

Is an Assignment for the Benefit of Creditors a Viable Option for a Debtor?

BY MARY K. WHITMER & JAMES W. EHRMAN

In the United States, a general assignment or an assignment for the benefit of creditors is simply a contract whereby the insolvent entity (Assignor) transfers legal and equitable title, as well as custody and control of its property, to a third party (Assignee) in trust, to apply the proceeds of sale to the assignor's creditors in accord with priorities established by law.¹ An ABC can be described as a state court bankruptcy. Ohio Rev. Code Chapter 1313 governs ABCs. In Ohio, an ABC is commenced when the trust document by which the assets are transferred from the Assignor to the Assignee is filed with the Probate Court which then oversees all subsequent proceedings.

Who was Loveman Steel Corporation?

Loveman Steel Corporation was founded in the mid-1930s by David and Darwin Loveman, father and son. The company began with offices in the Keithley Building and leased operations in Cleveland, selling steel plates, and cutting them to size. In 1948, Loveman built a facility in Bedford Heights. Darwin's sons Ralph and Jim came to work in the Company full time in the 1960s. The operations grew and eventually provided complete project management, design, and steel fabrication to many local and regional industries. In the early 1980s, the Company completed an addition to its Bedford facility. The fourth generation of Lovemans joined the Company in the 1990s.

In 2015, Loveman became one of the victims of China's economic slowdown that lowered the demand for steel globally and resulted in a world-wide flooding of the steel markets. While Loveman had managed to pay off its secured line of credit by the fall of 2015, it still owed mortgage debt on its real property and was struggling to pay its day-to-day bills. Creditors began collection lawsuits. Loveman began to look for a way to bring the business to an orderly close and pay as much as possible to all of its creditors.

Why an Assignment for the Benefit of Creditors?

Although bankruptcy is called a debtor's remedy, bankruptcies have become prohibitively expensive for small corporate debtors. The vast amount of required disclosure, paperwork and reporting, along with the participation of unsecured creditors through estate funded attorneys, run up the costs for a small filer. Banks either refuse to participate or spend vast amounts papering cash collateral transactions — all paid for by the debtor. More often than not, the debtor loses control of the company's wind down at some point. It is not unusual for a small debtor to spend its limited capital fending off motions for a Chapter 11 or Chapter 7 Trustee. Even a fast § 363 sale free and clear of liens often leaves the unsecured creditors in charge through a liquidating trust with little hope of recovery other than through the net recoveries of clawback litigation. Loveman never seriously considered a bankruptcy filing.

Loveman also wanted to avoid a receivership in which the debtor's management would lose all ability to influence the direction of the company once a judge had appointed the receiver, normally with input only from the secured creditors. The Lovemans feared that a quick sale of the assets by the receiver would produce just enough to pay the secured creditor even though it seemed clear to them that if marketed properly, a dividend could be paid to unsecured creditors.

Loveman elected to try an assignment for the benefit of creditors because it would stop the race to the courthouse, avoid the expense of bankruptcy, and eliminate the uncertainties in the selection of the fiduciary. Loveman's board of directors passed resolutions allowing Loveman to transfer all of the company's assets to a trust, selected Mark Dottore as trustee, and gave specific instructions in the trust instrument about the sale of the assets — including granting the trustee authority to operate the business.

How it Works

Loveman's Trust Agreement and Assignment for the Benefit of Creditors provided for the transfer of all of the company's real and personal property into the Loveman Trust. In addition to the trust language transferring the assets, Loveman executed quit claim deeds to transfer on the record the Loveman real estate to the Trustee. The transfers prevented any single creditor from obtaining a judgment lien and jumping ahead other general creditors. Loveman's personal property was likewise protected by Ohio Revised Code § 1309.309(L) which provides that a perfected security interest attaches to all of the assets upon the filing of an Assignment for the Benefit of Creditors thereby priming any subsequent or unrecorded lien.

The Probate Court case is commenced upon the filing of a Notice of Filing with the Trust Agreement attached. The Notice had to be served on all of Loveman's 225 unsecured creditors. Concurrently, the Trustee filed and served upon all creditors a Motion to Operate, requesting permission to continue Loveman's operations pending a sale. By operating the business, the Trustee was able to keep supplying Loveman's customers, which in turn kept the customers paying on their accounts. The ongoing business operations also enhanced the value of Loveman's heavy equipment which would have cost as much or more to move than it was worth. Sold in place, Loveman's heavy equipment enhanced the value of the building and made the sale package work.

Ohio Rev. Code § 1313.31 allows the trustee to carry on the business of the assignee upon the application of three quarters of the creditors (in number and amount). The Trustee met this burden by applying to the Probate Court to carry on Loveman's business, and providing notice to all creditors soliciting objections to his Motion to Operate. By their unanimous silence, the creditors were deemed to have consented to continuing Loveman's business operations.

Cooperation

From inception, we had remarkable cooperation from every direction. The Probate Court clerks, staff, magistrates and the judge cheerfully embraced our experiment. The Bank supported the orderly sale efforts and did not participate in the proceedings, except to cash its check, paying it in full. Almost without exception, unsecured creditors stopped their pursuit, allowing an orderly wind-up. Our colleagues who represented creditors and potential purchasers were undeterred and even enthusiastic. They were alert and interested, and satisfied that the Trustee had the power to convey good title to the assets. Accordingly, the case benefited from a lack of contention and acrimony that saps other cases of assets and energy.

Claims

Ohio Rev. Code § 1313.39 requires that creditors present claims in accordance with Ohio Rev. Code § 1313.42, including the filing of an affidavit. The Trustee concluded that forcing all 225 of Loveman's creditors to file claims was expensive and wasteful for the creditors and burdensome for the Trustee and the Probate Court. Accordingly, the Trustee designed a streamlined procedure for the allowance of claims that was approved by the Probate Court. Each creditor received notice of the amount of its claim as recorded on Loveman's books and records. If the creditor agreed with the amount listed, it would do nothing and the claim would be allowed in that amount. If it disagreed, there were streamlined procedures to determine the amount of the claim. Only three creditors requested hearings, and all three were settled without the need for litigation.

The Sale

The Trustee hired Hanna Commercial Real Estate to market the property. There were many potential bidders and six letters of intent. After numerous rounds of bidding, the Trustee and the high bidder entered into an Asset Purchase Agreement which allowed the Buyer a reasonable period to perform due diligence.

Bump in the Road

During the due diligence period, the investigation into the environmental issues resulted in findings of low level contamination caused by the migration of pollutants from the real property across the street. These findings were further examined to determine the exact nature and extent of the contamination, and the due diligence period was extended several times. Eventually it was determined that the contamination was concentrated on one end of Loveman's larger real estate parcel (Parcel 004).

In order to save the sale, the Trustee-Assignee retained Greg DeGulis of McMahon & DeGulis to investigate and find a solution that would satisfy both the Buyer and its bank. DeGulis proposed that the area most affected by the contamination could be severed from Parcel 004 and the severed portion consolidated with Loveman's smaller real estate parcel (Parcel 009). He also determined that the remaining contamination on Parcel 004 could be remediated for \$150,000. DeGulis then proposed that only Parcel 004 be sold to the Buyer with Parcel 009 remaining in the Loveman Trust for 99 years, and the Trustee and the Buyer entering into a 99 year lease for Parcel 009 with the lease payments equal to the amount of Parcel 009's real estate taxes.

The Buyer and the Buyer's lender agreed to the solution. Special thanks to the Mayor of Bedford Heights and the Bedford Heights City Council who signed off on the plan and saved many jobs in their community.

Statutory Amendments

The last amendment of Ohio Rev. Code Chapter 1313 was passed in 1953. Revisions could be made that would make this process more user-friendly:

- Updated statutory authority to sell, such as recently included in Chapter 2735;
- Statutory authority for preference recovery;
- Easing of notice procedures, which are presently costly and burdensome;
- Updated statutory authority to operate the business;
- Flexible claims administration procedures.

¹We couldn't improve on this simple and straightforward definition, so we are giving it attribution: Wikipedia!



Whitmer & Ehrman LLC was formed in 2016 by partners Mary K. Whitmer and James W. Ehrman. Together they have more than 80 years of experience in bankruptcy and commercial law. Mr. Ehrman and Ms. Whitmer regularly act as and/or represent fiduciaries in insolvency proceedings. Ms. Whitmer is also General Counsel to Dottore Companies LLC. Mary has been a CMBA member since 1985. James has been a CMBA member since 1986. They can be reached at (216) 771-5056 or mkw@WEadvocate.net or jwe@WEadvocate.net.