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## Feature

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### So You Want to Arbitrate a Chose in Action Obtained Through an ABC?

#### Assignees in ABCs Have Authority to Assert Claims of Assignor



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**Editor's Note:** For more information about ABCs generally, purchase *General Assignments for the Benefit of Creditors: The ABCs of ABCs, Third Edition (ABI 2015)*, written by Mr. Berman, available in the ABI Bookstore at [abi.org/bookstore](http://abi.org/bookstore) (members must log in first to obtain member-only pricing).

The Court of Chancery of the State of Delaware recently issued a ruling tipping favor toward the ability of assignees in assignments for the benefit of creditors (ABCs) to assert claims against third parties originally held by the assignor. An ABC is a process under state law whereby an insolvent person or entity may assign all of its assets to an assignee, who then is directed to liquidate the assets for distribution among the assignor's creditors. Although ABCs operate under state law and therefore laws governing ABCs vary from state to state, the general mechanics of an ABC remain largely the same.

One of the major challenges for ABCs is the dearth of statutory guidance or case law governing the issues that may arise in an ABC. The ABC regimes in many states consist of decades-old statutes and a handful of cases. Practitioners often try to analogize the rights, duties and procedures of federal bankruptcy law to ABCs, but that practice is easily countered by the fact that federal bankruptcy law is entirely irrelevant to a state statutory scheme.

In the case of *CVD Equipment Corp. v. Development Specialists Inc.*,<sup>2</sup> the Delaware Chancery Court weighed in on whether an assignee may assert claims in arbitration originally held by

the ABC assignor under an agreement with a third party. Stion Corp. originally contracted with CVD Equipment Corp. for the purchase of equipment. Stion eventually became insolvent and assigned its assets in an ABC under California law to an assignee, Development Specialists Inc. Stion transferred all rights, titles and interests in its assets to the assignee under the assignment agreement. Specifically, the agreement provided

[Stion] hereby assigns, grants, conveys, transfer[s], and sets over to [the] Assignee all right[s], title[s] and interest[s] in personal property and assets ... and claims, and choses in action that are legally assignable, together with the proceeds of any nonassignable choses in action that may hereafter be recovered or received by ... [Stion].

In turn, the assignment agreement provided that the assignee

shall have all powers necessary to marshal and liquidate the estate including but not limited to ... (f) [t]o settle any and all claims against or in favor of [the] Assignor, with the full power to compromise, or, in the Assignee's sole discretion, to sue or be sued, and to prosecute or defend any claim or claims of any nature whatsoever existing in favor of [the] Assignor.<sup>3</sup>

The assignee then sold most of Stion's assets but retained choses in action. The contract between Stion and CVD contained a mandatory arbitration clause regarding any disputes arising under the contract. Pursuant to this provision, the assignee eventually filed an arbitration action against CVD for breach

<sup>1</sup> The authors note that Development Specialists, Inc. was the assignee in the case discussed herein and Polsinelli served as its special litigation counsel.

<sup>2</sup> No. CV 11062-VCG, 2015 WL 4506052, 2015 Del. Ch. LEXIS 193 (Del. Ch. July 23, 2015) (unpublished).

<sup>3</sup> The assignment agreement included a granting of the power of attorney to the assignee, "which power of attorney specifically includes the right of the Assignee to prosecute any action in the name of the [Stion] as Attorney in Fact ... and [the assignee] shall be deemed to be a representative of the [Stion] with respect to all such potential or actual claims."

of the contract between CVD and Stion. The threshold issue was whether the arbitration provision in the contract could be interpreted — consistent with basic principles of contract and equity — in such a way as to reasonably conclude that the parties voluntarily consented to submit this dispute between the assignee and CVD to arbitration. The arbitrator determined that the assignee had standing to bring the arbitration action.

CVD countered by filing a motion to dismiss the arbitration in the chancery court, arguing that it had no contractual duty to arbitrate with the assignee because the assignee was “a stranger” to the contract between Stion and CVD. In turn, the assignee moved to dismiss CVD’s injunction case. The assignee argued that it could enforce the contract against CVD, including the arbitration provision, against CVD because it stood in the seller’s shoes and may, as a matter of law, exercise any contractual right that could have been exercised by the seller. The assignee further argued that (1) CVD negotiated and agreed to arbitrate all claims arising out of or relating to the contract, (2) the assignee properly stood in Stion’s shoes as its legal representative pursuant to the ABC, (3) the “no assignment” provision of the contract did not bar the ABC or allow CVD to escape its obligation to arbitrate, and (4) ordinary principles of contract interpretation allowed the assignee to be a “party” to the arbitration clause.

Since there were no Delaware cases concerning the assignment of causes of actions to an assignee in an ABC, the assignee relied on case law outside the jurisdiction and a comparison to a bankruptcy trustee.

For example, among other cases holding that assignees generally stand in the shoes of the assignors, the assignee cited to *Credit Managers Association v. National Independent Business Alliance*, where a California appeals court allowed the assignee in an ABC to set aside a default judgment entered against the assignor.<sup>4</sup> In this case, the California court highlighted that “the right of the assignee to defend against a foreclosure of the mortgage is not based upon a transfer of the rights and equities of the creditors, but upon the fact that the title of the property has been vested in [the assignee] in trust for the creditors.”<sup>5</sup> The court concluded that the assignee “was the ‘legal representative’ of the assignor and as trustee for all the creditors, was charged with the duty to defend the property in its hands against all unjust adverse claims.”<sup>6</sup>

The assignee also relied on an older California decision that permitted an assignee in an ABC to proceed on the assignor’s behalf. In *First National Bank of Stockton v. Pomona Tile Manufacturing Co.*, the court ruled that the ABC statutory scheme “merely adopted the common-law rule that the assignee simply stands in the shoes of his assignor.”<sup>7</sup> Thus, under this rule, the court noted that in an ABC, “the creditors, the parties benefited thereunder, part with nothing and place themselves in no worse position than they were prior to the assignment for their benefit.”<sup>8</sup>

Recently, a California court echoed these prior decisions, stating that the “[a]ssignee acquired all of the assets of [the assignor], and held them in trust for the benefit of all of [the assignor’s] creditors. [The] Assignee, under this arrangement, stood in the shoes of [the] Tenant, and [the] Assignee

could properly assert any rights that [the] Tenant had in the Security Deposit.”<sup>9</sup> Thus, despite a lack of Delaware case law, the assignee had sufficient authority in other jurisdictions.

The assignee also analogized its position to that of a bankruptcy trustee. The assignee cited a variety of state and federal authorities that have ruled that assignees in ABCs are similar to bankruptcy trustees. For instance, an assignee quoted one bankruptcy court: “Once the trust agreement is created, the assignee stands in the debtor’s shoes and can protect him or her from creditors because the assignee now possesses legal and equitable title to all assets.”<sup>10</sup> While acknowledging that ABCs and bankruptcies are different statutory remedies for debtors, the assignee reminded the chancery court that even state courts have concluded that “like a bankruptcy trustee, an assignee for the benefit of creditors has the exclusive authority to pursue ... ‘choses in action’ for the benefit of all creditors.”<sup>11</sup>

The chancery court stated that it could decide the issue more narrowly. The court first found that the arbitration provision contained in the contract provided that issues of substantive arbitrability (*i.e.*, whether the arbitrator or court decides what claims are subject to arbitration) is left to the arbitrator’s purview. Thus, the chancery court stated that the only issue for it to decide was whether the ABC assignee’s ability to assert an assignor’s breach-of-contract claim is a nonfrivolous legal claim. CVD argued that the assignee’s ability to assert Stion’s claim was frivolous because the contract contained a provision titled “no assignments” and that CVD did not intend to arbitrate with third parties at the time that it entered into the contract. The chancery court rejected that argument, noting that the “no assignments” section title was simply a provision title and that the actual text of the provision allowed the parties to assign the contract.

Next, the court accepted the assignee’s position that the parties agreed to arbitrate “all claims” and that, but for Stion’s insolvency, Stion would be the one that would have asserted the claim against CVD. Accordingly, the chancery court concluded that the assignee’s ability to assert the arbitration claims was a nonfrivolous legal claim.

The lesson from this case of first impression is that arbitration provisions applying Delaware law in contracts between an assignor under an ABC and a third party are enforceable. The chancery court’s decision in *CVD Equipment Corp.* adds further case law articulating the rights and powers of assignees in an ABC proceeding.<sup>12</sup> Through this decision, assignees and their debtors have further comfort that all of the debtor’s property vests in the assignee, with the ability of the assignee to assert any claims and causes of action the debtor could assert prior to the ABC assignment. **abi**

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4 162 Cal. App. 3d 1166, 1168 (Cal. Ct. App. 1984).

5 *Id.* at 1171.

6 *Id.* at 1172.

7 186 P.2d 693, 703 (Cal. Ct. App. 1947).

8 *Id.* at 703.

9 *Sherwood Partners Inc. v. Stewart AP Inc.*, No. H025291, 2004 WL 363531, at \*23 (Cal. Ct. App. Feb. 27, 2004).

10 *In re TYS Inc.*, 2010 WL 502985, at \*9 (Bankr. D. Mass. Feb. 5, 2010).

11 *Spector v. Melee Entm’t LLC*, 2008 WL 362125, at \*5 (Del. Super. Feb. 6, 2008).

12 See Geoffrey L. Berman, *General Assignments for the Benefit of Creditors: The ABCs of ABCs*, Third Edition, at 47-48 (ABI 2015).