conclude that existing law provides opportunities for abuse that need to be corrected. For example, they report: there are no meaningful limitations on who may be an assignee; the assignee may be judgment-proof; there are no qualifications to be an assignor; there are no limitations on compensation of the assignee; the assignee is not required to give notice of the distribution plan; the procedure for objecting to a claim in an assignment is unclear; assignments can be used to separate the assets of the debtor from the liabilities; assignments can be used to benefit secured creditors at the expense of general creditors; assignments can be used to benefit insiders. (Exhibit pp. 1-6 *passim*.) The authors list several proposals for reform (Exhibit p. 5):

> The current statutory scheme ought to be changed to curtail abuses permissible under the current laws. First, there should be statutory requirements concerning the financial condition of an Assignee, as a condition to its eligibility to serve as an Assignee. Such requirements could be satisfied by a combination of bonds and insurance covering not only acts of defalcation by the Assignee but, in addition errors or omissions by the Assignee.…
>
> Second, there should be statutory provisions requiring prior notice to creditors in connection with an Assignee's proposed disposition of property, including proposed disposition of causes of action.…
>
> Finally, an Assignee should be required to provide a written report to creditors concerning liabilities and assets consistent with the Assignee's duties as a fiduciary, including, the existence of any causes of action or claims against others, together with a statement of the Assignee's intentions with respect to the proposed disposition of such assets.…

Further study, consultation with knowledgeable practitioners and other interested persons, and a review of the literature on GABCs may point to other issues that should be considered.

(2) Use of General Assignments for Reorganizations

Commissioner Wied suggests the possibility of supplementing existing business reorganization procedures, whether informal or under Chapter 11, by bolstering the general assignment to permit the assignee to continue operation of the debtor's business at the debtor's expense, and providing other rules that would induce the interested parties "to accept and work within a private (i.e.,

state sanctioned) reorganization scheme" resulting in great savings in time and expense. (Exhibit pp. 17-18.)

Mr. Berman, of the Credit Managers Association, recognizes that Chapter 11 may not work for small businesses, and says that "an out of court workout has been, and remains, a valuable alternative." (Exhibit p. 10.) He concludes, however: "There is no need to attempt to revamp the general assignment law(s) to create a process that already exists and works without governmental oversight." Mr. Berman does not believe that assignees would want the authority to continue to operate a business where there would be any risk for losses generated in the assignee's operations. "If the business is viable, then the debtor should reorganize out of court or through a Chapter 11 and not through a general assignment."

Mr. Hamer also cites the liability problem as an impediment to using a GABC as a vehicle for rehabilitation. (Exhibit p. 7.) "This alone is a severe impediment to any knowledgeable assignee using the process as a rehabilitative mechanism."

A study of the reorganization proposal would have to consider these issues as part of the problem to be solved. We do not view Commissioner Wied's letter as a recommendation to empower assignees under GABCs to operate their own Chapter 11 proceedings, but rather to make certain changes in the law as appropriate to achieve a limited objective, taking into account the need to balance opportunity and risk.

Scope and Pace of Project

While the Commission has broad authority to study this area, in view of our past experience and the commentary received thus far, *the staff does not think that a major codification effort should be undertaken.* A number of specific issues are identified in Commissioner Wied's letter and in the Kollitz and McNutt article, and further research may identify other problems. The GABC community has recognized that problems arise, since they report on efforts to amend the statutes to deal with them and to coordinate GABC law with bankruptcy changes. To put some of the remarks concerning "government control" in proper context, it should be noted that without the special rules and exceptions (e.g., to bulk transfer rules, fraudulent transfer rules, attachment liens, etc.) provided in the existing statutes, common law assignments would not be very useful.

The staff suggests focusing on particular problems and working with the GABC community and others to come to an appropriate resolution. This would mean

supplementing the existing scattered statutes, rather than rewriting them or codifying the major case-law rules. The study should evaluate the seriousness of the potential for abuse and perhaps find actual cases of abuse that point to the need for a statutory remedy.

The law of general assignments is complex, and we do not have a well-developed statutory scheme as a starting point for improving the law. *The staff believes the Commission should contract with an expert academic consultant to prepare a background study and advise the Commission.* If this course is approved, we will investigate who would be willing to serve as a consultant.

The staff sees the question of expanding GABCs from a liquidation role to foster reorganization, subject to appropriate limitations, as a secondary study. We have not researched the issue beyond the letters attached to this memorandum, but in light of the negative reaction of two commentators, the staff suggests further investigation of the benefits and problems involved in this proposal. We would invite further commentary from interested persons and bar committees, and if a consultant is hired, we would seek the consultant's advice on the issue.

We are also informed that the American Bankruptcy Institute's Task Force on General Assignments is working on a model statute governing administration of general assignments. (See Exhibit p. 10.) We will follow this work, although it may be of limited value since the model statute is based on existing California law.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

Trust Them, This is an Assignment for the Benefit of Someone

By Howard Kollitz and Scott H. McNutt[1]

I. INTRODUCTION

There has been considerable interest recently in the use by California debtors of the business liquidation device known as an assignment for the benefit of creditors ("Assignment"), a device tracing its origins to English common law.[2] Recent articles and educational programs have stressed the benefits of Assignment.[3] Increased public awareness of this vehicle, combined with the anticipated proliferation of limited liability companies and limited liability partnerships, suggests that there will be a significant increase in the use of Assignments.

An Assignment is much like an out-of-court Chapter 7 bankruptcy liquidation, with one major distinction: in a Chapter 7, an independent trustee is selected by the Office of the United States Trustee to liquidate a debtor's assets; by contrast, in an Assignment, the debtor (the "Assignor") selects the liquidator (the "Assignee") pursuant to a contract. An Assignment can be a desirable and cost effective alternative to a Chapter 7 liquidation, as well as to other liquidation devices.[4] In many instances, a professional and ethical Assignee can liquidate an insolvent business, resolve claims and distribute assets quicker and cheaper than a Chapter 7 trustee. On the other hand, Assignments allow opportunities for abuse that Chapter 7 bankruptcy proceedings do not. Under Chapter 7, the bankruptcy Court and the Office of the United States Trustee actively supervise the conduct of cases, police for conflicts and assure notice to all interested parties. All this protection comes at a financial cost to the bankrupt estate, usually borne by unsecured creditors.

This article does not advocate that one form of liquidation is superior to another, as the best alternative will always turn on the specifics of the claims, the assets and the creditors. However, this article does point out the specific forms of abuse to which Assignments are susceptible. Finally, this article advocates certain changes in Assignment law that will curb some of the potential for abuse.

II. THE GENERAL THEORY BEHIND ASSIGNMENT AND THE PITFALLS

An Assignment creates a contract transferring all of the interests in property of the Assignor to an Assignee, who acts as a fiduciary responsible for liquidating these interests.[5] The consent of creditors to an Assignment is presumed.[6] The Assignment puts the property of the Assignor outside of the reach of unsecured creditors.[7] The Assignment vests in an Assignee all of the claims against others which belonged to the Assignor prior to the Assignment, certain claims against others which actually belonged to creditors of the Assignor before the Assignment, and certain claims against others which would not exist outside of an Assignment.[8]

There are no meaningful limitations on who may be an Assignee; this selection is entirely in the

Continued on page 8

1. Howard Kollitz is the principal of a professional corporation which is a partner in the law firm of Danning, Gill, Diamond & Kollitz, LLP, of Los Angeles, California. Mr. Kollitz is a member of the Debtor/Creditor Relations and Bankruptcy Committee of the Business Law Section. Scott H. McNutt is a member and shareholder in the law firm of Severson & Werson, A Professional Corporation, resident in its San Francisco office. Mr. McNutt is the Chair of the Debtor/Creditor Relations and Bankruptcy Committee.
2. Leslie R. Horowitz and John A. Lapinski, *An Alternative to Bankruptcy in the '90s: Assignment for the Benefit of Creditors*, 16 L.A. Law. 21, 22 (May 1993).
3. *See, e.g.*, Geoffrey L. Berman, *Common Law Assignments for the Benefit of Creditors: The Reemergence of the Non Bankruptcy Alternative*, 21 Cal. Bankr. J. No. 4 (1993).
4. In addition to a Chapter 7 liquidation proceeding ("Chapter 7") under Title 11 of the United States Code (the "Bankruptcy Code"), California corporations, partnerships, limited liability companies and limited liability partnerships may seek to liquidate under the supervision of a Superior Court of the State of California. *See*, Cal. Corp. C. §§1907, 15032, 17351. Such a Court supervised dissolution may be implemented by the Court's appointment of a Receiver to marshal and liquidate assets for the purpose of paying claims of creditors. *See*, Cal. Civ. Proc. C. §564(b)(5)(8).
5. *Creditors' Rights And Remedies*, §26, pp. 54-55, 16 Cal.Jur.3d (Rev) Part 2 (1995), and cases cited therein.
6. *Brainard v. Fitzgerald*, 3 Cal.3rd 157, 44 P.2d 336, 338-339 (1935).
7. *Brainard*, 44 P.2d at p. 339 (1935). *See also*, Cal. Civ. Proc. C. §493.030(a).
8. *See, Credit Managers Association of Southern California v. National Independent Business Alliance*, 162 Cal.App.3d 1166, 209 Cal.Rptr. 119, 121-122 (1984) (Assignee stands in the place of the Assignor with respect to claims of the Assignor against others); Cal. Civ. C. §3439.08(d) Assignee may assert rights of creditors to avoid fraudulent transfers of the Assignor's assets; Cal. Civ. C. §1954.1 (Assignee may prevent real property landlord of Assignor from repossessing property for up to 90 days regardless of provisions in the lease); Cal. Civ. Proc. C. §1800 (Assignee may recover "preferential" transfers to legitimate creditors made by the Assignor, notwithstanding §3432 of the Cal. Civ. C.).

Assignments... from page 7

discretion of the Assignor. The actions necessary to effect an Assignment are considerably less complicated and less time consuming than preparing for bankruptcy under Chapter 7 of the Bankruptcy Code. As a result, the Assignee frequently provides the form for the contract of Assignment and also assists the Assignor in gathering the information necessary to consummate the Assignment.

Similarly, there are no required qualifications to be an Assignor. Any individual, partnership, corporation, or other entity, which owns any property, not otherwise specifically prohibited by law or its own form of internal rules, which owes any money to anybody, has the right to make an Assignment.[9] The Assignor need not be insolvent in either the balance sheet sense (value of assets exceeding liabilities) or equity sense (unable to pay its debts as they mature).[10] It is the Assignor who determines whether an Assignment is appropriate. There is no form of "involuntary" assignment.[11]

Although the law provides that an individual Assignor may claim as exempt certain property, an individual is almost never a candidate to be an Assignor.[12] Unlike a case under the Bankruptcy Code, an Assignment cannot discharge liability to creditors for debts, beyond actual distributions on such debts received by such creditors.[13] The absence of the discharge concept in Assignments means that Assignments typically involve corporations or other forms of limited liability business vehicles.

In the typical assignment, the Assignor will cease to exist upon making the Assignment and often has no interest in its outcome. However, the Assignor not only makes the decision as to whether it is an appropriate candidate to liquidate through the Assignment device but, more importantly, the Assignor selects the individual or entity who will serve as the Assignee. Although creditors can be, and often are, consulted by the prospective Assignor concerning the selection, the Assignee cannot be selected absent the Assignor's consent.[14] This leads to the ironic result that the Assignor, the party least interested in the outcome of the Assignment, is solely responsible for the selection of the Assignee.

Existing law does not require the Assignee to be a financially responsible party. An Assignee need not even be an individual, meaning that an Assignee can avoid personal liability by creating an appropriate limited liability vehicle. An Assignee need not be solvent. An Assignee is not required to post any type of bond or other undertaking. There is no requirement that an Assignee have any experience relevant to the duties to be performed by an Assignee.

If the Assignment so provides, the Assignee can employ lawyers, accountants and other professionals, as well as insiders of the Assignor, without the approval of any court or other authority, who will be paid from the proceeds of the liquidation of the Assignor's assets before creditors receive any distribution. In this regard, there is no specific statutory procedure for scrutinizing the amount of compensation which an Assignee can pay to itself or to its professionals, employees or agents. The Assignor and Assignee can fix the amount of compensation of an Assignee in the contract of assignment. Only if, for whatever reason, the Assignee did not require that the contract of assignment fix the amount of compensation for the Assignee or the Assignee seeks compensation other than as provided for in the contract of assignment, must the Assignee involve the creditors, and possibly the Superior Court, in the decision making process on this issue.[15]

With respect to the administration of the assets transferred to the Assignee, except as to claims by or against the Assignee which require resolution through litigation, typically the Assignee never sees the inside of a courtroom in the discharge of its duties. By contrast, state and federal court receivers take control of a debtor's property only subject to the authority of the appointing court. Similarly, a bankruptcy trustee is closely supervised

Continued on page 21

9. Horowitz and Lapinski, *supra*, note 2 at 22.
10. *Sabichi v. Chase*, 108 Cal. 81, 41 P. 29, 30-31 (1895).
11. Witkin, Summary of California Law, *Contracts*, §924, pp. 824-825 (9th Ed. 1995), and cases cited therein.
12. Cal. Civ. Proc. C. §1801.
13. *Boteler v. Robinson*, 105 Cal.App. 611, 288 P. 135, 137 (1930).
14. *See, e.g., Bass v. Quittner, Stutman & Trister*, 381 F.2d 54, 56-57 (9th Cir. 1967).
15. General jurisdiction to determine the rights among parties to an Assignment for the benefit of creditors, including rights of creditors, reposes in the Superior Court. *Hempy v. Public Utilities Commission*, 56 C.2d 214, 14 Cal.Rptr. 436, 438 (1961). If requested to do so, the Superior Court may modify the compensation for the Assignee provided for in the contract of Assignment in the appropriate circumstances. *McDougal v. Fuller*, 148 Cal. 521, 83 P. 701, 704 (1906).

Assignments... from page 8

by the Bankruptcy Court. An Assignee is unsupervised by the court or by any other authority in the liquidation of assets or in the process of making distributions to creditors, absent a dispute with another party which results in someone initiating litigation.[16] In the context of an Assignment, there is no authority similar to that of the United States Trustees in Bankruptcy cases, who oversee and supervise the administrative activities of bankruptcy trustees.[17]

The unregulated and unsupervised Assignee is invested with an impressive array of powers. An Assignee, in certain circumstances specified by statute, can deprive creditors of the benefit and value of temporary protective orders, attachment liens, judgment liens, consensual security interests and collections on legitimate debts.[18] An Assignee can be subrogated to the rights of a creditor who has obtained a temporary protective order or attachment lien to defeat lien rights acquired by other creditors.[19] An Assignee can prevent a landlord of real property from repossessing its property after a default under the lease.[20] The Assignee, selected by the insiders in control of the Assignor, is given the right by statute to recover certain types of payments or transfers made to such insiders.[21]

Under existing California law, there is a statutory scheme which provides for priorities in the payment of claims of creditors subject to an Assignment.[22] Unlike a case under the Bankruptcy Code, if their security interests or liens are properly perfected, and not subject to avoidance by the Assignee, secured creditors should be unaffected by the Assignment absent an agreement of the secured creditor, such as an agreement to subordinate the security interest to the Assignee's expenses of administration.[23] There is no automatic stay in an Assignment which requires creditors to seek relief in court, as is the situation in cases under the Bankruptcy Code.[24]

In the recent past, the common law Assignment for the benefit of creditors device has been modified by statutes in order to make an Assignment more like a liquidation case under the Bankruptcy Code.[25] There have also been suggestions that existing law governing Assignments should be amended to limit the claims of real property landlords and the claims of employees under employment contracts, to make the distribution scheme to such creditors in Assignments more like the distribution scheme in a liquidation under the Bankruptcy Code.[26]

III. WEAKNESS IN THE STATUTORY SCHEME

A. There Are No Notice Requirements

Although reputable Assignees always do give notice to creditors, there are no laws which require Assignees to give notice or to consult with creditors of the Assignor in connection with any disposition of any or all of the Assignor's assets. Accordingly, due to the lack of notice requirements, there is a potential for abuse by disreputable Assignees.

Laws requiring notice and specific procedures with respect to the bulk transfer of property of a debtor do not apply to either the transfer of assets by the Assignor to the Assignee, or to any disposition of such assets by the Assignee, regardless of

Continued on page 22

16. It must be noted that, unlike an Assignee, a receiver must be an individual who does not have certain specified real or potential conflicts of interest, who is capable of taking a required oath, who can post a bond in an amount fixed by the court, and who must obtain authorization from the court appointing her or him before disposing of assets. *See*, Cal. Civ. Proc. C. §§566, 567, 568, 568.5.
17. Title 28, U.S.C. §586.
18. Cal. Civ. Proc. C. §§493.030(a) and 1800(a)(10),(b).
19. Cal. Civ. Proc. C. §490.060(a).
20. Cal. Civ. C. §1954.1.
21. Cal. Civ. Proc. C. §1800(a)(3) and (b).
22. *Creditors' Rights and Remedies*, 16 Cal.Jur.3d §§57-60, pp. 83-86 (Rev) Part 2 (3rd Ed. 1995), and statutory authorities cited therein.
23. 11 U.S.C. §506(c).
24. 11 U.S.C. §362(a).
25. Benjamin S. Siegel. *Assignments for the Benefit of Creditors: Pending Changes to California Law*, 20 Cal. Bankr. J. No. 3 (1992).
26. *See*, 11 U.S.C. §502(b)(6), (7). Existing law with respect to the ability of an Assignee to recover certain payments made by the Assignor to creditors holding legitimate claims, the ability of an individual who is an Assignor to exempt certain properties from an Assignment and the recognition of priorities among unsecured creditors of otherwise equal stature, as well as proposals that landlords' claims and employees' claims be "limited," all create interesting topics for entirely separate discussions. One might question whether California has enacted, or will be enacting, laws which set the stage for litigation involving the prohibition against states impairing the obligation of contract, as well as litigation involving the mandate to the effect that there be uniform laws on the subject of bankruptcies throughout the United States. *See*, U.S. Const., Art. I, §10 "No State shall ... pass any ... law impairing the obligation of Contracts."); *W.B. Worthen Co., et al. v. Thomas*, 292 U.S. 426, 54 S.Ct. 817, 817-819 (1934). Arkansas law which exempted insurance proceeds from claims of existing creditors violated Article I, § 10. *See, also*, U.S. Const., Art. I, §8, cl. 4 Congress shall have the power to, "... establish ... uniform laws on the subject of Bankruptcies throughout the United States."; *International Shoe Co. v. Pinkus*, 278 U.S. 261, 49 S. Ct. 108, 110 (1929). States may not pass or enforce laws to interfere with or complement the National Bankruptcy Act or to provide additional or auxiliary regulations; *In re Wisconsin Builders Supply Co.*, 239 F.2d 649, 652 (7th Cir. 1956), cert. den. 353 U.S. 985 (1957) Presence or absence of a discharge provision as not sole criterion of the invalidity or validity of state legislation in the insolvency field covered by federal law.

Assignments... from page 21

the value of such assets. Neither an Assignee nor a buyer of properties from an Assignee need give any prior, or any other, notice to the Assignor's creditors.[27] Furthermore, laws requiring notice and prescribing specific procedures with respect to how a secured creditor can dispose of the debtor's property, subject to its security interest, do not apply to an Assignee.[28]

Existing law does require that an Assignee give notice to creditors to advise them to file claims with the Assignee.[29] It should be noted that the filing of a claim with an Assignee may be deemed to constitute a waiver by the claimant of certain rights to object to various aspects of the particular Assignment.[30] Yet, the notice required by statute to be given by the Assignee to creditors, advising them of the deadline to file claims, is not required to advise creditors of the potential consequences of filing a claim with the Assignee.[31] There is neither a statutory designation as to whom may object to creditors' claims filed with the Assignee, nor a statutory procedure for the presentation of such objections. The procedure for objecting to a claim in an Assignment is unclear. It depends on either the Assignee, or perhaps others, filing a lawsuit in the Superior Court to disallow a claim or, in the much more likely alternative, a creditor filing a lawsuit in response to the Assignee disallowing a claim.[32]

B. The Assignee May be Judgment Proof

The Assignee is a fiduciary to creditors and, as such, is subject to liability for a breach of its duties.[33] The Assignee is also a fiduciary to the Assignor who selected it, subject to whatever provisions might be set forth in the Assignment agreement or instrument.[34] However, these fiduciary relationships are only meaningful if there is a financially responsible Assignee.

C. The Assignment Can Be Used to Perpetrate a Fraud

Potential Assignment abuses can be illustrated by three hypothetical situations:

1. ***Separating Assets of the Debtor from Liabilities of the Debtor.*** In this hypothetical, the principals of the corporate Assignor conclude that the business is no longer viable as a going concern, given its liabilities, but that there is a core business to salvage out of a liquidation. The core business could consist of a configuration of specific tangible assets linked with a customer list or it could simply involve a client base in the case of a service business. The principals of the debtor decide to liquidate the corporate debtor by making an Assignment for the benefit of creditors. The principals interview several prospective Assignees, negotiate the Assignee's compensation arrangement, effect the Assignment, and then purchase the specific, targeted assets of the corporate debtor from the Assignee, all without notice to unsecured creditors.

This situation does not, of course, always lead to abuse, but the opportunities are evident. Will the Assignee fight hard for the best price for assets from the same parties who hired the Assignee? Will competing bids be solicited when concerned creditors are unaware of what is happening?

2. ***Assignment for the Benefit of Secured Creditors.*** Difficult situations arise when the Assignor's principals have guaranteed certain claims. These situations are complicated when the guaranteed obligations are secured, as these creditors often wish to avoid all the hoops imposed by the UCC on the disposition of collateral. A second hypothetical situation might be the use of an Assignment to relieve a secured creditor from the expense and difficulty of foreclosing on its collateral. In this hypothetical, the principals of a corporate debtor, who have guaranteed the indebtedness owed by the debtor to the secured creditor, negotiate an agreement with the secured creditor to the effect that the debtor will agree to make an Assignment, the guarantees will be exonerated or reduced in amount, and the Assignee will sell the debtor's assets (the secured creditor's collateral) to a buyer which the Assignor (or persons in control of the Assignor) has located. In this situation, the Assignee pays over all of the proceeds of the liquidation to the secured creditor, less the fees and expenses of the Assignee, all without notice to unsecured creditors. Once again, will the Assignee be inclined to maximize values for unsecured creditors?

Continued on page 23

27. Cal. Comm. C. §6103(c)(6).
28. *See*, Cal. Comm. C. §9101, *et seq.*
29. Cal. Civ. Proc. C. §1802.
30. *Lacy v. Gunn*, 144 C. 511, 78 P. 30, 32 (1904).
31. Cal. Civ. Proc. C. §1802.
32. *Hemby*, 14 Cal.Rptr. at p. 438 (1961).
33. *Creditors' Rights And Remedies*, §§45 and 50, pp. 71-72, 78, 16 Cal.Jur.3d (Rev) Part 2 (3rd Ed. 1995), and cases cited therein.
34. *Creditors' Rights And Remedies*, §§55 and 56, pp. 82-83, 16 Cal.Jur.3d (Rev) Part 2 (3rd Ed. 1995), and cases cited therein.

Assignments... from page 22

3. ***Assignment for the Benefit of Principals.*** A third hypothetical situation is the use of an Assignment to resolve the potential liability of insiders of the debtor. Assume the principals of the corporate debtor have received substantial payments from the corporation that these principals must repay, for example, loans or other forms of authorized or unauthorized distributions. These same principals interview prospective Assignees, select an Assignee, negotiate the compensation of such Assignee, cause the debtor to make the Assignment, and then settle the claims of the Assignee against them for less than the full amount of liability, all without notice to unsecured creditors.

None of the foregoing hypothetical situations will always result in illegal conduct by the Assignee, the principals of the Assignor, or anybody else involved in the Assignment. However, the current statutory scheme is overly susceptible to abuse because the law creates opportunities for participants to engage in wrongful conduct to the detriment of the intended beneficiaries of the liquidation process.

IV. PROPOSALS FOR REFORM

The advocates of the status quo in the Assignment process suggest that secured creditors can certainly take care of themselves, and that unsecured creditors have adequate protections under existing law. For example, if unsecured creditors are dissatisfied with the Assignment they can file an involuntary petition for relief against the Assignor under the Bankruptcy Code, in an attempt to terminate the Assignment and cause a trustee in bankruptcy to be appointed, who would perform his or her duties under the supervision of the United States Trustee and the Bankruptcy Court.[35] Depending upon the circumstances, faced with an involuntary petition contested by the Assignee, the Bankruptcy Court might or might not exercise jurisdiction over the debtor.[36] The Bankruptcy Court might abstain from hearing the matter, and such decision is not reviewable by appeal or otherwise.[37] However, the ability to terminate an Assignment after the damage has been done and allow a trustee in bankruptcy to try to pick up the pieces is a questionable remedy and ignores the potential for abuse of the Assignment.

The advocates of the status quo might also suggest that the Assignee, Assignor, principals of the Assignor and others are all accountable to unsecured creditors for any wrongful conduct on their part which causes damage. However, again, the ability of creditors to seek recourse after the damage has been done is a questionable justification for ignoring the potential for abuses of the Assignment device under existing law.

The current statutory scheme ought to be changed to curtail abuses permissible under the current laws. First, there should be statutory requirements concerning the financial condition of an Assignee, as a condition to its eligibility to serve as an Assignee. Such requirements could be satisfied by a combination of bonds and insurance covering not only acts of defalcation by the Assignee but, in addition, errors or omissions by the Assignee. The bonding and insurance companies, motivated by their own self interest, will, in effect, then designate those parties who are ineligible to serve as Assignees.

Second, there should be statutory provisions requiring prior notice to creditors in connection with an Assignee's proposed disposition of property, including proposed disposition of causes of action. Assignees should not be required to, or allowed to, function under a system where the absence of notice is the rule and practice with respect to the disposition of assets. The greatest protection against abuse is the scrutiny of transactions by interested creditors.

Finally, an Assignee should be required to provide a written report to creditors concerning liabilities and assets consistent with the Assignee's duties as a fiduciary, including, the existence of any causes of action or claims against others, together with a statement of the Assignee's intentions with respect to the proposed disposition of such assets. Such a written report to creditors should be furnished within an appropriate time frame so as to allow creditors a meaningful opportunity to take action in response to such report. Adequate exceptions should be made in any such statute to deal with time sensitive matters which require the Assignee to act before such report can be prepared and served on creditors.

Continued on page 24

35. 11 U.S.C. §303.
36. 11 U.S.C. §§305(a), 543(d).
37. 11 U.S.C. §305(c).

Assignments... from page 23

V. CONCLUSION

Due in part to the potential abuse of the Assignment process, many states have prohibited common law Assignments for the benefit of creditors.[38] Yet, when properly used it can be a less time consuming and less costly method to effectuate payment to creditors than a bankruptcy. In order to preserve in California the ability to utilize the Assignment, as a desirable alternative to Court supervised proceedings, the California statutes governing Assignments should be amended to ensure that this device will be used properly for the benefit of the intended beneficiaries, the unsecured creditors, while preserving the Assignment as a cost effective and expeditious business liquidation vehicle. ■

38. Berman, *supra* note 3, at 359, n. 6.

The Hamer Group

11500 West Olympic Boulevard • Suite 605
Los Angeles, California 90064

Telephone: 310•477•4533
Facsimile: 310•477•9626

Law Revision Commission
RECEIVED
DEC 6 1996
File: D-400

December 4, 1996

Nathaniel Sterling, Esq.
Executive Secretary
California Law Revision Commission
400 Middlefield Road, Suite D2
Palo Alto, CA 94303-4739

RE: Colin Wied, Esq. Letter of November 6, 1996
regarding General Assignments for the Benefit of Creditors

Dear Mr. Sterling,

The undersigned has received a copy of certain correspondence regarding the above matter. This firm has been extremely active over the years in both rehabilitative work and general assignments for the benefit of creditors and Superior Court receiverships as well as being a disbursing agent for Bankruptcy Court cases.

We believe that the statutes and case law currently in effect with respect to general assignments for the benefit of creditors are more than adequate to cover cases that are typical and which this office has handled. There are a number of cases where an assignee may consider limited operation of a company to enhance assets such as the receivables, finish work-in-process and the like. As an assignee we do not believe that there is any impediment to such limited operation.

With respect to rehabilitation, our firm has handled many cases over the years with great success. The one problem that we see if an assignee were to use the general assignment as a vehicle for rehabilitation, is the liability that almost certainly would accrue to the assignee. This alone is a severe impediment to any knowledgeable assignee using the process as a rehabilitative mechanism.

In summary, we support the position that we understand Credit Managers Association of California has taken on this issue.

Very truly yours,

The HAMER GROUP

Frederick Hamer

F:\WP51\THG\Sterling

cc: Geoffrey L. Berman
John A. Lapinski, Esq.
Arthur Greenberg, Esq.
Colin Wied, Esq.
David Gould, Esq.
Benjamin S. Seigel, Esq.
Sheri Bluebond, Esq.
Whitney Rimel, Esq. Chair State Bar Debtor/Creditor Committee
Jeffrey Krause, Esq. State Bar Debtor/Creditor Committee
Howard Kollitz, Esq.
Joel Weinberg, Esq.

CREDIT MANAGERS ASSOCIATION of CALIFORNIA

40 E. VERDUGO AVENUE • BURBANK, CA 91502-1931
MAILING: P.O. BOX 7740 • BURBANK, CA 91510-7740
TELEPHONE (818) 972-5300

FAX NUMBERS:
ADJUSTMENT BUREAU (818) 972-5301 • COLLECTIONS/ACCOUNTING (818) 972-5302
CREDIT INFORMATION SERVICES (818) 972-5303 OR (818) 972-5305

December 9, 1996

Direct Dial No. (818) 972-5315

Law Revision Commission
RECEIVED

DEC 16 1996

File: D-400

Nathaniel Sterling, Esq.
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D1
Palo Alto, CA 94303-4739

Re: ***Colin Wied Letter of November 6, 1996 re General Assignments for the Benefit of Creditors***

Dear Mr. Sterling:

I received a copy of Mr. Wied's letter of November 6, 1996 and felt it important that you understand the concerns of this Association, which acts regularly as an assignee for the benefit of creditors, with certain ideas and comments in Mr. Wied's letter.

Mr. Wied states that statutory law is far from complete as it addresses general assignments and you correctly noted in your transmittal to the California Law Revision Commission members that the prior statutory scheme in California was repealed years ago. This Association was against government regulation of general assignments then and remains opposed today. California has however enacted a number of statutes governing the administration of general assignments since then, many of which were introduced with this Association's input and concurrence. Further, there are a number of cases that have been tried in the state courts over the years on issues that have arisen in general assignment cases and this Association has been a party to many of those matters.

I strongly disagree with Mr. Wied's suggestion that there is no statute that establishes the priority of payment for claims in a general assignment. Specifically, the priority of claims is addressed in the Code of Civil Procedure §1204, 1204.5, in the California Revenue and Taxation Code and by operation of federal law (31 U.S.C. §3713). This Association does not pay claims "hoping no one objects".

There is statutory support for an assignee having avoiding powers similar to a bankruptcy trustee. Specifically, an assignee has the rights of a lien creditor pursuant to Uniform Commercial Code § 9-301 and Code of Civil Procedure §1800 enables an assignee to recover preferential transfers in the same manner as a trustee (or debtor-in-possession) in a bankruptcy proceeding. No clarification or codification of the law in this area is necessary.

OFFICES IN: **San Leandro (510) 632-7500 • Las Vegas (702) 259-2622 • Sacramento (916) 686-1222**

Mr. Wied also suggests that general assignments might be used to effect a reorganization of a distressed debtor. I do not argue with the assertion that Chapter 11, as a process, does not generally work, especially for small businesses. This Association, in conjunction with the National Association of Credit Management, worked to effect the revisions in the Bankruptcy Code enacted as the Bankruptcy Reform Act of 1994. That Act included the Small Business provisions to Chapter 11 to enable small debtors a more streamlined approach to the reorganization process. For those debtors where reorganization through bankruptcy is not a viable alternative, an out of court workout has been, and remains, a valuable alternative. Again, this Association has been a leader in administering out of court work outs so that debtors can effectively reorganize without the costs and delays usually associated with bankruptcy proceedings. There is no need to attempt to revamp the general assignment law(s) to create a process that already exists and works without governmental oversight.

Mr. Wied's comments on page three of his letter regarding authority to continue a debtor's operations miss the point. General assignments are a liquidation alternative to Chapter 7. They are not generally a mechanism to operate a business (though in rare occasions an assignee may in fact operate a business to maximize values of inventory, work in progress, etc.). I do not know any assignee that will operate a business where the assignment estate, or the assignee, would be at risk for losses generated by the assignee's operations. If the business is viable, then the debtor should reorganize out of court or through a Chapter 11 and not through a general assignment.

Additionally, if you are not aware, the American Bankruptcy Institute has a task force working under the auspices of its Unsecured Trade Creditor Committee, which is in the process of preparing a Model Statute(s) on General Assignments, as well as a manual on assignments so that lawyers and credit professionals to become more educated on the process. The basis of the Model Statute is the California statutory scheme as it exists today. There is a consensus among the task force members that some level of protection for creditors needs to be in place. I am the Chairman of that task force.

You should also be aware that an effort was made last year to amend certain existing statutes to bring conformity to California law with the changes made in the Bankruptcy Reform Act of 1994 and other areas of concern to practitioners and professionals who use and act as assignees. That legislation was not enacted and is being prepared for reintroduction in the upcoming legislative year.

I hope that the California Law Revision Commission will fully review the state of California's existing statutory support for general assignments before it attempts to change the system in place.

Very truly yours,

By: Geoffrey L. Berman
Assistant Secretary and
Manager, Adjustment Bureau

\GLB:sl\CALRCML.D09

cc: Colin Wied, Esq.
David Gould, Esq.
Benjamin S. Seigel, Esq.
Sheri Bluebond, Esq.
Andrea T. Porter, Esq.
Whitney Rimel, Esq.
Jeffrey Krause, Esq.
John A. Lapinski, Esq.
Howard Kollitz, Esq.
Joel Weinberg, Esq.
Richard Kaufman, CAE, President, Credit Managers Association of California (i/o)
Anne Wray, Chairman, Credit Managers Association of California

LAW OFFICES
KATZ, HOYT, SEIGEL & KAPOR LLP
A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
11111 SANTA MONICA BOULEVARD
SUITE 820
LOS ANGELES, CALIFORNIA 90025-3342
TELEPHONE (310) 473-1300
FACSIMILE (310) 473-7138

BENJAMIN S. SEIGEL*
JEFFREY H. KAPOR
SCOTT H. JACOBS
ALAN J. COHEN
WILLIAM SCHOENHOLZ*
JACK R. LENACK
RUSSELL L. ALLYN
DOUGLAS M. LIPSTONE
MOIRA DOHERTY
MARLA MILNER
* A PROFESSIONAL CORPORATION

CHARLES J. KATZ (1905-1983)
LOUIS C. HOYT (1905-1994)

DINA TECIMER
OF COUNSEL

December 16, 1996

Law Revision Commission
RECEIVED
DEC 30 1996
File: D-400

Nathaniel Sterling, Esq.
Executive Secretary
California Law Review Commission
400 Middlefield Road
Suite D2
Palo Alto, CA 94303-4739

Re: Colin Wied Letter of November 6, 1996
Regarding General Assignments for the
Benefit of Creditors

Dear Mr. Sterling:

I join Geoffrey L. Berman, the assistant secretary and manager of the adjustment bureau of Credit Managers Association of California and Frederick Hamer of The Hamer Group in providing you with comments concerning Mr. Wied's letter of November 6, 1996 concerning the present state of the law in California with regard to general assignments for the benefit of creditors.

I have served on the Debtor/Creditor Relations and Bankruptcy Committee of the Business Law Section of the California State Bar and was Chair of the Assignment for Benefit of Creditors Sub-Committee. I was instrumental in the drafting of legislation in 1992 which added Section 1802 to the California Code of Civil Procedure and also amended other sections of the Code to confirm certain provisions of California law to the Bankruptcy Code with regard to preferences that could be recovered by an assignee for the benefit of creditors.

I have been closely associated with credit management in California as a credit manager and as an attorney since 1961.

I concur with the remarks made by Messrs. Berman and Hamer in their letters to you.

Because the State Bar has a very dedicated Debtor/Creditor Relations and Bankruptcy Committee in the business law section, I suggest that Mr. Wied's letter together with the

letters of commentary you have received, including this letter, be referred to that Committee for review and recommendation. The current statutory system in place in California regarding assignments for the benefit of creditors is working well. From time to time various modifications are necessary to keep pace with Federal Bankruptcy Laws. However, to change the entire statutory scheme would, in my humble opinion be a major mistake.

Very truly yours,

BENJAMIN S. SEIGEL

BSS/jn

cc: Geoffrey L. Berman
John A. Lapinksi, Esq.
Arthur Greenberg, Esq.
Colin Wied, Esq.
David Gould, Esq.
Sheri Bluebond, Esq.
Whitney Rimel, Esq.
Jeffrey Krause, Esq.
Howard Kollitz, Esq.
Joel Wienberg, Esq.
Fred Hamer, Esq.

\wpdata\Ben\Sterling.ltr

A Partnership Including Professional Corporations
2049 Century Park East
Los Angeles, CA 90067-3208
310-277-4110
Facsimile 310-277-4730

Boston
Chicago
Los Angeles
Miami
Newport Beach
New York
St. Petersburg (Russia)
Vilnius (Lithuania)
Washington, D.C.

Associated (Independent) Offices:
Barcelona London
Brussels Madrid
Lisbon Paris

McDERMOTT, WILL & EMERY

David Gould, P.C.
Attorney at Law
310-277-4110

Law Revision Commission
RECEIVED
DEC 26 1996
File: D-400

December 20, 1996

Nathanielson Sterling, Esq.
Executive Secretary
California Law Revision Commission
400 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: *Letter dated November 6, 1996 from Collin Wied re General Assignments for the Benefit of Creditors*

Dear Mr. Sterling:

I have been furnished with a copy of Ben Siegel's letter to you of December 16, 1996 concerning comments to Collin Wied's letter of November 6, 1996.

I have practiced in this field for 30 odd years and have served as the Chair of the Debtor-Creditor Relations in the Bankruptcy Committee of the Business Law Section of the State Bar, served as the President of the Financial Lawyers Conference and the Los Angeles Bankruptcy Forum. I consulted with Ben Siegel in the drafting the of the 1992 Legislation which added Section 1802 to the California Code of Civil Procedure and made other conforming amendments.

I too join in the comments made by Messrs. Katz, Berman and Hamer in their letters to you.

As part of a national firm, I have the advantage of seeing how the flexibility of a common law assignment for the benefit of creditors as is used in California compares to non-bankruptcy remedies in other states in which our firm has offices. I believe that the practice in California is far better than anywhere else in the country and my partners in other offices look with envy to the flexibility of a California common law assignment for the benefit of creditors.

In summary, I think the Commission should take heed of the folksy saying "if it ain't broke, don't fix it!".

Sincerely,

DAVID GOULD

DG:jr
cc: Benjamin S. Siegel, Esq.
Geoffrey L. Berman
John A. Lapinski, Esq.
Arthur Greenberg, Esq.
Colin Wied, Esq.
Sheri Bluebond, Esq.
Whitney Rimel, Esq.
Jeffrey Krause, Esq.
Howard Kollitz, Esq.
Joel Weinberg, Esq.
Fred Hamer, Esq.

LA\JAR\SHARED\WP\LETTERS\96\50CORDG.047

Law Revision Commission
RECEIVED
DEC 26 1996
File: D-450

LAW OFFICES
GREENBERG & BASS
A REGISTERED LIMITED LIABILITY PARTNERSHIP
16000 VENTURA BOULEVARD
SUITE 1000
ENCINO, CALIFORNIA 91436-2730

DAVID ADELMAN
ROBERT D. BASS*
WILLIAM E. CROCKETT*♦
JAMES R. FELTON◊
ANDREW GOODMAN**
ARTHUR A. GREENBERG*
HAROLD GUTENBERG
GARY K. SALOMONS*
BRUCE Z. WALKER*‡

*A PROFESSIONAL CORPORATION
◊ALSO ADMITTED IN ARIZONA
♦ALSO ADMITTED IN MISSOURI
*ALSO ADMITTED IN NEVADA
**ALSO ADMITTED IN NEW YORK
‡ALSO ADMITTED IN FLORIDA
‡ALSO ADMITTED IN GEORGIA

(818) 382-6200
(818) 986-5687
(213) 872-2655
FAX (818) 986-6534

RECYCLED PAPER

December 23, 1996

Nathaniel Sterling, Esq.
Executive Secretary
California Law Review Commission
400 Middlefield Road, Suite D2
Palo Alto, CA 94303-4739

Re: Colin Wied Letter of November 6, 1996
Regarding General Assignments for the
Benefit of Creditors

Dear Mr. Sterling:

I have read with interest the various correspondence with respect to Mr. Wied's letter.

As we trust you are aware, this office is substantially engaged in a debtor/creditor practice, with a primary emphasis on insolvency-related matters. We are regularly involved in general Assignments for the Benefit of Creditors, representing assignors, assignees, and creditors. We would respectfully request that you keep us advised with respect to any further activity regarding general Assignments for the Benefit of Creditors.

We thank you for your assistance and extend our best wishes for a prosperous New Year.

Very truly yours,

GREENBERG & BASS
A Registered Limited
Liability Partnership
Arthur A. Greenberg /mcd
By:
ARTHUR A. GREENBERG

AAG:met
cc: Colin Wied, Esq.
Geoffrey L. Berman

aag-6\WPDATA\STERLING.LT1

C.W. WIED PROFESSIONAL CORPORATION
501 WEST BROADWAY, SUITE 1780
SAN DIEGO, CA 92101

COLIN W. WIED
TELEPHONE: (619) 338-4030
FACSIMILE: (619) 338-4022

DIRECT DIAL NO.
(619) 338-4024

November 6, 1996

Law Revision Commission
RECEIVED
NOV 0 6 1996
File:

* * * * *

The second proposal would involve considerably more study, and would be of considerable interest to the insolvency community, including especially institutional lenders, reorganization attorneys and turnaround/workout specialists. My recommendation is two-pronged.

First, current law respecting General Assignments for the Benefit of Creditors (GABC) is ill defined. A GABC creates a trust, but there are no generally applicable statutory trust provisions. (Probate trust law is specifically inapplicable.) Statutory law is far from comprehensive, and case law adds little. For example, no statute sets out the priority of payment of claims. Assignees typically follow the priority set out in the Bankruptcy Code (11 U.S.C. Section 507), hoping no one objects. GABCs take place frequently, and are favored as a private, speedy and less costly business liquidation, as opposed to the more costly, time consuming and relatively ineffective Chapter 7 (11 U.S. Code) liquidation. They are handled, for the most part, by less than a half dozen companies in California. The assignee under a GABC is given some of a bankruptcy trustee's avoiding powers. It would be worthwhile to study whether interested parties would like a clarification and codification of GABC law.

Second, it would be worthwhile to study whether the GABC concept could be extended from simply liquidation (a Chapter 7 substitute) to reorganization (a Chapter 11 substitute). The entire insolvency community will acknowledge that Chapter 11 is not an adequate means of reorganization of small to medium large (i.e., non-public) businesses. It is too complicated, and it was made that way intentionally. Congress reasoned that if no party to a Chapter 11 had a clear shot, all parties would be compelled to negotiate. In practice, the reverse has happened. Bankruptcy litigation is a growth industry for lawyers, accountants and other professionals. The administrative cost of any Chapter 11, by itself, precludes successful reorganization of most companies. Chapter 11 success rate is abysmal - less than 10% of the cases result in confirmed plans, and only half of those fully perform the confirmed plan. Added to the low rate of plan confirmation is the enormous cost in money and time to creditors.

It is true that many companies that file Chapter 11 are "dead on arrival," and should never have filed Chapter 11. Of those that are viable, usually such a high level of mistrust exists between the debtor and its creditors that a reorganization plan cannot be negotiated before escalating administrative costs (i.e., attorneys' fees which must be paid in full before a plan can be

Cal. Gov. Code Sections 12,750 et. seq. The third reason is the obvious one: these companies are, in reality, governmental agencies. Current California law makes it difficult, if not impossible, for such companies to file under Chapter 9. The regulatory state agencies are simply unaware of the extent to which their interests may be impacted in a Chapter 11. If fully informed, they would probably conclude it to be in their interest to be able to authorize Chapter 9 filings by the agencies which they fund.

The second proposal would involve considerably more study, and would be of considerable interest to the insolvency community, including especially institutional lenders, reorganization attorneys and turnaround/workout specialists. My recommendation is two-pronged.

First, current law respecting General Assignments for the Benefit of Creditors (GABC) is ill defined. A GABC creates a trust, but there are no generally applicable statutory trust provisions. (Probate trust law is specifically inapplicable.) Statutory law is far from comprehensive, and case law adds little. For example, no statute sets out the priority of payment of claims. Assignees typically follow the priority set out in the Bankruptcy Code (11 U.S.C. Section 507), hoping no one objects. GABCs take place frequently, and are favored as a private, speedy and less costly business liquidation, as opposed to the more costly, time consuming and relatively ineffective Chapter 7 (11 U.S. Code) liquidation. They are handled, for the most part, by less than a half dozen companies in California. The assignee under a GABC is given some of a bankruptcy trustee's avoiding powers. It would be worthwhile to study whether interested parties would like a clarification and codification of GABC law.

Second, it would be worthwhile to study whether the GABC concept could be extended from simply liquidation (a Chapter 7 substitute) to reorganization (a Chapter 11 substitute). The entire insolvency community will acknowledge that Chapter 11 is not an adequate means of reorganization of small to medium large (i.e., non-public) businesses. It is too complicated, and it was made that way intentionally. Congress reasoned that if no party to a Chapter 11 had a clear shot, all parties would be compelled to negotiate. In practice, the reverse has happened. Bankruptcy litigation is a growth industry for lawyers, accountants and other professionals. The administrative cost of any Chapter 11, by itself, precludes successful reorganization of most companies. Chapter 11 success rate is abysmal - less than 10% of the cases result in confirmed plans, and only half of those fully perform the confirmed plan. Added to the low rate of plan confirmation is the enormous cost in money and time to creditors.

It is true that many companies that file Chapter 11 are "dead on arrival," and should never have filed Chapter 11. Of those that are viable, usually such a high level of mistrust exists between the debtor and its creditors that a reorganization plan cannot be negotiated before escalating administrative costs (i.e., attorneys' fees which must be paid in full before a plan can be

Essential to the idea of expanding the scope of the GABC is the creation of a recognized profession consisting of business turnaround/reorganization experts. Such professionals would be business people, not necessarily accountants or lawyers. These professionals now exist, although for a variety of reasons they are infrequently used in non-public cases. A means will have to be devised for qualifying and certifying those who would become assignees under the expanded GABC.

I will be providing copies of this letter to some highly qualified business turnaround/ workout companies for their comment, as well as to some California companies that regularly act as assignees under GABCs. If there is interest in the idea, perhaps the Commission would want to constitute an advisory group of consultants. I believe such a group could be formed at no cost, for it should be in the pecuniary interest of all groups to help advance this concept.

I look forward to discussing these undertakings with you and the Commission.

Very truly yours,

Colin W. Wied

CWW/slg

L:\CLRC\GABC1.LTR