Scribbles Squibs # 9 (May 10, 2013) ASSIGNMENT FOR BENEFIT OF CREDITORS: A POOR MAN'S BANKRUPTCY

by Attorney Jonathan Sauer

1. The Problem: At Sauer & Sauer, we recently had a mechanical contractor, Honest and Brave Subcontractor (hereafter HBS), owed almost two hundred thousand dollars from Nowanna Pay General Contractor (hereafter NPGC), which had made an assignment for benefit of creditors (hereafter assignment.) This raised/raises a variety of questions. What *is* an 'assignment for benefit of creditors'? And, how does this vary from a bankruptcy? How does a creditor 'remain safe'? And, how does agreeing with the assignment affect possible payment bond claims and other potential remedies? This article will try to answer these questions. And, then, we'll tell you what happened to HBS.

2. A Creditor's Rights Against a Debtor in Bankruptcy: A bankruptcy is a federal statutory remedy which provides for a 'fresh start' for 'debtors'. While there are a variety of forms bankruptcy can take, within the construction context, there are generally only two forms applicable. And, while complex, rules relative to which claims get paid and which don't are expressly set out in the bankruptcy statutes and accompanying rules. Less so with an assignment.

Under a Chapter 7, a debtor says that it isn't trying to continue in business and simply wishes to liquidate its estate and get a discharge from its debts. Quite often, except in 'no asset' cases - meaning that the debtor claims he doesn't have any money at all – with the initial bankruptcy notice, there is a reference to a 'bar date'. That is the date by which proofs of claim have to be submitted to the court. For a Chapter 11 – a reorganization (the debtor wants to stay in business) – the procedure is somewhat more complex. For Chapter 11's, at some point, creditors will be presented with a 'disclosure statement' and a 'plan of reorganization', which will indicate which claimants will get paid and how much. The creditors vote on the plan and a certain percentage of the creditors and/or their claims are necessary for the plan to be accepted. Claims by construction claimant creditors (hereafter trade debt), generally speaking, are paid in the lowest of the three major bankruptcy levels of creditors: unsecured claimants. It is unusual for any trade debt to be paid at all in most Chapter 7's and payments for trade debt in Chapter 11's will be cents on the dollar, with the projected time for payment years into the future.

3. The Four Potential Pitfalls in Agreeing to an Assignment for Benefit of Creditors: How is an assignment different? For one thing, this is in no way any form of a court proceeding. It is a private, extra-judicial process – not subject to court supervision - to attempt to close out a company and pay the creditors, the results of which could be binding in a later bankruptcy proceeding. The idea behind this is that the debtor is trying to *avoid* filing bankruptcy. This is a Massachusetts statutory remedy, variations of which exist in a dozen or more other states.

Before discussing the details of a Massachusetts assignment, we need to touch on **four** potential claim-killers as to claims generally, meaning actions, inactions or circumstances that can conclude/prevent a claim by a trade creditor against its debtor or against the debtor's payment bond surety. **The first.** When a debtor makes a payment of less than the full debt (particularly on a debt with a disputed amount) marked 'final payment', in many circumstances, irrespective of how small that payment might be in relation to the debt, a court might find that this

extinguishes the debt under the defense of 'payment'. **The second.** A related concept is that when a group of circumstances, actions and inactions coupled with some kind of apparent plan of concluding a debt by some payment(s), a court might find that these circumstances when taken in their entirety reflect an offer (by the debtor) and an acceptance (by the creditor) so as to constitute an 'accord and satisfaction', meaning that the debt has been paid in an amount satisfactory to the creditor. **The third.** 'Release' means that a creditor has signed a paper indicating that in exchange for receiving a certain sum of money, the debt against the creditor has been concluded. *This should always be studied when presented with lien waivers, as most lien waivers have <u>some</u> release language in them.* **The fourth**. As a matter of law, a payment bond surety has all of the factual and legal defenses of its bond principal (the bonded party).

4. A brief legal explanation of what a Massachusetts Assignment for Benefit of Creditors is: It is detailed in three statutory sections. MGL Chapter 203, s. 40 provides in part: "If a debtor residing in the commonwealth has made an assignment to a trustee for the benefit of his creditors, the acts of the trustee thereunder in protecting and caring for the property and converting it into money, if done in good faith and with reasonable judgment and discretion, shall, subject to the following section, be valid notwithstanding subsequent proceedings in insolvency by or against the debtor." MGL Chapter 203, s. 41 requires that: "the assignment conveys all the property and estate of the debtor wherever situated." And, the trustee must give notice to: "all known creditors". Also, "the trustee shall furnish to all assenting creditors and to all other creditors having claims in excess of three hundred dollars, at least fifteen days before distribution of any assets, a statement in writing indicating, the total assets of the trust, the total liabilities of the trust, and administrative costs, trustee's fees, legal fees, and other miscellaneous expenses." Distribution of the assets has to be in accordance with MGL C. 216.

What is the ***<u>one</u>*** thing for a creditor to understand concerning an assignment? It is just this. While a debtor may transfer its property to a trustee so that proceeds thereof may be applied on a pro rata basis to pay its debts, absent express agreement by its creditors to accept the proceeds as full satisfaction of their claims, the debtor is not released from payment of any unpaid balances. <u>U. S. v. Rome</u>, D.C.Mass.1976, 414 F.Supp. 517. This simply means that if, as a creditor, you do not 'assent' to the assignment, all of your rights against the debtor, such as they might be, are still intact. ***The converse is also true.*** Namely, if you agree to participate in the assignment by giving a written assent to the trustee, then all of your rights against the debtor are only as are provided for by the assignment. That's all she wrote. The fat lady has *definitely* sung.

5. What happened to HBS*:* HBS received notice of such an assignment in a situation where it was owed nearly two hundred thousand dollars by NPGC. It received a letter from a lawyer claiming to be the 'assignee' of the rights of the company and that there is a plan to pay the debtors. (Sometimes the assignee is referred to as a 'trustee'.) And, all that HBS needed to do was to provide a written 'assent' to the assignment by a certain date. Part of what the letter said:

"Upon liquidation of the assets and after satisfying any priority claims that may arise, the Trustee-Assignee anticipates making a distribution of available proceeds to holders of <u>allowed</u> claims. A copy of the executed Agreement is enclosed for your review. (ED: it wasn't.)

Pursuant to the ABC, **a distribution to creditors is made only to those creditors who affirmatively assent to the ABC**. Accordingly, enclosed with this letter is (i) an Assent to the Assignment and (ii) a Claim Form. In order for you to participate in the ABC and receive a distribution, you must execute both forms and return them to this office. For purposes of reconciliation and allowance of your claim, please attach an itemized statement of your claim against the Company and any supporting documentation you may have. Claims that are not supported by available documentation may be disallowed. Return the executed Assent and Claim Form and any claim material to this office on or before April 25, 2013." (Emphasis added)

The letter itself was nominal meaning that there was no indication that assenting to the assignment would work any harm to the claimant. *However,* the attached "ASSENT TO ASSIGNMENT AND PROOF OF CLAIM" specifically provided in the first paragraph:

> ". . . the undersigned hereby becomes party to the provisions of said Assignment as an Assenting Creditor thereunder, and in accordance with the provisions of said Assignment, agrees to accept in full payment of its claim, debt, demand, cause of action and/or right to payments, the dividends which *may* be payable under said Assignment and to release, acquit and discharge the Assignors and their officers, directors, affiliates, attorneys and *representatives,* from such claim, debt, demand, cause of action and/or right to payment as therein provided." (Emphasis added)

Although various documents were referenced, none of them were provided. One wonders if the assignee hopes that whoever reads the document won't understand that he is giving up HBS's rights under the Assignment without actually ever having received or even *read* the Assignment.

A creditor getting a letter like this might think that here is its only and last chance to get paid *something*. The wording of the thing seems to suggest that if you sign these documents you *will* get paid *something*. So, you might sign these documents, hoping for some payment. The problem with this is that by signing the assent and submitting the claim form, you have agreed that as to NPGC you have agreed to accept as compensation for your claim whatever you might receive pursuant to the assignment, *even if this is nothing.* And, keep in mind that a surety has the same defenses of its principal, factually and legally. So, agreeing to participate in an assignment might foreclose whatever rights you might have against that party's payment bond because the principal no longer owes anything on the debt due to the acceptance of the assignment. Put another way, assenting to the assignment releases the underlying debt and the surety would only be liable if there were an underlying debt.

Now, a release is a kind of a contract. Massachusetts release and contract law provides that a party signing one is bound to it: (a) even if he didn't read it; (b) even if he didn't understand it; (c) even if it is written in a foreign language which he doesn't understand.

6. Your Rights Against the Debtor if You Do Not Assent to the Assignment: So, how do you get paid if you *don't* agree to such an assignment? Well, there is nothing in the law pertaining to assignments which in any way gives up any of the legal rights you might have against the debtor *provided that you don't sign the assignment.* You can file mechanics' liens, payment bond

claims (and suits), actions to reach and apply and, if appropriate, actions to seek bank account and real estate attachments. As to HBS, we specifically advised the trustee that we did not assent to the assignment and pursued a payment bond suit against NPGC contractor and its surety. We have settled with all parties at one hundred cents on the dollar and are awaiting the check.

7. Conclusion: So, the important things to understand about assignments: (a) they are not done under court supervision; (b) your assent to the assignment most likely means that you have given up all of your other rights against your debtor; (c) your assent to the assignment probably means that your claim against the debtor's payment bond may no longer be viable; (d) in all likelihood, a court would find that your participation in the assignment constitutes at least an 'accord and satisfaction' as to your claim, if not an outright release (depending on language used.)

(These materials are intended as general information only, not legal advice. When confronted with a problem you don't understand, seek the assistance of legal counsel.)

HERE ARE FIVE THINGS TO KNOW ABOUT OUR FIRM:

1. We guarantee our billing rate for five years in writing and give a 25% discount as to the fees on the first file for new clients in 2013 mentioning this offer.
2. We endeavor to maintain wherever possible future business relationships with your contracting party by emphasizing a fair and reasonable approach, which often helps promote earlier (and cheaper) case resolutions than does 'mean and angry'.
3. We try to defer until later in the case the more expensive elements of discovery – i.e. depositions – in order to try less expensive discovery first and, where possible, mediation. (We recently obtained 1.5 million dollars for a subcontractor against a bankrupt general contractor's payment bonds (three projects) without a single deposition ever being taken and without having to even answer interrogatories!)
4. No charge to non-clients for quick answers to *general* Massachusetts construction law questions.
5. Being a smaller firm, our attention is *solely* on our clients and their problems, not on feeding the overhead of a fancy office and many partners, associates and support staff. We only have to feed our five dogs, most of which are *quite large!*

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