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Feature

By Russell C. Silberglied[1]

A Cautionary Tale for Drafters of General Assignment Agreements

Russell C. Silberglied
Richards, Layton & Finger, PA
Wilmington, Del.

Russell Silberglied is a director with Richards, Layton & Finger, PA in Wilmington, Del.

A recent unpublished decision from the U.S. Bankruptcy Court for the Southern District of New York, *In re Schiff Fine Art LLC*,[2] denied a motion of an assignee for the benefit of creditors (the "assignee") to dismiss or abstain from hearing an involuntary chapter 7 case. The opinion has garnered attention because the assignee had already been liquidating the estate for approximately 10 months by the time his motion was denied. While this result is atypical and disconcerting, particularly for an assignee that has spent significant resources doing his/her job, a close read of the opinion demonstrates that its central holding turned on a few key facts that are absent in almost all assignment for the benefit of creditors (ABC) cases.

First, the debtor in *Schiff Fine Art* actually consented to the involuntary petition — an action that is unheard of after a voluntary ABC. Second, the general assignment contained a highly unusual provision that the assignor would retain sole authority to defend litigation against the assignor. Thus, practitioners and companies considering an ABC should not despair that *Schiff Fine Art* creates significant risks in an ABC case, but instead should take it as a warning not to significantly depart from a standard general assignment agreement; the result here likely would have been different if a standard assignment agreement were used.

Facts

The debtor/assignor, Schiff Fine Art (SFA), was an advisory business for purchasing and selling fine art. In the year before the involuntary bankruptcy, several individuals sued SFA and its sole member, Lisa Schiff, alleging fraud in connection with art sales. For example, certain suits alleged that SFA and Schiff sold artwork for clients but failed to remit to the seller all of the sale proceeds, while others alleged that they failed to use millions of dollars given to them by a prospective buyer to purchase artwork as instructed.

Shortly after the suits were filed, SFA made an ABC to the assignee. The opinion gives few details about the assignment, but it quotes one highly unusual provision:

> [The] Assignor [*i.e.*, SFA] shall retain the sole and exclusive right to defend any litigation or investigations (whether civil, criminal, or regulatory in nature) to which [the] Assignor is a party, to select counsel to represent [the] Assignor (as well as any former employees, members, and agents of [the] Assignor) in the same, and to be the sole decision-maker in all such pending or future litigations and investigations.[3]

However, the general assignment transferred and assigned all of the assignor's assets to the assignee.[4] Upon taking the assignment, the assignee appears to have done exactly what one would expect an assignee to do under the circumstances: He commenced a "public auction sale of some of SFA's art inventory, [pursued] negotiations for the private sale of additional art inventory, and initiated a lawsuit against Schiff to recover SFA's former assets."[5] In addition, the assignee "post[ed] a provisional bond and advertis[ed] for creditors to submit notice of claims."[6] He then filed an ABC case in state court in New York.

1 The views expressed in this article are those of the author and not necessarily those of Richards Layton & Finger, PA or its clients.
2 2024 WL 1085148 (Bankr. S.D.N.Y. March 12, 2024).
3 2024 WL 1085148 at *3 (the "Litigation Defense Provision").
4 *Id.* at *4.
5 *Id.* at *2.
6 *Id.* at *4.

Nevertheless, when Schiff filed her own personal bankruptcy case, the plaintiffs in some of the lawsuits filed an involuntary chapter 7 case against SFA. In an unusual twist from most ABC cases, SFA filed a consent to the chapter 7 case, after which the assignee moved to intervene and to dismiss or abstain on the basis that assets were already being liquidated in the ABC case. The bankruptcy court permitted intervention, but denied the motion to dismiss or abstain, with one caveat.

Motion to Intervene Granted

Because the debtor had consented to the petition, the assignee filed a motion to intervene in order to move to dismiss or abstain. The petitioning creditors opposed the motion to intervene, arguing that the assignee had no separate or independent interest and that the chapter 7 trustee could protect the assignee's interests. The court disagreed and granted the motion to intervene. It held that "Mr. [Douglas] Pick's role as Assignee for the benefit of SFA's creditors gives him an interest in SFA's assets, and that those assets are among 'the property or transaction which is the subject of the action.'"[7] Because a chapter 7 trustee would be "tasked with liquidating the same assets that Mr. Pick is attempting to liquidate in his state court-authorized role as Assignee," whether the bankruptcy case proceeds would "necessarily impact his interest[s] in SFA's assets."[8]

The petitioning creditors contended that the assignee's interest would not be impaired because the chapter 7 trustee and the assignee would have the same goal of liquidating assets to achieve the largest return for creditors. According to the court, this argument "ignores the reality that Mr. Pick believes he has made great progress and is on the cusp of taking long-planned steps that he thinks will realize creditor recoveries."[9]

Moreover, the court held that the assignee's interest would not be adequately represented by any other party, including the trustee. "In fact, there is a significant chance that causing Mr. Pick to file a proof of claim for the value of his pre-petition services would deprive him of court-approved full fee payment in the state court proceedings, and instead subject him to a possible cents-on-the-dollar recovery as an unsecured creditor of a bankruptcy estate."[10] Thus, the court granted the assignee's motion to intervene with reasoning that seemingly recognized and credited the role of an assignee for the benefit of creditors.

The Court's Analysis

The assignee sought dismissal under § 303(d) of the Bankruptcy Code or dismissal or abstention under § 305. The court denied the dismissal request and invited further briefing as to one issue concerning the abstention request.

Dismissal Under § 303(d) Denied Because an Assignee Is Not a "Debtor"

The most direct path to dismissal of an involuntary petition is typically a motion pursuant to § 303(d).[11] Titled "Involuntary cases," § 303 states that "the debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer to a petition under this section."[12] Rule 1011 of the Federal Rules of Bankruptcy Procedure, titled "Responsive Pleading or Motion in Involuntary Cases," similarly provides, "The debtor named in an involuntary petition may contest the petition." The court stated that "[n]otably absent from these provisions is any express authorization for any other party to contest an involuntary petition."[13]

The assignee argued that several opinions have nevertheless permitted an assignee to move to dismiss an involuntary petition. The court found those cases to be "materially distinguishable" because "they all involve instances where the debtor failed to file an answer to the involuntary petition, whereas here, the debtor ... has consented to the petition; in fact, SFA has represented that it likely would file a voluntary bankruptcy petition if the involuntary Petition is dismissed."[14]

It is nearly unprecedented for an entity first to voluntarily enter into an ABC, then change course and consent to an involuntary bankruptcy petition — much less to threaten that it will file its own voluntary bankruptcy petition. Typically upon making a general assignment, the assignor's board of directors and officers dissolve the entity and resign as soon as possible. After all, having just made the general assignment, the entity no longer has any assets, and a fiduciary has been selected to wind up the entity's affairs. Thus, there usually is no one left at the assignor to consent to an involuntary petition or to file a voluntary petition, even if there were a reason (or cash to pay professionals) to do so.

The most likely explanation of why this case was different is that Schiff was the sole member of the assignor/debtor limited liability company (LLC), and the assignee sued Schiff.[15] Because SFA was a single-member LLC, Schiff had no reason to resign, and presumably she became disenchanted with the assignee when he sued her. This seems to explain why Schiff took an action rarely — if ever — seen in corporations or LLCs with multiple equityholders, officers and directors.

In addition, many assignees' forms for general assignment agreements contain a broad power of attorney that enables the assignee to act on the assignor's behalf. The power of attorney can be necessary to avoid situations when there is no one to execute documents or file tax returns once the assignor dissolves and/or has no remaining directors or officers. If worded broadly enough, such a power of attorney might enable the assignee to move to dismiss an involuntary petition *in the name of the debtor*, thereby obviating the aforementioned § 303(d) and Bankruptcy Rule 1011(a) limitations on who may file a motion to dismiss. Thus, while the court denied the motion to dismiss on the facts of this case, most cases have facts that are quite different, which could lead to the opposite result.

7 *Id.* at *5
8 *Id.* at *6.
9 *Id.*
10 *Id.* at *6.

11 Courts also may dismiss an involuntary bankruptcy petition under 11 U.S.C. § 707(a) or abstain under 28 U.S.C. § 1334(c)(1). *See, e.g., In re Korean Radio Broad. Inc.*, 2020 WL 2047990 (Bankr. E.D.N.Y. March 31, 2020) (granting assignee's motion to dismiss under §§ 707(a) and 305 or, in the alternative, abstaining under § 1334(c)(1)).
12 11 U.S.C. § 303(d).
13 *Schiff Fine Art*, 2024 WL 1085148 at *7.
14 *Id.*
15 *Id.* at *2.

Abstention Request Held in Abeyance Due to Contract Language

The court's ruling on § 303 did not end the analysis because the assignee also moved to dismiss or abstain under § 305(a). It reads, in pertinent part, "The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title ... if ... the interests of creditors and the debtor would be better served by such dismissal or suspension."[16] Unlike § 303(d), § 305(a) does not mention who may file a motion for relief under that section or limit such relief to the debtor.

Thus, an assignee may — and frequently does — seek dismissal or abstention under § 305(a). Moreover, the grounds for dismissal or abstention under § 305(a) — the best-interests test — align with the assignee's typical argument for dismissal or abstention: The assignee already has been undertaking the same activities that a chapter 7 trustee would perform, and is up to speed and can do it more efficiently and with fewer costs. As a result, the bankruptcy court need not waste its judicial resources on the matter.

Nothing in the *Schiff Fine Arts* opinion undermines this typical argument. The portions of the opinion granting intervention specifically credit similar arguments in connection with the test for intervention. It thus seems that normally, the *Schiff Fine Art* case would have considered this argument favorably in connection with a § 305(a) motion.

However, the case turned on the unusual litigation-defense provision, which retained for the assignor the "sole and exclusive right to defend any litigation," and the power "to be the sole decision-maker in all such pending or future litigations and investigations." The court determined that "[a]n application to dismiss a petition ... is inherently 'defensive' 'litigation.'"[17] Thus, the court held that the contractual provision vested the sole power to move to dismiss the petition in the debtor/assignor, not the assignee.

The court determined that it was a closer call "whether seeking abstention under Section 305 ... constitutes affirmative or defensive litigation."[18] It invited further briefing on the subject because under the contractual language, if abstention also is "defensive" litigation, the court would necessarily reach the same result, but if abstention is "affirmative" litigation, the contractual language is inapplicable and the assignee may seek such relief.[19]

This limitation is not a concern for future cases as long as the parties use a standard form of general assignment. Such standard forms vest all power to control litigation with the assignee. This makes sense, because the assignee, as a fiduciary for the estate, is charged with overseeing the claims process and objecting to claims to the extent that they are invalid or overstated, as long as it makes economic sense to do so (*i.e.*, spending significant litigation costs to defend a low-dollar unsecured claim might be a net negative for the estate even if the claim is invalid).

Therefore, normally there would be no reason to permit the assignor to defend such cases. Equally important, the assignor normally would have no desire to do so; having assigned all of its assets to pay creditors ratably, the assignor has no cash to pay legal fees and is economically unaffected by the result of the litigation. While the opinion does not expressly so state, the most likely explanation for the departure from the norm in the *Schiff Fine Arts* general assignment agreement is that Schiff likely was concerned that if the assignor suffered a litigation judgment and did not pay it due to its insolvency, the plaintiff would pursue her — as the sole member and manager of the assignor — on a veil-piercing or alter-ego theory.

Thus, presumably, she had an interest in making sure that the assignee did not decide to take a default judgment in litigation under a theory that the legal costs of defense were not warranted. While that has some logic from Schiff's standpoint, it created something quite different from what is normally found in a general assignment agreement, and that difference had significant consequences on the motion.

Conclusion

The result of *Schiff Fine Art* was no doubt frustrating: An assignee for the benefit of creditors who was liquidating the company for almost a year wound up being replaced by a bankruptcy trustee right on the eve of additional sales. However, the result was driven not by some general concept that bankruptcy courts will not abstain from involuntary cases when an ABC is pending, but by the particular facts of the case. If parties wish to avoid the result of *Schiff Fine Art*, they should use a standard general assignment agreement that does not reserve litigation rights for the assignor, and grants a broad power of attorney to the assignee. abi

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16 11 U.S.C. § 305(a)(1).
17 2024 WL 1085148 at *8.
18 *Id.* at *9.
19 The issue subsequently became moot because the newly appointed chapter 7 trustee entered into a stipulation whereby the assignee would withdraw his motion and the assignee's counsel would be retained by the trustee. *See In re Schiff Fine Art LLC*, Case No. 24-10039(DSJ), Dkt. 45 (Bankr. S.D.N.Y. April 12, 2024).