THE BUSINESS LAW SECTION OF THE FLORIDA BAR
SUPPORT FOR PROPOSED AMENDMENTS TO CHAPTER 727 –
ASSIGNMENTS FOR THE BENEFIT OF CREDITORS.

Summary

The proposed amendments seek to clarify and/or streamline certain procedures applicable to an assignment for the benefit of creditors ("ABC") pursuant to Chapter 727, Florida Statutes (the "Statute"). Several members of the Business Law Section of The Florida Bar (the "Section") who participated in the substantial re-draft of the Statute in 1987 also participated in the Section committee (the "Committee") that drafted the proposed amendments. The Committee utilized its members' historical knowledge, together with contributions from current participants in all facets of a typical ABC, to draft proposed revisions which will, if enacted, leave the intent of the Statute fully intact while modifying certain procedures to better accommodate current practices and conditions.

The Committee refrained from proposing any amendment to the Statute which would fundamentally alter the substantive rights of the parties to an ABC. The Section carefully considered the arguments in support of more substantive amendment to certain provisions of the Statute, but supports the Committee's recommendation to limit the proposed revisions to the amendments set forth in Exhibit A hereto and would oppose any substantive amendments to the Statute at this time, for the reasons discussed below.

Statutory Background

An ABC is a state law procedure for the administration of an insolvent estate. An ABC allows a debtor to voluntarily assign its assets to a third party of the debtor's choosing. That third party (the "Assignee") is charged with the duty of liquidating the debtor's assets for the purpose of satisfying creditors' claims against the debtor. Many ABC cases are filed with the consent of some or all of the debtor's creditors.

Though the practice has been codified since Roman times, ABCs originally existed at common law in the United States.[1] In Florida, the original ABC act was enacted in 1889 (chapter 3891, Laws Fla.), but was substantially re-drafted in 1987 (chapter 87-174, Laws Fla.) ("1987 Amendments") and further amended in 1989, 1991, 1997, 1998, 1999, 2007, and 2008 (as amended, "ABC Statute"). The constitutionality of an ABC was affirmed by the Florida Supreme Court in 1896[2] and has been upheld in subsequent cases.[3]

ABCs are similar to federal bankruptcy liquidation proceedings in that they ensure full reporting to creditors and require equal distribution of a debtor's assets according to the priorities established in the Statute. An ABC is primarily distinguishable from the federal bankruptcy

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[1] *See Moecker v. Antoine*, 845 So.2d 904, 910 (Fla. 1st DCA 2003).
[2] *See Dorr v. Schmidt*, 38 Fla. 354, 359 (Fla. 1896).
[3] *See Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 526 (1933) ("[I]t is apparent that Congress intended that such voluntary assignments, unless so put aside, should be regarded as not inconsistent with the purposes of the federal act."); *In re Mader's Store for Men, Inc.*, 77 Wis.2d 578, 592 (Wis. 1977).

process in that (1) it does not impose an automatic stay in favor of the debtor,[4] (2) it does not grant an Assignee special authority to recover pre-filing transfers as a result of the ABC,[5] and (3) unlike most types of bankruptcy proceedings, it does not provide a discharge of any debt.

Proposed Amendments

In recent years, several disputes have arisen in ABC cases concerning some of the ABC Statute's more "practically difficult" procedures, inconsistent procedural requirements, and the applicability of other state procedural rules to ABC proceedings. Some of those disputes have been settled by the courts under fact-specific rulings, but results have not been consistent on a statewide basis. Accordingly, both practitioners and judges alike desire additional statutory guidance and/or clarification regarding the appropriate procedures for an ABC proceeding.

Notice

There is currently a subtle conflict in the statute between s. 727.108(4), which allows an Assignee to conduct the business of the assignor for a limited period of time (up to 14 days) or longer upon notice, and s. 727.111(4), which requires not less than 20 days' notice of an assignee's continued operation of the assignor's business for longer than 14 calendar days. Common sense displays that an Assignee's compliance with both provisions is impossible unless the notice required by s. 727.111(4) is sent before the assignment has even occurred.

To remedy the conflict, the Committee proposes an extension of the time within which an Assignee may conduct the business of the assignor under s. 727.108(4) from 14 days to 45 days.[6] The additional time is a more realistic window within which an Assignee can assess the business, determine a strategy for liquidation, and, if necessary, give notice of intent to operate the business for an additional period of time. To streamline the deadlines set forth in the statute into multiples of 7 days, the Committee also proposes to extend the minimum amount of time for notice under the statute from 20 days to 21 days.[7] The Committee leaves intact the condition that such operation of the business must be in the best interest of the estate.

Additionally, the proposed amendments introduce a negative notice procedure in ABC cases.[8] The purpose of such a procedure is to reduce both the administrative burden on the court and the administrative cost for the estate necessitated by the conduct of hearings for relief which is neither contested nor opposed. Negative notice is a common procedural tool in federal bankruptcy court, and attorneys and creditors are generally familiar with the requirements for utilizing such notice. For example, under the proposed amendments, in the case of an Assignee's notice that it will conduct the business of the assignor for a period longer than the prescribed

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[4] Although there is no automatic stay in favor of the debtor, the Statute does preclude creditors from commencing proceedings against the Assignee, except as provided therein, and from levying, executing, attaching, or similarly pursuing assets of the estate in the possession, custody, or control of the Assignee, unless the creditor is a consensual lienholder. *See* § 727.105(13).

[5] Certain other state laws allow such recovery under some circumstances, such as Florida's Fraudulent Transfer Act (Ch. 726, Fla. Stat.), but those laws are independent of the ABC process.

[6] This extended timeframe also requires amendment of § 727.109(3).

[7] *See* §§ 727.103(13) & 727.111(4).

[8] The proposed amendments define "Negative Notice" as the notice procedure set forth in s. 727.111(4).

period of time, such notice could be served on negative notice ("Negative Notice") by including a specific form "warning" in the document (as set forth in s. 727.111(4)) that –

1) the Assignee proposes to take the actions described therein without further notice or a hearing unless a party in interest files an objection within 21 days of service of the notice;
2) any such objection must be filed with the clerk of court and served on the Assignee's attorney and any other appropriate person(s);
3) if an objection is filed and served, the court may schedule a hearing; and
4) if no objection is filed, the Assignee and the court will consider the proposed relief unopposed.

If no objection is filed within the time prescribed, the Assignee may continue to operate the assignor's business for an additional 90 days. Such Negative Notice procedure would also be available for a proposed sale of assets of the estate other than in the ordinary course of business, the compromise or settlement of a controversy, and the payment of fees and expenses to an Assignee or professional persons employed by the Assignee.

Assignee Bond

Much like a receiver in a receivership, Assignees are required to file a bond with the clerk of court to ensure the faithful discharge of their duties. The purpose of the bond is to protect the assignor's creditors from potential loss in the event of the Assignee's improper and irreparable disposition of the assignor's assets.[9] Section 727.104(2)(b) currently requires the court to set the bond "in an amount not less than double the liquidation value of the assets of the estate." "Liquidation value" is defined in s. 727.103(12) as "the value in cash obtainable upon a forced sale of assets after payment of valid liens encumbering said assets." The reason for deducting the value of liens encumbering the assets when calculating "liquidation value" is that a debt secured by a lien against the debtor's asset does not need the protection of a bond. It is already protected by the lien, which attaches to the asset and may be enforced despite disposition by the Assignee.

In addition to assets secured by liens, unliquidated assets are also less susceptible to immediate and irreparable disposition by an Assignee. The difficulty of valuing the asset consequently increases the difficulty of selling the asset. As a result, in cases where a significant portion of the debt is secured and/or unliquidated, some courts have been requiring a bond that is too high. An unnecessarily high bond requirement causes an estate to incur needless additional cost and may even discourage otherwise qualified Assignee candidates from serving as Assignees.

To clarify the Statute, the Committee proposes to amend s. 727.104(2)(b) to provide that the Assignee's bond must not be less than $10,000.00 or double the liquidation value of the unencumbered and liquid assets of the estate, whichever is higher. The amendment would guarantee a minimum bond amount, yet ensure that the bond amount is not substantially and artificially inflated by a large amount of secured and/or unliquidated debt.

[9] *See Williamson v. Leith*, 36 F.2d 643, 644 (Fla. 5th DCA 1929).

Discovery

Disputes have recently arisen among practitioners concerning the applicability of the discovery provisions in the Florida Rules of Civil Procedure to ABC cases. As Assignees are statutorily charged with the duties to (a) determine whether or not prosecution of the estate's claims and causes of actions is in the best interest of the estate,[10] (b) examine the validity and priority of claims against the estate,[11] and (c) conduct due investigation of the estate's assets' value and benefit to the estate,[12] discovery capabilities are imperative. An Assignee must be able to conduct discovery related to claims and potential causes of action in order to properly discharge his obligations to an estate. The Committee proposes to amend s. 727.108(1)(a) and s. 727.113 to clarify and confirm an Assignee's right to conduct discovery (as provided for in the Florida Rules of Civil Procedure) in the following circumstances:

1) In order to determine whether to prosecute claims and causes of action on behalf of the estate; and
2) Concerning objections to claims.

Rejection of Unexpired Leases

The statute currently allows an assignee to reject unexpired leases of non-residential real property or personal property.[13] However, it sets forth little guidance regarding the proper procedure for such rejection. In the interest of establishing consistent practices, the Committee proposes amendments to s. 727.110 that would clarify and/or codify the procedure for such rejection, specifically (a) the parties entitled to notice of the rejection, (b) the information that should be included in the notice of such rejection, and (c) the effective date of the rejection. The amendments also confirm the termination of an estate's rights, obligations, and liability concerning the property in the event a lessor fails to take possession thereof upon rejection and, as noted above, the availability of the Negative Notice procedure for the notice of rejection.

Objections to Claims

In an ABC, creditors of an assignor file claims with the Assignee, who is charged with determining the validity and priority of such claims before distributing the assignor's assets in accordance with statutory requirements. The Assignee or any other party in interest may object to a creditor's claim. The Committee proposes procedural amendments to s. 727.113(1) to clarify (a) which parties are entitled to service of any such objection, and (b) the service address of the claimant. As noted above, this provision would also be subject to the Negative Notice procedure.

Opposed Amendments

In addition to the issues discussed above, various courts across the State have grappled with disputes over a secured creditor's substantive rights regarding estate property. The issue that has garnered the most attention is that which relates to an Assignee's abandonment of property to a secured creditor. To date, each such dispute has been resolved prior to reaching

[10] *See* § 727.108(1)(a).
[11] *Id.* at (10).
[12] *Id.* at (11).
[13] *See* §§ 727.108(5) & 727.109(6).

review by the Florida Supreme Court. As a result, the decisional law is provides little guidance in respect of the eventual judicial resolution of future disputes. Valid arguments exist on both sides of the issue.

Notwithstanding the lack of statutory clarity, as previously noted, the Section would oppose any substantive amendment of the ABC Statute at this time. Specifically, the Section would oppose amendment, elimination, and/or extension of an Assignee's right to abandon assets to a duly-perfected secured or lien creditor under s. 727.108(11) for the following reasons:

Historical Perspective: An Assignee's Abandonment of Property

The fundamental reason for filing an ABC case is, and always has been, to administer a debtor's estate most efficiently for the benefit of its creditors. While other traditional insolvency procedures (like bankruptcy, foreclosure, or a receivership) have their benefits, there are many cases where such procedures are too lengthy, expensive, and/or complicated to afford any real advantage. In those cases, an ABC is the best - and often the only - way to quickly and effectively liquidate a debtor's assets in an organized manner that ensures fairness to both the debtor and its creditors, without completely depleting assets that might otherwise be available for payment to creditors. Put differently, the ABC Statute provides assignors, Assignees, and creditors with a framework for ensuring equitable resolution while avoiding unnecessary (and often lengthy and expensive) administrative hurdles.

Prior to the 1987 Amendments, Assignees did not have statutory permission or authority to abandon an asset to a duly-perfected secured or lien creditor.[14] As a result, many cases arose in which a secured creditor had no option other than to pay for and wait through additional foreclosure proceedings in order to properly acquire an asset it was plainly entitled to and the assignee did not want to keep. It did not matter that the insolvent estate had no equity in the asset, that the asset was costing the estate money it did not have, and/or that the asset had no benefit to the estate. In such cases, both the secured creditor and the estate wasted time and money, and administrative costs increased the amount of the debt owed and/or depleted funds that could have been conserved for payment to creditors. Effectively, no efficient mechanism for administration of the insolvent debtor's estate existed and even a well-organized ABC could not completely get the job done.

To solve this problem, the Section proposed and the Florida Legislature subsequently enacted s. 727.108(11) as part of the 1987 Amendments to the ABC Statute. Section 727.108(11) reads as follows:

> The assignee shall . . .abandon assets to duly-perfected secured or lien creditors, where, after due investigation, he or she determines that the estate has no equity in such assets or such assets are burdensome to the estate or are of inconsequential value and benefit to the estate.

Essentially, Section 727.108(11) requires an Assignee to abandon an estate asset directly to a secured creditor where the Assignee determines that the estate has no real interest in the asset.

[14] *See* §§ 727.01-727.08, Fla. Stat. (1889) (repealed 1987).

This provision arguably eliminated the necessity for separate foreclosure proceedings and the unnecessary expense, wait, etc. associated therewith.

Current Economic Conditions

Over time, lending practices and procedures change. In addition, as we all know, the past five years have brought about rarely witnessed economic turmoil. Some suggest that secured and/or lien creditors' motivations concerning collateral available to satisfy existing obligations have also changed. Where a creditor was formerly concerned with acquiring a secured asset most efficiently, the current over-saturation of available property in certain markets and/or the perceived difficulty in administering or liquidating certain assets can prompt secured creditors to delay, sometimes indefinitely, their contractual rights to seek satisfaction of outstanding debt obligations through utilization of their "in rem" rights against collateral.

Instead, secured creditors are looking to alternative sources of recovery, such as personal guarantees. These personal guarantees are contractual obligations, often entered into by the principals of the debtor at or about the time the secured creditor extends the financing necessary to purchase the subject collateral. Secured creditors can opt to pursue a personal guarantee or "in personam" remedy first, holding off on foreclosure actions against underwater assets. Though this course of action is often fully within the creditor's rights under applicable loan documents, it leaves an Assignee in the unenviable position of holding assets that have no meaningful sale prospect (at least, no prospects that would come close to paying off the outstanding debt in full).

In short, Assignees are directed by statute to shed assets that are burdensome to the estate, but when secured creditors do not want to take possession of those underwater assets, a quagmire results – there is a quest for liquid assets despite there being real (albeit underwater) assets right in front of everyone's noses. As a result of this tension, disputes have arisen over the implications of an Assignee's duty under s. 727.108(11). Some Assignees assert the right to forceably abandon an asset to a secured or lien creditor when the conditions set forth in s. 727.108(11) are met. Not surprisingly, the affected creditors deny such a right exists and insist that they cannot be forced to accept an asset just because they contracted for the *right* to demand payment therefrom. The creditors assert that an asset abandoned by an Assignee, then refused by a creditor, reverts back to the assignor, though such result seems to contravene the irrevocability of an ABC. There is no easy answer.

The Prudency of Amendment

At first blush, this issue may seem ripe for amendment. Like many of the procedural issues addressed in the proposed amendments, the conflict detailed above has produced significant litigation and uncertainty regarding the ABC process, most of which might be eliminated through clarification of the Statute. However, unlike certain other issues, the "abandonment" issue discussed above concerns substantive property rights, such that any amendment would have numerous implications on the general effectiveness of the ABC process. Florida Statute 727.108(11) is not a "glitch" in the law. Its import appears to have been thoughtfully and appropriately considered 25 years ago, admittedly without the benefit of a crystal ball that could have predicted the manner in which an inflated real estate market would subsequently crash with such an enormous amount of underwater property in its wake.

Additionally, and perhaps most importantly, as set forth below, amendment of section 727.108(11) to remove the abandonment concept is unlikely to solve any real problem.

First and foremost, the fact that the abandonment conflict exists as a result of specific (and temporary) economic and market conditions, largely related to the bursting of the real estate "bubble," is reason enough to refrain from amending the Statute. There are fundamental policy reasons against the substantive amendment of any law to accommodate temporary circumstances. The current version of the Statute, specifically in respect of abandonment, appears to have functioned effectively for the first 20+ years of its existence. There is no indication that it will not continue to do so once the current economic conditions stabilize, particularly with respect to the real estate market. Moreover, as a practical matter, the Florida Legislature cannot be expected to change the law each and every time economic conditions change, nor is it sound policy to even consider such a course.

Second, abolishment of an Assignee's abandonment right will do little to assuage the complaints voiced by secured creditors who argue that an Assignee should not be able to force an interest in property upon them. The reason is that abandonment by an Assignee abandons only the Assignee's interest in the asset, which can (by definition) be no greater than the assignor's former interest. After all, a basic tenant of property law is that one can transfer only what he owns. As a result, in the situation described above, where a debtor has only bare legal title and/or a right of possession (i.e., where the debtor has no equity in the asset), all the Assignee can acquire from the assignor or "give" the secured creditor is that right of possession – the secured creditor is already the equitable owner of the asset by virtue of its lien, for which it previously bargained. The only way to avoid such an ownership interest is for the lien to be released.

For the foregoing reasons, the Section opposes substantive amendment of the ABC Statute to amend, eliminate, and/or extend an Assignee's right to abandon assets to a duly-perfected secured or lien creditor under section 727.108(11). The Section believes it is the responsibility of the Courts to interpret the Statute, and that the conflicts concerning an Assignee's right to abandon under current economic conditions will be resolved by the Courts, if necessary, whensoever an appropriate case presents itself.