

How Ill. Bankruptcy-Alternative Laws Have Endured

By **Donald Swanson** (September 2, 2022)

An assignment for the benefit of creditors, or ABC, is, historically, a nonjudicial process for administering the affairs of a failed business.

ABC laws are rooted in English common law and predate enactment of federal bankruptcy laws in the U.S.[1]

An ABC is made by a formal, voluntary transfer of most or all of a business's assets to an assignee, in trust, to apply the property or its proceeds to the payment of debts and to return any surplus to the debtor.



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Like a bankruptcy trustee, the assignee is a representative of creditors, charged with responsibility to administer the debtor's assets and distribute the proceeds ratably among creditors.

Unlike a bankruptcy trustee, the Illinois assignee need not seek court approval for the numerous acts of administration.

For creditors, such out-of-court proceedings often result in quicker and larger distributions, compared with bankruptcy, and debtors gain the advantage of avoiding bankruptcy court while still having a qualified professional to generate the largest-possible returns for creditors from disposition of debtor's assets.

An ABC creates an express trust, under which the assignee acts as trustee, the debtor is the assignor and the creditors are beneficiaries. As with other express trusts, a beneficiary's consent is not a condition of the assignment's validity.

Common Law

Since 1839, Illinois has recognized the validity of common law ABCs, and the rules for such assignments have remained largely intact over the intervening years — for nearly two centuries. The following two cases illustrate the longevity and continuity of such common laws.

From 1839

In *Cross v. Bryant* in 1839,[2] the Illinois Supreme Court declared the following:

- "A debtor may lawfully convey his property in trust to another for the benefit of any one creditor or class of creditors, and may direct by his conveyance how and to whom the proceeds shall be appropriated and paid"; and
- "A general assignment of a debtor's property in trust for all his creditors, is valid when it is coupled by no unjust conditions for the purpose of coercing the creditor."

The assignment in the present case is valid because it is positive and absolute, "no unjust terms are coupled with it to coerce the acceptance of it by the creditors," creditors are not required to accept the property, payments to creditors are not "on the condition of their

executing an absolute release of their respective claims," acceptance of payments by creditors is to be purely voluntary, and if creditors remain unpaid after liquidation, they are free to pursue whatever remedy they may elect to collect the residue of their claims.

From 2010

In *First Bank v. Unique Marble & Granite Corp.* in 2010,[3] the Illinois Second District Appellate Court declared:

- "In Illinois, between 1877 and 1939, a statute governed voluntary assignments, but they also existed at common law";
- "An assignment for the benefit of creditors is a voluntary transfer by a debtor of its property to an assignee in trust for the purpose of applying the property or proceeds thereof to the payment of its debts and returning the surplus, if any, to the debtor";
- "A debtor may choose to make an assignment for the benefit of creditors, which is an out-of-court remedy, rather than to petition for bankruptcy, because assignments are less costly and completed more quickly";
- "The assignment is a unique trust arrangement in which the assignee (or trustee) holds property for the benefit of a special group of beneficiaries, the creditors";
- "Thus, the assignee owes a fiduciary duty to the creditors";
- "Absent some defect in the creation of the assignment itself, an assignment passes legal and equitable title to the debtor's property from the debtor to the assignee"; and
- "In such case, the assignment is valid without the consent of any of the debtor-assignor's creditors."

Illinois' Old ABC Statutes

Enacted

In 1877 the Illinois Legislature enacted an ABC statute titled the Voluntary Assignment Act.

Suspended

In 1900, however, the Illinois Supreme Court declared that the Federal Bankruptcy Act of 1898 "suspends or supersedes" Illinois' Voluntary Assignment Act.

In *Harbaugh v. Costello* in 1900,[4] the Illinois Supreme Court reasoned as follows.

The final provision of the Federal Bankruptcy Act of 1898 says, "Proceedings commenced under State insolvency laws before the passage of this act shall not be affected by it."

This means that no assignment can be made, under the Voluntary Assignment Act, after passage of the Federal Bankruptcy Act of 1898.

Since the Federal Bankruptcy Act of 1898 and the Illinois Voluntary Assignment Act both

seek a pro rata distribution of debtor's assets among debtor's creditors, the two laws "cannot be in force together without direct and positive collision," so that "the Federal act suspends or supersedes the State law."

Revoked

All prior federal bankruptcy acts were repealed. The Bankruptcy Act of 1800 was repealed in 1803, the Bankruptcy Act of 1841 was repealed in 1843 and the Bankruptcy Act of 1867 was repealed in 1878.

So, the Illinois Legislature expected, and waited for, a repeal of the Federal Act of 1898 as well — because a repeal of the Federal Act would automatically reinstate Illinois' Voluntary Assignment Act.

But Congress never repealed the Federal Act of 1898 — instead, that act remained in effect until Congress replaced it, in 1978, with the current U.S. Bankruptcy Code.

After waiting four decades for a repeal of the Federal Act of 1898, without the desired result, the Illinois Legislature finally gave up and repealed Illinois' Voluntary Assignment Act of 1877.

Common Law ABCs Continue and Adapt in Illinois

Notwithstanding repeal of Illinois' Voluntary Assignment Act, Illinois courts continue to recognize and allow common law assignments for benefit of creditors — governed by case law.

Further, Illinois case law on ABCs adapts to meet new circumstances.

Illustrating such adaptation is the *First Bank v. Unique Marble* opinion discussed above. The question in *First Bank v. Unique Marble* was whether a lienholder's secured claim, perfected under the Uniform Commercial Code, takes priority over — or is subject to — the ABC assignee's fees and costs of administration.

The opinion provides a detailed analysis and arrives at this conclusion:

- "An assignee cannot be required to forgo the payment of the reasonable fees and costs of administering the assignment until perfected security interests have been fully satisfied"; and
- "If assignees were required to forgo payment in favor of perfected security interests, no assignee would take on the task of liquidating assets, and assignments for the benefit of creditors would cease to be available as an efficient method of maximizing the liquidation value of troubled companies."

Conclusion

ABC laws in Illinois are alive and well, despite revocation of the old Illinois ABC statute. Good for them.

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[1] Information in this article is from, (i) a 2006 article by Alan P. Solow, Bruce L. Wald and Daniel A. Zazove, titled "Illinois Common Law Assignments for the Benefit of Creditors," published by Illinois Institute for Continuing Legal Education, and (ii) the court opinions cited and discussed herein.

[2] Cross v. Bryant, 3 Il. 36 (1839).

[3] First Bank v. Unique Marble & Granite Corp., 938 N.E.2d 1154, 345 Ill. Dec. 233 (2010).

[4] Harbaugh v. Costello, 184 Ill. 110, 56 N.E. 363 (1900).