

# **Common Law Assignments for the Benefit of Creditors as practiced in Illinois**

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## I. INTRODUCTION

The exorbitant cost of going broke is of great concern to many troubled companies in Illinois and other jurisdictions. Some insolvency professionals are rejecting the bankruptcy court in favor of common-law assignments for the benefit of creditors as an efficient and expedient process for the orderly wind up of the financial affairs of an insolvent business enterprise. Compared to a chapter 7 Case, an assignment is far more efficient, less costly, of shorter duration and frequently results in greater realization of asset value and therefore larger recoveries for creditors.

## II. NATURE AND EFFECT OF ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

In Illinois and in many other common law states, assignments are commenced by delivery and acceptance of a duly authorized written, voluntary transfer of assets to a fiduciary, in trust, for payment of the assignor's debt.<sup>1</sup> Like a bankruptcy trustee, the assignee is the fiduciary representative of creditors, charged with the responsibility of administering assets and distributing the proceeds. Unlike a bankruptcy trustee, the assignee is not obliged to seek creditor or court approval for the assignee's administration. For creditors, this out-of-court proceeding usually results in more prompt and larger distributions. Debtors who wish to avoid a costly and protracted bankruptcy proceeding may still benefit from the services of a qualified professional who is charged with the responsibility of generating the highest return for creditors.

The assignment for the benefit of creditors creates an express trust with the assignee acting as trustee.<sup>2</sup> The creditors are the beneficiaries of the trust. As with other express trusts, the consent of the beneficiaries is not a condition of validity, and creditors need not consent to an

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<sup>1</sup> *Illinois Bell Tel. Co. v. Cool F Furniture House, Inc.*, 157 Ill.App.3d 190 (1987).

<sup>2</sup> *Tribune Co. v. Canger Floral Co.*, 312 Ill.App. 149, 37 N.E.2d 906,909 (1st Dist. 1941).

assignment for the benefit of creditors.<sup>3</sup> Since 1839 the Illinois Supreme Court has recognized the validity of common law assignments.<sup>4</sup>

A valid assignment for the benefit of creditors unconditionally places the debtor's property in the hands of the assignee and beyond the reach of the debtor's creditors. Provided that an unconditional Assignment was properly authorized, executed, delivered and accepted before any creditor engages in post-judgment enforcement proceedings, collection efforts such as levy and execution or service of citations to discover assets will be unavailing.<sup>5</sup>

Like Chapter 7 bankruptcy cases for business organizations, assignments for the benefit of creditors will not discharge a debtor from any of its debts or liabilities unless the assets are sufficient to pay all claims in full. Therefore, Assignments are not appropriate to administer the assets of debtors who want to remain in business or for individual debtors.

In some states assignments for the benefit of creditors are regulated by statute. Typically, these statutes require the initiation of a formal court proceeding, the recording of assignments, the filing of schedules of assets and liabilities, and the posting of a bond in some multiple of the value of the property under the assignee's control. In those states, the added cost and complexity of the assignment process limits its attraction as a bankruptcy alternative. At one time, Illinois had a statute governing assignments for the benefit of creditors. The legal effect of statutory assignments in Illinois was superseded by the enactment of federal bankruptcy laws in 1898. The Illinois assignment statute was formally repealed in 1939, and since that date assignments have been governed by common law.

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<sup>3</sup> *Watson v. Willerton*, 258 Ill.App. 390 (1930).

<sup>4</sup> *Cross v. Bryant*, 3 Ill. 36 (1839).

<sup>5</sup> *Consolidated Pipe & Supply Co. Inc. v. Rovanco Corp.*, 897 F.Supp. 364, 370 (USDC N.D. Ill. 1995); *Bach v. Chas. Weiner & Sons, Inc.*, 6 Ill.App.2d 284, 127 N.E.2d 279 (1st Dist, 1955).

### III. FORMAL REQUIREMENTS

#### A. Valid Assignments

Valid assignments for the benefit of creditors have several formal requirements.

1. Assignments must be in writing and must contain express language establishing a trust over specific property for the benefit of creditors.<sup>6</sup>
2. The trust agreement must set forth the powers and duties of the assignee/trustee.<sup>7</sup>
3. Property that is subject of the Assignment must be expressly conveyed into the trust for the benefit of all creditors and not merely for one creditor or a group of creditors to the exclusion of others.<sup>8</sup>
4. The transfer of property to the assignee must be absolute and unqualified and constitute all of the debtor's interest, both legal and equitable, in the property conveyed.<sup>9</sup>
5. The Assignment cannot attempt to discharge claims against the debtor or coerce creditors into accepting anything less than full payment as a condition of participating in the distribution.<sup>10</sup>
6. The Assignment cannot exempt the assignee from personal liability for willful misconduct or gross negligence.<sup>11</sup>
7. The debtor must not condition or reserve any benefit or use of the assigned property, and any reservation of right to control the property or the conduct of the assignee will render the Assignment void.<sup>12</sup>

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<sup>6</sup> *Black v. Palmer*, 15 Ill.App.2d 207,145 N.E.2d 797, 800 (1st Dist. 1957)

<sup>7</sup> *Illinois Bell Telephone Co. v. Wolf Furniture House, Inc.*, 157 Ill.App.3d 190, 509 N.E.2d 1289, 109 Ill.Dec. 277 (1st Dist. 1987)

<sup>8</sup> *Browne-Chapin Lumber Co. v. Union National Bank of Chicago*, 159 Ill. 458, 42 N.E. 967 (1896)

<sup>9</sup> *In re Birk and Johnson*, 295 F. 510 (7th Cir. 1923)

<sup>10</sup> *Tribune Co. v. R. & J. Furniture Sales, Inc.*, 20 Ill.App.2d 370,155 N.E.2d 844, 846 (1st Dist. 1959); *Gessler v. Myco Co.*, 29 Ill.App.2d 227, 172 N.E.2d 303 (2d Dist. 1961)

<sup>11</sup> *Robinson v. Nye*, 21 Ill. 592 (1859); *Finlay v. Dickerson*, 29 Ill. 9 (1862).

<sup>12</sup> *Hardin v. Osborne*, 60 Ill. 93 (1871)

8. The assignee must formally accept the Assignment for it to be valid and effective.<sup>13</sup>

9. The Assignment must be delivered and accepted by the assignee prior to the debtor's receipt of any post judgment enforcement action. Illinois courts have ruled that the prohibition against transfers contained on the face of the citation to discover assets bars debtors from making transfers of their property to assignees.<sup>14</sup>

#### **B. Effect of an Invalid Assignment**

If an Assignment is invalid, the debtor's property in the possession of the assignee can be reached by creditors through judicial process.<sup>15</sup>

### **IV. POWERS AND DUTIES OF ASSIGNEE**

Once an Assignment has been duly authorized, properly executed, tendered to and accepted by the assignee, actual possession of the debtor's property is immediately delivered to the assignee for safeguarding and ultimately for disposition. Generally, the assignee will take control of the debtor's bank account and cause a change of address form to be lodged with the post office. At one time it was common for the assignee to record a copy of the Assignment in each county where the debtor owned real property. Like a trustee in bankruptcy, the assignee has a duty to liquidate the debtor's assets for the highest and best price. Frequently, the assignee will sell the debtor's tangible assets by public auction or at a sale upon a return of bids.

Experienced assignees promptly notify the debtor's creditors including all state and local taxing authorities that an assignment has been made and the intended disposition of the debtor's property. Generally, the assignee's notice provides a summary of the assets and liabilities of the

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<sup>13</sup> *MacVeagh v. Chase & Sanborn*, 67 Ill.App. 160 (1896)

<sup>14</sup> *Consolidated Pipe & Supply Co., Inc., v. Rovanco Corp.* 897 F Supp 364 (ND IL. 1995) *City of Chicago v. Air Auto Leasing Co.* 297211 App 3d 873 (1998)

<sup>15</sup> See *Tribune Co. v. R. & J Furniture Sales, Inc.*, 20 Ill.App.2d 370,155 N.E.2d 844, 846 - 847 (1st Dist. 1959)

debtor, states the reasons for the debtor's financial difficulty, and includes a claim form for each creditor to complete and lodge with the assignee. The assignee or the assignee's lawyer will carefully examine all mortgages and security interests to make sure all asserted lien claims are properly perfected. Section 9-309 of the Illinois' Uniform Commercial Code subordinates unperfected security interests to the assignee's interest in personal property.<sup>16</sup>

The assignee will also examine the debtor's books and records to determine whether the debtor has made or suffered any transfers of its property that are voidable under Illinois Uniform Fraudulent Transfer Act (P.A. 86-814), 740 ILCS 160, et seq., effective January 1, 1990. Finally, the assignee will determine whether the debtor made voidable transfers under the Bankruptcy Code such as preferences (11 U.S.C. §547) or fraudulent conveyances (11 U.S.C. §548) that only a trustee in bankruptcy could recover. Although the assignee does not have the same standing as a bankruptcy trustee to recover these transfers, the assignee as the representative of creditors has the authority to initiate an involuntary bankruptcy case and often the threat of a bankruptcy filing is sufficient to cause the return the voidable transfer.

The assignee acquires only the debtor's property rights to the assigned assets. A debtor's assets may be subject to pre-existing security interests, mortgages or liens, and if properly perfected, such encumbrances remain valid against the assignee. Therefore, after the debtor's property has been sold, collected or otherwise administered the assignee must first pay the holders of valid claims secured by liens or security interests against the debtor's assets from the proceeds of their respective collateral.<sup>17</sup> After payment of all valid encumbrances, the assignee will pay the costs of administration including any unpaid post-assignment rent, insurance, or

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<sup>16</sup> 810 ILCS 5/9-309

<sup>17</sup> *In re Mossier Co.*, 23 F. 262 (7th Cir. 1917), but see *First Bank v. Unique Marble and Granite Corp.*, 345 Ill. Dec. 1154, 938 N.E. 2nd 1154 (Ill. App. 2010).

utilities, the assignee's own fees and expenses<sup>18</sup> and the fees of the assignee's attorney<sup>19</sup> and, in appropriate cases, the attorney for the debtor.

Frequently the assignee and secured creditors work cooperatively to fund the costs of the assignee's administration from the secured creditors collateral as many lenders no longer employ the staff to administer the collateral of a defaulting borrower.<sup>20</sup>

Once the costs of administration have been paid, the assignee will make distribution to the debtor's unsecured creditors. In an assignment all claims of the United States, including tax claims are paid first (Title 31 U.S. Code § 3713(a) and then claims due state and local governments. Once governmental claims are paid in full, the assignee pays wage claims to laborers or servants as required by 770 ILCS 85/1. The remaining surplus is distributed pro rata among general creditors.

## **V. ASSIGNEE'S RIGHT TO CONDUCT BUSINESS**

At one time it was uncertain as to whether or not the assignee was empowered to continue the operation of the debtor's business post assignment until sale<sup>21</sup> or to sell the debtor's assets on credit.<sup>22</sup> The modern view and the one espoused by most assignees permits the operation of the debtor's business for the limited purpose of selling the assets on a going concern basis in order to maximize value. Assignees will also consider sales of the assets on credit in appropriate circumstances where adequate security is provided and the subject property cannot be sold for cash.

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<sup>18</sup> *Randolph & Randolph v. Scruggs*, 190 US. 533, 538-39 (1903)

<sup>19</sup> *In re Peerless Manufacturing Co.*, 523 F.2d 110, 112 (7th CA 1975)

<sup>20</sup> *First Bank v. Unique Marble and Granite Corp.*, supra at 1161-62.

<sup>21</sup> see *Gardner v. Commercial National Bank of Providence*, 95 Ill. 298 (1880), and *Milligan v. O'Connor*, 19 Ill.App. 487 (1886)

<sup>22</sup> see *Pierce v. Brewster*, 32 Ill. 268 (1863), and *Watson v. Willerton*, 258 Ill. App. 390 (1930)



## **VI. SPECIAL ISSUES RELATING TO THE ASSIGNMENT OF REAL PROPERTY**

Prior to the enactment of federal and state environmental regulations, common-law assignees would record a copy of the Assignment/ Trust agreement in each county where the debtor's assets were located. Eventually, recording lead to the unintended consequence of placing the assignee in the chain of title to any real property owned by the debtor, and thus a potentially responsible party where the real estate was environmentally challenged. Although most assignees no longer record their assignments, the concern about how to administer a debtor's real estate remains an important issue. The personal property of an assigning debtor is frequently auctioned or sold to a purchaser who may not be interested in purchasing the debtor's premises. In those situations the sale of the real estate may occur long after the operating assets have been sold and removed. Until a sale is concluded, the assignee remains responsible for insuring and preserving the real estate as long as it remains in the trust. When real property is included among the debtor's assets, an assignee should engage the services of a broker to market the real property while the remaining assets are administered.

When time permits, most assignees insist on a phase I or in appropriate circumstances a phase II environmental survey before accepting an assignment of real property. Realistically, the constraints imposed by assignors waiting until the last minute before making assignments do not allow enough time to complete the survey. In those cases, assignees may insist on an environmental indemnity from a solvent third party such as a bank which holds the mortgage on the real estate. Alternatively, the lender may be agreeable to allowing sufficient proceeds from a sale of the real estate to be utilized to remediate any environmental hazard. In other circumstances an assignee may insist that the debtor transfer the real property into a newly formed limited liability company with the assignee as the sole member.

## VII. ADVANTAGES, DISADVANTAGES, AND PRACTICAL CONSIDERATIONS

The most attractive features of Assignments are the relative speed of the distribution and reduced costs of administration compared to a bankruptcy case. In addition the debtor has the ability to select a competent professional to act as assignee as opposed to the random selection of a bankruptcy trustee. In appropriate cases additional considerations may include the priority afforded tax claims ahead of wage claims (the opposite of the Bankruptcy Code) and the ability of the assignee to direct the tax payment to the trust fund portion of tax obligations for which management may have personally liability.<sup>23</sup>

One negative aspect of assignments is the lack of discharge of indebtedness and as a consequence rarely do individuals or business entities hoping to reorganize make assignments. Other drawbacks include, at least in Illinois, the inability of assignees to recover voidable preferential transfers.

For some excellent examples of assignment forms see **[to be supplied]**.

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<sup>23</sup> *Muntwyler v. United States*, 703 F.2d 1030 (7th Cir. 1983); *In re Avildsen Tools & Machine, Inc.*, 794 F.2d 1248 (7th Cir. 1986)