Alternatives to Bankruptcy:

A Guide for Creditors Navigating Business Liquidations

FINANCIALLY DISTRESSED COMPANIES FACING THE END OF THE ROAD (AND THEIR SECURED CREDITORS) ARE INCREASINGLY EXPLORING ALTERNATIVES TO BANKRUPTCY FOR LIQUIDATING THEIR BUSINESSES. BANKRUPTCY CASES (CHAPTER 7 OR CHAPTER 11) CAN PROVIDE FOR AN ORDERLY WIND-DOWN AND CLAIMS RECONCILIATION PROCESS, WITH THE ADVANTAGES, AND FROM THE DEBTOR'S PERSPECTIVE, CERTAIN DISADVANTAGES THAT COME WITH HAVING BANKRUPTCY COURT OVERSIGHT, TRANSPARENCY AND–ULTIMATELY–FINALITY. HOWEVER, THE BANKRUPTCY PROCESS CAN BE COSTLY, TIME-CONSUMING, AND–PERHAPS MOST CONCERNING FOR THE DISTRESSED COMPANY'S DECISION-MAKERS–CAN RESULT IN A DEBTOR'S OR TRUSTEE'S INVESTIGATION AND PURSUIT OF CLAIMS AND CAUSES OF ACTION AGAINST THE COMPANY'S OWNERS, MANAGEMENT AND AFFILIATES.

As a result, companies will often pursue alternative means of liquidating, including assignments for the benefit of creditors, receiverships, UCC Article 9 foreclosure sales, and informal wind-downs. Understanding these alternatives is essential for creditors seeking to maximize recoveries and minimize exposure.

ASSIGNMENT FOR THE BENEFIT OF CREDITORS

An assignment for the benefit of creditors, usually referred to as an "ABC," is a voluntary state law alternative to bankruptcy. In an ABC, a distressed company (the Assignor) transfers all of its assets to a third-party fiduciary (the Assignee), who then liquidates the assets and distributes the proceeds to creditors. The process arises by contract—an agreement between the Assignor and the Assignee—rather than through a court filing, though some states provide for court supervision of the process.

The Assignee functions like a Chapter 7 trustee in many respects. The Assignee takes control of the debtor's assets, manages the liquidation process, notifies creditors of the ABC, establishes a deadline for filing claims, investigates and pursues claims against third parties, reconciles claims against the debtor and distributes proceeds according to recognized state law priorities. Like bankruptcy, secured creditors are paid first, followed by the administrative costs of the assignment proceeding, state law priority claims (such as taxes and unpaid wages), and finally general unsecured claims.

ABCs offer several advantages over a bankruptcy case. ABCs are typically faster and less expensive than bankruptcy cases, potentially leaving more assets available for distribution to creditors. Debtors find ABCs attractive because they often involve less public exposure than a bankruptcy case. Moreover, in an ABC, the Assignor selects the Assignee (unlike in Chapter 7 bankruptcy, where the United States Trustee, part of the U.S. Department of Justice, appoints a Chapter 7 trustee). The Assignor may choose an Assignee that has particularized experience and industry contacts that can help maximize the value of the Assignor's assets—an advantage that ultimately can benefit creditors. The Assignor may also choose an Assignee that is less likely to investigate and pursue claims against the Assignor's management, owners, and affiliates—of course, this "advantage" for the debtor-Assignor may be a disadvantage from creditors' perspective. In bankruptcy, an independent fiduciary (such as a Chapter 7 trustee, or a creditors' committee in a Chapter 11 case) will almost certainly investigate these potential claims and causes of action, potentially yielding value for creditors.

ABCs also have their disadvantages. There is no automatic stay in ABC's in most states (as there is in bankruptcy), meaning creditors can continue collection efforts unless otherwise enjoined by a court order (which is difficult to obtain).[1] Also, state law generally does not permit the sale of assets free and clear of liens and does not override anti-assignment provisions in contracts or invalidate "ipso facto" clauses that allow contract counterparties to terminate due to an insolvency event, like bankruptcy. This minimizes the Assignee's ability to maximize value compared to a bankruptcy filing; in bankruptcy, the debtor's assets can be sold free and clear of liens, claims, and encumbrances, and contracts can be assumed and assigned to third parties in most cases regardless of whether the contract includes an anti-assignment provision or allows for termination upon a bankruptcy filing.

Perhaps most notably, the procedures for ABCs vary significantly depending on the state in which the ABC is commenced (as opposed to bankruptcy, which is governed by a uniform federal statutory scheme). Certain states operate under common law principles (e.g., Illinois, Massachusetts), while others follow a statutory framework (e.g., California, Delaware, Florida, New York, New Jersey and Wisconsin). Some states' ABCs (e.g., Delaware, Florida and New Jersey) have court oversight (to varying degrees), while others don't. Some states (e.g., California and Florida) have preference statutes similar to Section 547; other states (e.g., Wisconsin and New Jersey), have preference statutes with different reachback periods (four months rather than 90 days) and different proof requirements; and other states, such as Illinois and Delaware, have no preference statute at all. On top of all that, some court decisions have questioned whether state preference laws are preempted by the Bankruptcy Code to begin with.

Given the lack of consistency (and in many instances, transparency) across ABCs, creditors that learn of a customer's ABC should strongly consider contacting the Assignee to gather information relevant to the ABC and retain counsel where appropriate to protect their interests.

THE UNIFORM ASSIGNMENT FOR THE BENEFIT OF CREDITORS ACT

The lack of uniform state law governing ABCs has historically contributed to significant complications in practice, especially when a state's existing law is underdeveloped or rarely utilized, or when a distressed business's assets are located in multiple states. In some jurisdictions, existing ABC statutes date back to the 19th century and have not been updated to address modern business realities. To address these concerns, the Uniform Law Commission recently approved the Uniform Assignment for the Benefit of Creditors Act, (Uniform ABC Act) designed to standardize and modernize the ABC process, provide greater consistency and uniformity across all fifty states, encourage its further use by improving the clarity and integrity of the law, and make ABCs a more robust tool for debtors and a more predictable process for creditors nationwide. Nebraska recently enacted the Uniform ABC Act and in several other states, the Uniform Act is in various states of the legislative process.

Key provisions of the Uniform ABC Act include:

- **Scope and Applicability:** The Uniform ABC Act applies to assignments made by an Assignor whose principal place of business is in the enacting state, whose internal affairs are governed by the enacting state's law, or if an individual whose principal residence is in that state.
- **Assignee Independence Requirements:** An Assignee must not be a creditor, affiliate, or insider of the assignor; must not hold a claim against the assignment estate (other than for fees and expenses); must not have a material financial interest in the outcome of the assignment; and must not hold an equity interest in the Assignor (other than a noncontrolling interest in a publicly traded company).

- **Assignment Agreement Requirements:** The assignment agreement must be in writing and signed by both the Assignor and the Assignee. It must identify the parties, transfer all of the Assignor's assets, describe the assigned assets in sufficient detail, provide for distribution to creditors, describe the fees charged by the Assignee, and include a representation by the Assignor—under penalty of perjury—that all of the Assignor's assets are being assigned.
- **Fiduciary Duties:** The Assignee owes a fiduciary duty to the assignment estate for the benefit of creditors, including a duty of loyalty, a duty to use reasonable care to maximize distributions, and a duty to wind up the assignment in the best interests of the estate and creditors.
- **Notification to Creditors:** The Assignee must notify creditors of the assignment estate about the assignment proceeding. This notice must be sent within a reasonable time not to exceed 30 days from the effective date of the assignment agreement (the date the agreement is signed by both Assignee or Assignor or a later date set forth in the agreement).
- **Claims Bar Date:** The Assignee must establish a single date—generally not less than 90 and not more than 210 days after the effective date of the assignment agreement—by which creditors must submit proofs of claim. Any claim not timely filed may not share in the distribution of proceeds. A creditor that files a proof of claim consents to the jurisdiction of the court on matters involving the assignment.
- **Periodic Reporting:** The Assignee must provide creditors with periodic summaries (at least every six months) of assets, liabilities, and expenses of the assignment estate, and must send a final accounting upon completion of the assignment.
- **Avoidance Powers:** Unlike bankruptcy law, there is no "no-fault" preference clawback provision under the Uniform ABC Act. Instead, an Assignee's avoidance powers are limited to what creditors could have pursued under state fraudulent transfer or other applicable law.
- **Distribution Priorities:** The Uniform ABC Act establishes a clear hierarchy for distributions: (1) first, protected secured creditors receive the value of their collateral; (2) then administrative expenses of the assignment proceeding; (3) then claims entitled to priority under federal law; (4) then wage claims for amounts earned within 180 days before the assignment; and (5) finally general unsecured claims.

RECEIVERSHIPS

A receivership is a court-supervised process where an independent third party (the Receiver) is appointed to take custody and control of a business's assets, property, or operations. Unlike bankruptcy, which a debtor typically initiates, receiverships are usually commenced by creditors, shareholders, or regulators seeking to protect collateral or address fraud, mismanagement, or corporate deadlock.

Courts consider receiverships an extraordinary remedy. Among the factors courts weigh in appointing a Receiver are fraudulent conduct, imminent danger of loss of collateral, and irreparable injury to a secured lender. A Receiver's authority is defined by the court order appointing the Receiver and may include taking possession of assets, collecting accounts receivable, managing and operating the business, employing necessary staff, selling assets, commencing litigation, and assuming or rejecting leases.

Receiverships offer advantages similar to ABCs: they may be faster, more cost-effective, and more flexible than bankruptcy. There is usually no automatic stay; however, the court order appointing the Receiver usually includes an injunction preventing creditor collection activity. Trade creditors should carefully review any receivership order to understand claims procedures, deadlines for filing claims, and whether an injunction has been entered. Numerous states have recently enacted comprehensive receivership statutes, including Oregon (2018), Missouri (2016), Ohio (2013), Minnesota (2012), and Washington (2004), providing greater standardization in some jurisdictions.

UCC ARTICLE 9 FORECLOSURE SALES

Secured creditors may choose to foreclose on their collateral under Article 9 of the Uniform Commercial Code (UCC) rather than pursue a bankruptcy filing. In a UCC Article 9 foreclosure sale, the secured creditor seizes and sells or otherwise recovers the debtor's collateral following a default under the loan agreement. The process can be "friendly" (where the debtor consents to the seizure and sale as part of a peaceful arrangement) or "unfriendly" (involving contested litigation).

The foreclosure process requires notice of sale to the debtor, guarantors, and other creditors with security interests in the collateral, with a 10-day safe harbor period. Notably, there is no required notice to unsecured creditors. The sale may be conducted by public auction or private sale, but all aspects must be "commercially reasonable." Proceeds are paid to the secured creditor, which retains the right to assert a deficiency claim for any balance due. The sale conveys the collateral free and clear of the foreclosing security interest and junior interests. With respect to accounts receivable, the secured creditor notifies account debtors to make payment directly to the creditor.

For secured creditors, UCC Article 9 foreclosures are faster and generally less expensive than bankruptcy. However, the process has significant limitations. It addresses only the secured party's collateral—not unsecured claims or other debtor obligations. The sale does not dispose of claims against the debtor as a bankruptcy would, and buyers face potential successor liability risk. For unsecured trade creditors, Article 9 foreclosures also offer little transparency and no opportunity for meaningful unsecured creditor participation or recovery.

INFORMAL WIND-DOWNS AND OUT-OF-COURT COMPOSITIONS

In some cases, a distressed company may simply announce it is closing its doors and attempt to wind down informally, without any formal insolvency proceeding. These informal liquidations offer no structured claims process, no assurance of distributions, and no transparency for creditors. This may be the cheapest of the company's liquidation options—but it lacks the finality associated with the other alternatives, as creditors can continue to pursue claims against the defunct company, or even its affiliates, owners, and management when it becomes apparent the company's well has run dry.

Creditors confronted with an informal wind-down may threaten an involuntary bankruptcy petition to force greater transparency. Three or more creditors holding an aggregate amount of at least $21,050

COMPARISON OF LIQUIDATION ALTERNATIVES				
FEATURE	**CHAPTER 7**	**ABC**	**UCC ARTICLE 9 SALE**	**RECEIVERSHIP**
Governing Law	Federal Bankruptcy Code	State law (varies)	UCC Article 9	State or federal court order
Automatic Stay	Yes	No	No	Only if court order includes injunction
Who Controls Process	Court-appointed trustee	Assignee (usually selected by debtor)	Secured creditor	Court-appointed receiver
Sale Free and Clear of Liens	Yes	Generally no	Yes (as to foreclosing and junior liens)	Varies by court order
Preference Exposure	Yes (90-day/ 1-year lookback)	Varies by state	No	No
Notice to Unsecured Creditors	Yes	Yes	No	Varies
Cost/Speed	Higher cost, slower	Lower cost, faster	Lower cost, faster	Varies

(for cases filed on or after Apr. 1, 2025, and subject to change, usually increase, every three years) in unsecured, non-contingent claims that are not subject to a "bona fide" dispute as to liability or amount may join in an involuntary petition. If the petition is contested, the petitioning creditors must prove that the debtor is generally not paying undisputed debts as they come due. If the creditors are successful on their involuntary petition, an order for relief is entered and, if filed as a Chapter 7, a Chapter 7 trustee is appointed. The petitioning creditors may then seek reimbursement of the fees and expenses they incurred filing the involuntary petition as an administrative expense claim. Of course, creditors should be careful and do their diligence before joining an involuntary petition; there can be significant adverse consequences (i.e., sanctions and attorneys' fees) for the petitioning creditors if a debtor successfully defends and obtains a dismissal of an involuntary filing.

Out-of-court compositions and extensions represent another consensual alternative, where the debtor negotiates payment arrangements directly with groups of unsecured creditors. These arrangements bind only assenting creditors and offer advantages, including avoiding the stigma of bankruptcy, greater flexibility, faster resolution, and lower costs. However, they require near-unanimous creditor approval, offer no automatic stay, and cannot provide for a sale of assets free and clear of liens without secured lender consent and also cannot involve a transfer of non-assignable contracts without counterparty consent.

CONCLUSION

The landscape of business liquidation has evolved significantly, with companies and creditors alike increasingly recognizing that bankruptcy is not the only option for winding down a distressed company. For trade creditors, understanding these alternatives is essential. Each carries distinct implications for claims priorities, distribution prospects, and exposure to clawback actions. By staying informed about the options available and the rights attendant to each process, creditors can make more strategic decisions when a customer is facing financial distress—and maximize their recoveries and minimize risk when the inevitable occurs for that customer. BC

1. *A few states have enacted statutes providing for an automatic stay in assignment proceedings.*

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