

Tip # 5: There are state law alternatives to filing a bankruptcy case.

By Kim Fineman

If a liquidation is the right path for your struggling small business (see Tip #4 for a discussion of liquidation versus reorganization), there are state law options for winding down. Those alternatives to a bankruptcy filing may be a better fit for your needs. For that reason, your Bankruptcy and Restructuring attorney may, in some circumstances, suggest such an alternative procedure.

You could just dissolve the business. If there are outstanding debts, however, those liabilities may extend to the owners or managers even if the business has an Inc, LLC or LP structure. The baggage of those accrued liabilities also repels potential purchasers. To maximize the return for creditors and facilitate an orderly liquidation, state law provides certain mechanisms for the transfer of the assets of a troubled business free of unsecured debts. (Note: The rights of secured creditors are not impacted.) These are specific statutory exceptions, however. Simply stating in an asset purchase agreement that the buyer does not assume to liabilities of the seller won't work.

One option available to certain businesses under state law is a bulk sale. A "bulk sale" is defined as any sale outside the ordinary course of the seller's business of more than half of the seller's inventory and equipment based on fair market value on the date of the sale. California's bulk sale law protections only apply if: (1) the seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or a restaurant owner, (2) the seller is located in California and (3) the value of the assets being sold is between \$10,000 and \$5 million. If all those factors are met, and the selling business complies with certain notice and disbursement requirements, then the assets can be sold free of the seller's unsecured debts.

Another option, available to a wider variety of businesses, is a process known as an assignment for the benefit of creditors, or "ABC" for short. The availability of an ABC option varies from state-to-state. In California, it is a popular alternative to bankruptcy as it can provide a relatively quick and graceful exit strategy. Rather than having a business that has gone bankrupt, the press generally reads the business was acquired. In an ABC, the business assigns all of its rights in and control of its assets to a third-party professional in trust. That assignee then liquidates the property and distributes the proceeds to the assigning business' creditors. One of the key advantages of an ABC is that the liquidating business can be involved in the process up to the point of assignment and present the professional assignee with a prepackaged going concern sale. The liquidating assignee is selected by the business and can have specialized industry knowledge, unlike a standing Chapter 7 bankruptcy trustee. There is also a contract between the business and the liquidating assignee. Since an ABC does not require court procedures or oversight, there is less uncertainty and potential complications. This more informal procedure may, however, not provide the clarity of title some buyers need and otherwise would get with a court order approving the sale in a bankruptcy. Also, unlike in a bankruptcy case, executory contracts and leases cannot be assigned in an ABC without the consent to the other party to the contract.

As you can see, many factors are in play in determining which liquidation path is right for your business. Your business' unique circumstances will guide your Bankruptcy and Restructuring attorney's recommendations.