No. 1-11-1782

IN THE APPELLATE COURT OF ILLINOIS
FIRST DISTRICT

GERARD M. KENNY, as Trustee of the TRUST OF GERARD M. KENNY, Petitioner-Appellee,	)	
and	)	Appeal from the Circuit Court of Cook County, County Department, Chancery Division
BANK OF AMERICA, N.A., Intervenor-Appellee,	)	Case No. 09 CH 23413
v.	)	Judge Sebastian T. Patti
KENNY INDUSTRIES, INC., Respondent-Appellant.	)	

BRIEF AND SUPPLEMENTARY APPENDIX OF INTERVENOR-APPELLEE BANK OF AMERICA, N.A.

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INTRODUCTION

This appeal concerns whether Appellant Kenny Industries, Inc. should be allowed to take a contractual set-off against a judgment awarding annual payments to Appellee Gerard M. Kenny, as trustee of the Trust of Gerard M. Kenny ("Gerry's Trust") for the forced sale of the Trust's shares of Kenny Industries stock. If this issue sounds familiar, that would not be surprising, for this Court decided the same issue just over a year ago in *Kenny ex rel. Trust of Gerard M. Kenny v. Kenny Industries, Inc.*, 406 Ill. App. 3d 56 (1st Dist. 2010) (BA SA 1-9).[1] That decision capped off years of arbitration and litigation over the payments that Kenny Industries had to make to Gerry's Trust, which revolved largely around Kenny Industries' contention that amounts Gerard Kenny ("Gerry"), for unrelated reasons, owed to five of his siblings—John Kenny, Patrick Kenny, Philip Kenny, James Kenny, and Joan Kenny Rose (the "Kenny Siblings")—could be set off against the payments owed to Gerry's Trust. Like both the arbitrator and the circuit court, this Court concluded that Kenny Industries could not take the claimed set-off.

Refusing to take "no" for an answer, however, Kenny Industries returned to the circuit court with a new argument for the same set-off. Kenny Industries asserted that it was entitled to take the set-off and should be released from the prior judgment against it because, in late October 2010, the Kenny Siblings assigned to Kenny Industries their

[1] "BA SA __" refers by page number to the Supplementary Appendix to this brief. "GT Br. __" refers by page number to the brief submitted by Gerry's Trust. "GT A __" refers by page number to the Appendix to the brief submitted by Gerry's Trust. "KI Br. __" refers by page number to the brief submitted by Kenny Industries. "KI A __" refers by page number to the Appendix to Kenny Industries' brief. "R. C__" refers by page number to the common law record on appeal. "R. __" refers by page number to volume 8 of the record on appeal, which collects transcripts of proceedings in the circuit court. "Supp. R. C__" refers by page number to the supplemental record on appeal.

right to recover from Gerry. To Kenny Industries it was of no consequence that its obligation to Gerry's Trust had been reduced to judgment and that, before the assignment, it had learned that Appellee Bank of America, N.A. had previously perfected a security interest in the payments owed to Gerry's Trust. Disagreeing, the circuit court correctly ruled that Kenny Industries still lacks any right to take the claimed set-off.

For at least three independent reasons, the circuit court's ruling should be affirmed. First, Kenny Industries cannot take a set-off because the judgment against it is the source of its obligation to pay Gerry's Trust and the statute governing judgment set-offs precludes a set-off here. Second, the October 2010 assignment did not transfer the beneficial ownership of the right to collect from Gerry that would be required for any set-off. Third, Kenny Industries may not trump the prior perfected security interest of Bank of America by manufacturing a set-off right based on a seemingly uncompensated assignment from its own controlling shareholders made after it learned of Bank of America's security interest.

In short, the time has come to finally put an end to Kenny Industries' misguided effort to claim a manufactured set-off against its obligation to Gerry's Trust.

ISSUES PRESENTED

1. Did the circuit court abuse its discretion in finding that a judgment ordering both past and future payments to Gerry's Trust made Kenny Industries a judgment debtor as to all such payments, that Kenny Industries therefore has no contractual set-off rights, and that Illinois law forbids a judgment set-off?

2. Did an assignment "for collection purposes" give Kenny Industries the beneficial ownership of the judgment against Gerry that would be needed to assert a set-off?

3. Can Kenny Industries trump a prior perfected and disclosed security interest of Bank of America by using a seemingly uncompensated assignment from its own controlling shareholders to manufacture a set-off against the payments owed to Gerry's Trust?

STATUTES INVOLVED

735 ILCS 5/12-176

> Judgments between parties. Judgments between the same parties may be set off, one against another, if required by either party, as prescribed in the following Section.

735 ILCS 5/12-177

> Multiple judgments. When one of the judgments is delivered to an officer to be enforced, the debtor therein may deliver his or her judgment to the same officer, and the officer shall apply it, as far as it will extend, to the satisfaction of the first judgment, and the balance due on the larger judgment may be collected and paid in the same manner as if there had been no set-off.

735 ILCS 5/12-178

> Cases excepted. Such set-off shall not be allowed in the following cases:
>
> 1. When the creditor in one of the judgments is not in the same capacity and trust as the debtor in the other.
>
> 2. When the sum due on the first judgment was lawfully and in good faith assigned to another person, before the creditor in the second judgment became entitled to the sum due thereon.
>
> 3. When there are several creditors in one judgment, and the sum due on the other is due from a part of them only.
>
> 4. When there are several debtors in one judgment, and the sum due on the other is due to a part of them only.

5. It shall not be allowed as to so much of the first judgment as is due to the attorney in that action for his or her fees and disbursements therein.

810 ILCS 5/9-404

Rights acquired by assignee; claims and defenses against assignee.

(a) Assignee's rights subject to terms, claims, and defenses; exceptions. Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to:

(1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) Account debtor's claim reduces amount owed to assignee. Subject to subsection (c) and except as otherwise provided in subsection (d), the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) only to reduce the amount the account debtor owes.

(c) Rule for individual under other law. This Section is subject to law other than this Article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) Omission of required statement in consumer transaction. In a consumer transaction, if a record evidences the account debtor's obligation, law other than this Article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) Inapplicability to health-care-insurance receivable. This Section does not apply to an assignment of a health-care-insurance receivable.

STATEMENT OF FACTS

The brief submitted by Gerry's Trust gives a full account of how Kenny Industries became obligated under a January 2010 judgment to make annual payments to Gerry's Trust through 2020. GT Br. 4-9. That brief also fully recounts how the Kenny Siblings obtained an August 2010 judgment against Gerry and then assigned that judgment to Kenny Industries in late October 2010 in an effort to use a contractual set-off provision to save Kenny Industries from having to pay the amounts owed to Gerry's Trust. GT Br. 9-10. The brief of Gerry's Trust likewise explains why the circuit court concluded that Kenny Industries is not entitled to set the assigned August 2010 judgment off against the January 2010 judgment. GT Br. 10-12.

Instead of burdening the Court by repeating that recitation of the operative facts and procedural history of this case, we will simply describe the facts that directly bear on how Bank of America fits into this case. In August 2005, LaSalle Bank, N.A.—which merged into Bank of America in the fall of 2008—lent Gerry and his sister Mary Ann Kenny Smith ("Mary Ann") $3.5 million each for a hotel development project. R. C1346, C1364. Gerry promised to repay both loans in a promissory note related to his loan and a continuing guaranty related to Mary Ann's loan. R. C1346, C1364. Gerry also pledged a membership interest in the hotel project LLC to secure his obligations to the Bank. R. C1351.

By that time, Gerry was already party to two other agreements at issue in this litigation. In March 1987, Kenny Industries and its shareholders (namely, Gerry and the Kenny Siblings) entered into a Share Purchase Agreement ("SPA") to require Kenny Industries to purchase the stock of any shareholder who died, became totally disabled, or

had their employment with Kenny Industries terminated. KI A 11-17. Gerry, Mary Ann, and the Kenny Siblings also entered into a Contribution Agreement in May 2003 related to a hotel development project that called for Gerry to cover certain potential losses his siblings might sustain on the project. BA SA 34-50. To secure Gerry's obligations under the Contribution Agreement, his siblings obtained a security interest in Gerry's stock in a riverboat gambling enterprise, Casino Queen, Inc. BA SA 37.

Three months after Gerry and Mary Ann obtained their loans from LaSalle Bank, Kenny Industries terminated Gerry. *Kenny*, 406 Ill. App. 3d at 59 (BA SA 4). That termination decision led to arbitration over Kenny Industries' obligations under the SPA to Gerry's Trust—which had owned Gerry's stock in Kenny Industries since 1999—and litigation over Gerry's obligations under the Contribution Agreement to the Kenny Siblings. *Id.* at 59-61 (BA SA 4-6).

In the summer of 2008, while those disputes continued, LaSalle Bank, Gerry, and Mary Ann began negotiating an extension of the three-year initial term of the August 2005 loans. In February 2009—by which time Bank of America had succeeded to LaSalle Bank's position—those negotiations resulted in revised loan documents that extended the repayment period in exchange for additional collateral and other consideration. Supp. R. C297-314; R. C1369; BA SA 10-18. The additional collateral included a security interest in any right of Gerry's Trust to payment under either the SPA or any arbitration award or judgment on any claims related to the SPA:

> 2. Grant of Security Interest. As security for the payment of all Liabilities, each of the Trustee, on behalf of the Trust, and the Trust hereby assigns to the Bank and grants to the Bank a continuing security interest in, the following, whether now or hereafter existing or acquired:
>
> All of its:

> (i) rights to payment and other economic interests under, pursuant to, or in any manner relating to that certain Share Purchase Agreement, dated March 25, 1987 (as amended, the "Kenny Industries SPA"), among Kenny Industries, Inc., the Trust (as successor to Beneficiary), John E. Kenny, Jr., Patrick B. Kenny, Philip B. Kenny, James C. Kenny, and Joan E. Kenny Revocable Trust (as successor to Joan Kenny Rose), including, without limitation, any and all installment payments owing thereunder;
>
> (ii) Commercial Tort Claims relating in any manner to the Kenny Industries SPA; and
>
> (iii) all Proceeds, products, issues, profits and, distributions on, rights arising out of, and any and all claims arising out of the loss or interference with the rights or interests in, or damage to, any of the Debtor's rights or interest in the Kenny Industries SPA (including, without limitation, any payments made in connection with any arbitration award or judgment relating in any manner to the Debtor's rights or interests in the Kenny Industries SPA);
>
> provided, however, that, notwithstanding anything to the contrary set forth in this Agreement, the security interest granted pursuant to this Agreement shall not be deemed to extend to (a) any actual out-of-pocket costs, including attorneys' fees and expenses or other litigation expenses incurred in any arbitration proceeding, relating to the realization of any payments on account of Debtor's rights or interests in the Kenny Industries SPA or (b) any reserve for any estimated tax liability of the Beneficiary relating to any such payments certified by Bowen & Bowen or such other tax accountant acceptable to the Bank.

BA SA 11-12. Bank of America promptly perfected its new security interest on March 3, 2009 by filing the appropriate UCC financing statements with the Illinois Secretary of State's office. BA SA 19-30.

On March 25, 2009, the arbitrator charged with deciding what Kenny Industries owed Gerry's Trust as a result of Gerry's termination issued his Final Award. KI A 23-24. That Award incorporated a prior January 2009 Interim Award that valued the Trust's shares at $6,989,626, required Kenny Industries to pay that amount to the Trust in 15 annual installments starting retroactively on October 1, 2006, and rejected the offset

request of Kenny Industries. KI A 23; GT A 23-24. In January 2010, the circuit court confirmed the Final Award. KI A 25. And this Court affirmed that decision in December 2010. *Kenny*, 406 Ill. App. 3d at 65-66 (BA SA 8-9).

Meanwhile, Kenny Industries received notice of Bank of America's security interest in the arbitration award and subsequent judgment for Gerry's Trust. Counsel for Gerry's Trust told counsel for Kenny Industries about that security interest prior to October 2010. BA SA 32-33. And on October 19, 2010, Kenny Industries received a response to a Citation to Discover Assets that attached the relevant Security Agreement and other loan documents. *Id.* After another extension of the repayment periods (*see* R. C1346-63, C1369-75), Gerry's and Mary Ann's obligations to Bank of America matured by their terms on February 28, 2011 and repayment of the outstanding balances, which then totaled more than $7.5 million, became due and owing. R. C1339-40.

Even after losing its appeal over the confirmed arbitration award and learning that Bank of America had a perfected first priority security interest in that award, Kenny Industries still refused to pay the amounts owed to Gerry's Trust. Instead, it filed a motion for release of the January 2010 judgment. R. C1242-301. Kenny Industries maintained that it should be able to take a set-off for the entire amount of the January 2010 judgment because the Kenny Siblings, in August 2010, obtained a $7.7 million judgment against Gerry in the litigation over the Contribution Agreement and then, on October 29, 2010, assigned that judgment to Kenny Industries "for the purpose of collection." R. C1242-47; KI A 18.

As a result, Gerry's Trust was forced to initiate proceedings to collect the portion of the January 2010 judgment then due. Supp. R. C6-9. And when Kenny Industries

argued that its purported set-off rights should trump any security interests in the January 2010 judgment, Bank of America had to intervene to refute that argument and protect the priority of its security interest. R. C1339-44. Ultimately, the circuit court rejected Kenny Industries' set-off claim and reaffirmed its decision on reconsideration, ruling that Kenny Industries was a judgment debtor ineligible to take a set-off under the applicable Illinois statutes, 735 ILCS 5/12-176 through 735 ILCS 5/12-178. GT A 26-27, 29-30; KI A 1-3. Refusing yet again to take "no" for an answer, Kenny Industries has appealed from the June 2011 orders denying its reconsideration motion and requiring that Gerry's Trust and its lawyers be paid from an appeal bond that had secured the January 2010 judgment. KI A 4-5.

STANDARD OF REVIEW

What Kenny Industries ultimately seeks in this appeal is a reversal of the circuit court's decision denying its motion for release of the January 2010 judgment. A ruling on a motion for release of judgment is subject to abuse-of-discretion review. *Sec. State Bank of Hamilton v. Kimball*, 319 Ill. App. 3d 635, 638 (5th Dist. 2001); *Meyer v. First Am. Title Ins. Agency of Mohave, Inc.*, 285 Ill. App. 3d 330, 336 (2d Dist. 1996). "Under the abuse-of-discretion standard, a reviewing court does not decide whether it agrees with the circuit court's decision but, rather, determines whether the circuit court acted arbitrarily without the employment of conscientious judgment or, in view of all the circumstances, exceeded the bounds of reason and ignored recognized principles of law so that substantial prejudice resulted." *Certain Underwriters at Lloyd's, London v. Boeing Co.*, 385 Ill. App. 3d 23, 36 (1st Dist. 2008) (internal quotation marks omitted). In addition, this Court "may affirm the trial court's decision on any basis supported by

the record, regardless of whether the trial court relied on that ground when it made its decision." *Chapman v. Engel*, 372 Ill. App. 3d 84, 87 (1st Dist. 2007).

ARGUMENT

On appeal, Kenny Industries asserts for the very first time that its purported set-off rights apply only to the annual payments that it must make to Gerry's Trust for periods after the October 29, 2010 assignment of the Kenny Siblings' judgment against Gerry.[2] With respect to those post-October 29, 2010 payments, Kenny Industries says that it should be treated as an account debtor entitled to a set-off under the SPA. As we explain below, Kenny Industries is wrong for several reasons.

First, the circuit court correctly found that Kenny Industries is a judgment debtor as to all payments owed to Gerry's Trust, that it therefore has no set-off rights under the SPA, and that Illinois law otherwise forbids a judgment set-off. Second, the October 2010 assignment does not give Kenny Industries the beneficial ownership of the Kenny Siblings' judgment needed to claim a set-off under the SPA. Third, Kenny Industries cannot trump Bank of America's prior perfected security interest in the payments owed to Gerry's Trust by claiming an offset based on an unrelated judgment debt it received from its controlling shareholders (in a seemingly uncompensated assignment) after learning of Bank of America's security interest. For each of these independent reasons, the appealed orders should be affirmed.

[2] In the circuit court, Kenny Industries insisted that the October 2010 assignment allowed it to take a set-off against *all* amounts due to Gerry's Trust, no matter when they were due. As its opening brief confirms, Kenny Industries has now abandoned any claim of set-off rights with respect to all payments owing for the period prior to October 29, 2010. KI Br. 11-14.

I. The Circuit Court Correctly Found That Kenny Industries Is A Judgment Debtor Without Any Contractual Or Other Set-Off Rights.

Kenny Industries rests its entire appeal on the notion that the SPA, rather than the January 2010 judgment confirming the arbitration award, is the source of its obligation to make annual payments to Gerry's Trust after January 2010. Kenny Industries wants to be an account debtor under the SPA, rather than a judgment debtor under the January 2010 judgment, because it believes that it would have broader set-off rights as an account debtor. But the circuit court correctly found that Kenny Industries is a judgment debtor as to all of the annual payments owed to Gerry's Trust. GT A 26-27.

The January 2010 judgment expressly states: "Judgment is hereby entered in favor of Petitioner and against Respondent through the date hereof in the amount of $3,074,846.95, *plus future principal installments* and interest, all as provided for in the Final Award [of the arbitrator]." KI A 25 (emphasis added). The Final Award, in turn, provides:

> As to the amount of the award, and interest, it is clear that the Stock Purchase Agreement contemplated that the amounts due were to be paid in fifteen equal annual instal[l]ments. The provision for interest included in the contract language provides for interest payments on the unpaid balance of the principal, and not merely for interest on payments in arrears. *These payments are due, and shall be paid on each principal due date*.

KI A 23 (emphasis added). The Final Award also specifically incorporates the arbitrator's prior Interim Award by reference. *Id.* That Interim Award concludes: "The value of the Trust's shares in Kenny Industries, as of December 31, 2005 is $6,989,626. Pursuant to the Shares Purchase Agreement, *Kenny Industries is required to pay aforesaid amount to the Trust in 15 yearly equal installments*, plus interest, as set forth in the Shares Purchase Agreement." GT A 23 (emphasis added).

This language from the January 2010 judgment and the prior arbitration awards—which Kenny Industries tellingly omits from its brief—leaves no doubt that the January 2010 judgment obligates Kenny Industries to make all 15 annual payments to Gerry's Trust. Contrary to what Kenny Industries claims, the judgment and arbitration awards do not speak exclusively to amounts due through January 2010. KI A 23-24; KI A 25; GT A 23. And when the arbitration awards reference the SPA, they draw no distinction between amounts due before that date and amounts due afterward. KI A 23-24; GT A 23. In short, Kenny Industries' obligation to make annual payments through 2020 was determined by and made a part of the January 2010 judgment.[3]

As a result, the obligation to make those payments under the SPA merged into the January 2010 judgment and ceased to have any independent force. Under black-letter Illinois law, when a court enters judgment in a contract dispute, "the contract or instrument upon which the proceeding is based becomes entirely merged in the judgment, . . . it loses all of its vitality and ceases to bind the parties to its execution, . . . [i]ts force and effect are then expended, and all remaining legal liability is transferred to the judgment." *Doerr v. Schmitt*, 375 Ill. 470, 472 (1941); *see also Pyshos v. Heart-Land Dev. Co.*, 258 Ill. App. 3d 618, 624 (1st Dist. 1994) ("where a party obtains a judgment against another party, the underlying claim merges with the judgment and the judgment becomes a new and distinct obligation of the corporation which differs in nature and

[3] Indeed, that is exactly how this Court understood the January 2010 judgment in the appeal from that judgment: "The trial court granted the Trust's motion for summary judgment, confirming the arbitration award of $6,989,626 in total, and entered judgment against Kenny Industries in the amount of $3,074,846.95 through the date of the judgment *plus future principal installments* and interest as provided for in the arbitration award." *Kenny*, 406 Ill. App. 3d at 57 (BA SA 3) (emphasis added). And, as the brief submitted by Gerry's Trust details, Kenny Industries itself agreed that the January 2010 judgment covered all 15 installment payments. GT Br. 15.

essence from the original claim"). Accordingly, Kenny Industries' obligation to make annual payments to Gerry's Trust, even after January 2010, arises exclusively from the January 2010 judgment.[4]

That fact forecloses any entitlement to a set-off under the SPA. The SPA's offset provision allows set-offs only against payments to be made under the SPA: "If, at the time payments are to be made *under this Agreement* to the Shareholder . . . , the Shareholder . . . is indebted to any member of the Kenny Group, then the Company . . . may withhold any payment . . . and apply such withheld amount to the payment or partial payment of such indebtedness." KI A 16 (emphasis added). By its terms, that provision does not apply to payments owed under a judgment rather than the SPA.

Nor can Kenny Industries otherwise set off the August 2010 judgment assigned to it by the Kenny Siblings against the January 2010 judgment. Illinois's Code of Civil Procedure provides that while "judgments between the same parties may be set off, one against another" (735 ILCS 5/12-176), such a set-off "shall not be allowed" in certain specified circumstances. 735 ILCS 5/12-178. Two of those circumstances are present here.

[4] There is nothing to the contrary in the cases that Kenny Industries cites. *Brown v. Charlestowne Group, Ltd.*, 221 Ill. App. 3d 44, 45-46 (2d Dist. 1991), allowed a suit over later installment payments due under a contract because the existing judgment was expressly limited to certain prior installment payments, unlike here where the judgment orders payment of all installments. *Terry v. Watts Copy Systems, Inc.*, 329 Ill. App. 3d 382, 387-89 (4th Dist. 2002), involved the res judicata and collateral estoppel effect of statutorily limited proceedings before the Workers' Compensation Commission, and thus has absolutely nothing to do with this case. Likewise, *Rein v. David A. Noyes & Co.*, 271 Ill. App. 3d 768, 771-73 (2d Dist. 1995), *aff'd*, 172 Ill. 2d 325 (1996), upheld the dismissal of a factually and legally inapposite suit on res judicata and claim-splitting grounds.

First, Section 12-178(1) bars any set-off "[w]hen the creditor in one of the judgments is not in the same capacity and trust as the debtor in the other." 735 ILCS 5/12-178(1). As the brief of Gerry's Trust explains at greater length, that exclusion applies here because the creditor on the January 2010 judgment is *Gerry's Trust*, while the debtor on the August 2010 judgment is *Gerry individually*. GT Br. 20-22; KI A 25; BA SA 51-52. That lack of mutuality precludes a set-off under Section 12-178(1). *See* David J. Lanciotti & Eric Carlson, 5 *Nichols Illinois Civil Practice* § 82:82 (2004); *Lincoln Towers Ins. Agency, Inc. v. Boozell*, 291 Ill. App. 3d 965, 970 (1st Dist. 1997) (same under Insurance Code's set-off provision).

Second, Section 12-178(2) forbids a set-off "[w]hen the sum due on the first judgment was lawfully and in good faith assigned to another person, before the creditor in the second judgment became entitled to the sum due thereon." 735 ILCS 5/12-178(2) That exclusion applies here because Gerry's Trust assigned its rights under the January 2010 judgment long before Kenny Industries became entitled to the sum due on the August 2010 judgment. The Trust assigned its rights under the January 2010 judgment to Bank of America *in February 2009*. BA SA 10-12. The Kenny Siblings assigned the August 2010 judgment to Kenny Industries *in October 2010*. KI A 18. That chronology independently precludes a set-off under Section 12-178(2). *See* Lanciotti & Carlson, *supra*, § 82:82.

In sum, the circuit court did not remotely abuse its discretion in finding that Kenny Industries is a judgment debtor under the January 2010 judgment and has no contractual or other right to set the August 2010 judgment off against the January 2010 judgment. The orders that Kenny Industries appeals therefore should be affirmed.

II. Kenny Industries Would Not Be Entitled To A Set-Off Even If It Were An Account Debtor Rather Than A Judgment Debtor.

Even if Kenny Industries were an account debtor under the SPA as to the annual payments owed to Gerry's Trust after January 2010, it still would not be entitled to set off the August 2010 judgment against what it owes to Gerry's Trust. Such an entitlement would require that Kenny Industries be allowed to jump in front of all of the pre-existing secured creditors of Gerry's Trust based on a set-off right that first arose in late October 2010 when the Kenny Siblings assigned their judgment against Gerry to Kenny Industries. Neither the relevant legal principles nor the facts of this case permit such a transparently manipulative maneuver.

A set-off arises under the SPA only if, "at the time payments are to be made" to a Kenny Industries shareholder pursuant to the SPA, that shareholder "is indebted to" Kenny Industries or any of three related entities. KI A 16. There no longer is any dispute that when it became obligated to pay Gerry's Trust under the SPA, Kenny Industries had nothing to set-off against that payment obligation. KI Br. 11-14; *Kenny*, 406 Ill. App. 3d at 64 (BA SA 8). Instead, the *Kenny Siblings* had a claim against *Gerry* under the *Contribution Agreement*. *Kenny*, 406 Ill. App. 3d at 59-60 (BA SA 4-5). The Contribution Agreement had given the Kenny Siblings a security interest in Gerry's stock in Casino Queen, Inc., but not in Gerry's Kenny Industries holdings or his rights under the SPA. BA SA 37.[5] Plus, an anti-assignment clause prevented the Kenny Siblings from assigning their rights under the Contribution Agreement without consent from

[5] In the litigation over the Contribution Agreement that culminated in the August 2010 judgment, the circuit court determined that the Kenny Siblings could not enforce their security interest in Gerry's Casino Queen stock because they had not obtained the necessary approval from the Illinois Gaming Board to encumber that stock. Supp. R. C236-37.

Gerry. BA SA 39. And, by March 2009, Bank of America had obtained and perfected a security interest that gave it priority over the Kenny Siblings in collecting from any payments made to Gerry's Trust under the SPA. BA SA 11-12, 19-30.

Fearing that as a result Kenny Industries might actually have to pay Gerry's Trust for the forced sale of the Kenny Industries stock held by the Trust, the Kenny Siblings developed a plan to leap-frog Bank of America and other creditors of Gerry's Trust with superior rights to those payments. They would "assign" their right to recover from Gerry under the Contribution Agreement to Kenny Industries. Then Kenny Industries would claim a set-off against Gerry's Trust under the SPA based on Gerry's newly created "indebtedness" to Kenny Industries. KI A 18-22; Supp. R. C271. The anti-assignment provision of the Contribution Agreement, however, prevented the Kenny Siblings from assigning their right to recover from Gerry until after they obtained a judgment against Gerry in August 2010. BA SA 39, 51-52; Supp. R. C401-02. Accordingly, in late October 2010, the Kenny Siblings executed an "Assignment" purporting to transfer to Kenny Industries "their right, under the August 12, 2010 Judgment Order . . . , to payment from [Gerry] in the amount of $7,738,112.23." KI A 18.

But an analysis of the Assignment and the surrounding circumstances shows that the Assignment does not give Kenny Industries the right to set the August 2010 judgment off against any payments that Kenny Industries owes to Gerry's Trust under the SPA. There are two principal obstacles. The Assignment did not grant Kenny Industries the beneficial ownership interest in the August 2010 judgment that it would need to take a set-off under the SPA. And the trafficking of the August 2010 judgment between related

parties for the sole purpose of defeating Bank of America's prior perfected security interest precludes any set-off.

A. The Assignment Of The August 2010 Judgment Gave Rise To No Set-Off Rights Because It Was For Collection Purposes Only.

The SPA allows a set-off only if the obligations to be set off against each other are mutual between a Kenny Industries shareholder on the one hand and Kenny Industries or three related entities on the other. KI A 16. Under Illinois law, obligations are not mutual for set-off purposes if a party is not owed one of the supposedly offsetting obligations in the same capacity that it owes the other one—*e.g.*, as an owner, as a trustee, or as a collection agent. *See Bank of Chicago-Garfield Ridge v. Park Nat'l Bank*, 237 Ill. App. 3d 1085, 1092 (1st Dist. 1992). Accordingly, a party directly liable on one obligation may not assert a set-off right unless it has beneficial ownership of the other obligation it wants to use as a set off. *See Lincoln Towers*, 291 Ill. App. 3d at 970 (mutuality for set-off lacking where party did not have beneficial ownership of funds against which set-off was sought).

Crucially, moreover, an assignment of a debt for the purpose of collection "does not transfer the beneficial ownership" of that debt to the assignee. *Ecker v. Big Wheels, Inc.*, 136 Ill. App. 3d 651, 654 (4th Dist. 1985); *see also Apex Digital, Inc. v. Sears, Roebuck & Co.*, 572 F.3d 440, 442 (7th Cir. 2009) ("an assignment of collection does not transfer beneficial ownership to the assignee under Illinois law"). Such an assignee, therefore, cannot use a debt assigned for collection purposes to take a set-off. *See Harrison v. Adams*, 128 P.2d 9, 12 (Cal. 1942) ("[T]he assignee must be the beneficial owner of the claim or judgment in order to use it as a set-off against a judgment against him.").

But that is exactly what Kenny Industries is trying to do in this case. The Assignment expressly states that it "shall be deemed an unconditional assignment of the Judgment *for the purpose of collection*." KI A 18 (emphasis added). By the Assignment's express terms, then, Kenny Industries lacks the beneficial ownership of the August 2010 judgment needed to have any set-off right under the SPA.

In the circuit court, Kenny Industries nonetheless maintained that it fully and exclusively owned the August 2010 judgment. It asserted that a provision of the Assignment governing any recovery received initially by the Kenny Siblings reflects an intent to transfer full ownership of the August 2010 judgment. Supp. R. C404. But other provisions plainly confirm that the Assignment is best understood as an assignment for collection purposes only.

First, the Assignment expressly preserves the right of the Kenny Siblings to ultimately recover any amounts that Kenny Industries collects from Gerry: "Notwithstanding the foregoing, nothing herein shall constitute a waiver of any Assignor's right to receive any properly authorized dividend issued or other distribution made by Assignee to any such Assignor on account of Assignor's ownership, either directly or indirectly, of stock in Assignee." KI A 19. In other words, whatever Kenny Industries collects from Gerry will be turned over to the Kenny Siblings via a dividend or other distribution, which the Kenny Siblings themselves would authorize as the controlling shareholders of Kenny Industries. That feature makes the Assignment operate as an assignment for collection purposes. *See Unifund CCR Partners v. Shah*, 407 Ill. App. 3d 737, 742 (1st Dist. 2011) (when assignment is for collection purposes, the assignor "retains the right to receive the amount owed when it is collected").

Second, aside from a boilerplate recitation that the Kenny Siblings received "good and valuable consideration" (KI A 18), the Assignment says absolutely nothing about what the Kenny Siblings supposedly received in exchange for the assignment of a $7.7 million judgment. KI A 18-22. If the Kenny Siblings were truly giving away beneficial ownership of a $7.7 million judgment, the Assignment surely would have described the consideration going to the Kenny Siblings. No one trades $7.7 million for something not even worth describing. The failure to describe whatever consideration supposedly went to the Kenny Siblings makes sense only if Kenny Industries was receiving simply the much less valuable right to merely collect the August 2010 judgment. *See Joseph v. Wilson*, 57 Ill. App. 3d 212, 217 (1st Dist. 1978) (using described consideration to determine nature and scope of contractual obligation); *Rhone-Poulenc Inc. v. Int'l Ins. Co.*, 71 F.3d 1299, 1303 (7th Cir. 1995) (Illinois law: "the amount of consideration for a contract, while only rarely usable to invalidate the contract, is often a good clue to what the contract means, . . . since the payment and the performance specified in a contract usually are commensurate"); *Sutter Ins. Co. v. Applied Sys., Inc.*, 393 F.3d 722, 726 (7th Cir. 2004) (applying same rule under Illinois law); *cf. Northwest Diversified, Inc. v. Desai*, 353 Ill. App. 3d 378, 381, 390-91 (1st Dist. 2004) (assignment failed for lack of consideration even though it stated that "it was given '[u]pon receipt of good and valuable consideration herein acknowledged and received,'" because the "document itself never state[d] what actual consideration was given" and no evidence showed any was exchanged).

At the very least, the language declaring that the assignment was "for the purpose of collection" (KI A 18), the provision reserving the Kenny Siblings' right to recover any

amounts collected by Kenny Industries (KI A 19), and the absence of any described consideration going to the Kenny Siblings (KI A 18-22) make the Assignment ambiguous on whether it transfers a beneficial ownership interest in the August 2010 judgment or merely assigns the judgment for collection purposes. Consistent with longstanding principles of Illinois law, such an ambiguity must be read against the drafters of the Assignment—Kenny Industries and the Kenny Siblings—particularly when the Assignment is asserted to defeat the rights of a third party like Bank of America. *See Pelz v. Streator Nat'l Bank*, 145 Ill. App. 3d 946, 954 (3d Dist. 1986) (any ambiguities regarding legal effect of assignment must be resolved against its drafter); *see also Dowd & Dowd, Ltd. v. Gleason*, 181 Ill. 2d 460, 479 (1998) ("any ambiguity in the terms of a contract must be resolved against the drafter of the disputed provision"); *Symanski v. First Nat'l Bank of Danville*, 242 Ill. App. 3d 391, 396 (4th Dist. 1993) (applying rule that "an instrument will be most strongly construed against the party who prepared it" to hold that defendant lacked contractual set-off right).

Accordingly, the appealed orders should be affirmed because the Assignment simply cannot be read to grant Kenny Industries the beneficial ownership of the August 2010 judgment that it would need to take a set-off under the SPA.

B. Kenny Industries And The Kenny Siblings Improperly Trafficked The August 2010 Judgment Solely To Obtain A Set-Off Advantage Against Other Creditors.

Even if the Kenny Siblings had successfully assigned their beneficial ownership of the August 2010 judgment to Kenny Industries, it still would be improper for Kenny Industries to circumvent Bank of America's perfected security interest in the annual payments owed to Gerry by setting off the assigned August 2010 judgment against those payments. Bank of America obtained that security interest in February 2009 and

perfected it in March 2009. BA SA 10-12, 19-30. Kenny Industries received notice of Bank of America's perfected security interest on several occasions thereafter, including by receipt of the loan and collateral documents creating that security interest on October 19, 2010. BA SA 32-33. Only afterward, on October 29, 2010, did the Kenny Siblings execute the Assignment purporting to transfer the August 2010 judgment to Kenny Industries. KI A 18-22. And, as Kenny Industries itself now admits, no set-off right could have arisen under the SPA until after the Assignment was executed. KI Br. 11-14.

These circumstances weigh heavily against giving Kenny Industries' supposed set-off rights priority over Bank of America's perfected security interest. In the first place, the law frowns upon trafficking in assets and debts for the sole purpose of obtaining a set-off advantage over other creditors. *See Mayco Plastics, Inc. v. TRW Vehicles Safety Sys., Inc.* (*In re Mayco Plastics, Inc.*), 389 B.R. 7, 33, 35-36 (Bankr. E.D. Mich. 2008) (refusing to allow set-off based on assignment acquired without discernable consideration and for no purpose other than gaining a set-off advantage over other creditors); *Fleet Capital Corp. v. Yamaha Motor Corp., U.S.A.*, No. 01 Civ. 1047, 2002 WL 31174470, at *32-*33 (S.D.N.Y. Sept. 26, 2002) (forbidding junior creditor from setting off "purchases" of account debtor's inventory against antecedent debt to the detriment of the senior secured creditor); 11 U.S.C. § 553(a)(2) (federal bankruptcy code forbids offsets based on transferred claims in certain circumstances); 215 ILCS 5/206(a) (Illinois law forbids set-off against insolvent insurance company when "the obligation of the company to such person was purchased by or transferred to such person with a view of its being used as a set-off or counterclaim"). Indeed, absent restrictions "to prevent creditors from trafficking in claims against the debtor to effect a setoff, . . . those indebted

to the debtor would have an incentive to purchase claims against the debtor from third-party creditors, most likely at a discount, in order to reduce their indebtedness through exercise of the acquired setoff rights. Allowing a creditor to create a setoff in this manner would contravene the equitable purposes underlying setoff and create an unfair advantage at the expense of other creditors." *In re Davicter Enters., Inc.*, 248 B.R. 794, 797 (Bankr. S.D. Ill. 2000) (internal citations omitted). Yet the only explanation for the (seemingly uncompensated) agreement to assign the August 2010 judgment to Kenny Industries is a desire to create a purported set-off right that would trump Bank of America's prior perfected security interest in the amounts that Kenny Industries owes to Gerry's Trust.

The general anti-trafficking policy is consistent with the Illinois Appellate Court's longstanding approach to the UCC provisions that govern the priority between perfected security interests and account debtor defenses like set-off: "[T]he assignee [here, Bank of America] may recover to the same extent as its assignor [here, Gerry's Trust], but the recovery is limited by valid and subsisting rights of set-off against the assignor *when notice of the assignment was received*." *Budget Premium Co. v. Am. Cas. Co.*, 136 Ill. App. 3d 682, 685 (3d Dist. 1985) (emphasis added). And the UCC does indeed insulate parties with security interests ("assignees" in UCC parlance) from set-off defenses that do not arise from the transaction that gave rise to the contract subject to the security interest, if the set-off "accrues" after "the account debtor receives a notification of the assignment." 810 ILCS 5/9-404(a)(2); *see also Artoc Bank & Trust, Ltd. v. Apex Oil Co.* (*In re Apex Oil Co.*), 975 F.2d 1365, 1368-69 (8th Cir. 1992) (giving assignee's security

interest priority where set-off was based on other transactions and accrued after notification of security interest).

Section 9-404—which carries forward the same basic rule of the former Section 9-318(1) considered in *Budget Premium*—provides that "the rights of an assignee are subject to: (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee." 810 ILCS 5/9-404(a). As the official comment to Section 9-404(a) explains,

> Under subsection (a)(1), if the account debtor's defenses on an assigned claim arise from the transaction that gave rise to the contract with the assignor, it makes no difference whether the defense or claim accrues before or after the account debtor is notified of the assignment. Under subsection (a)(2), the assignee takes subject to other defenses or claims only if they accrue before the account debtor has been notified of the assignment.

UCC § 9-404 cmt. 2 (2010). Accordingly, Section 9-404(a) is best interpreted as distinguishing between defenses that arise out of the transaction that underlies the contract subject to the security interest and those that arise out of other transactions. Those that arise out of other transactions do not apply to an assignee (Bank of America, here) if the account debtor (Kenny Industries, here) received notice of the assignee's security interest before the defense accrued.

The UCC thus belies Kenny Industries' assertion that an assignee with a security interest (like Bank of America) never has greater rights against an account debtor (like Kenny Industries) than the assignor who granted the security interest (like Gerry's

Trust).[6] As for Kenny Industries' related attempt to invoke the SPA provision that purports to make the SPA binding on "assigns" (KI A 16), "under Illinois law an assignee's acceptance of an assignment of a contract, without any express assumption of the obligation of the contract, does not bind the assignee merely because the contract provided that it was binding upon the assigns of the respective parties." *Quest v. Robertson*, 71 Ill. App. 3d 678, 681 (2d Dist. 1979).

The circumstances in which an assignee has greater rights than the assignor, and therefore is not subject to a set-off defense, are present in this case. The Security Agreement between Bank of America and Gerry's Trust does not assume any of the Trust's obligations under the SPA. BA SA 10-18. Kenny Industries received notice of Bank of America's security interest in any payments under the SPA before the "assignment" of the August 2010 judgment caused any set-off right to accrue. BA SA 32-33. And Kenny Industries' claim for a set-off based on the August 2010 judgment arises not from the transaction behind the SPA but from the completely separate transaction behind the Contribution Agreement. *Compare* KI A 11-17 (SPA), *with* KI A 18-22 (Assignment), *and* BA SA 34-50 (Contribution Agreement).

The general policy against trafficking in debts to leapfrog secured creditors likewise dovetails with the judicial insistence that any set-off be based on clear mutuality. Many courts strictly construe any doubts about mutuality against the party asserting the set-off. *See Lincoln Towers*, 291 Ill. App. 3d at 970; *Illinois v. Lakeside Cmty. Hosp.,*

[6] Tellingly, the case that Kenny Industries cites on this point involved an assignment made *after* the liability in question had accrued, and the assignee was aware of that liability when he took the assignment. *Carlyle v. Jaskiewicz*, 124 Ill. App. 3d 487, 492-94 (1st Dist. 1984). As Kenny Industries acknowledges, there was no basis for any set-off liability when Bank of America obtained its security interest in February 2009. KI Br. 11-14.

Inc. (*In re Lakeside Cmty. Hosp., Inc.*), 151 B.R. 887, 891 (N.D. Ill. 1993). And courts have refused to allow account debtors to take set-offs based on debts held by third parties even when the third party and the account debtor are related entities and a separate agreement authorizes the triangular set-off. *See MNC Commercial Corp. v. Joseph T. Ryerson & Son, Inc.*, 882 F.2d 615, 620 (2d Cir. 1989); *Bank Leumi Trust Co. of N.Y. v. Collins Sales Serv., Inc.*, 393 N.E.2d 468, 469 (N.Y. 1979).

Those authorities are relevant here. As we have shown, the Assignment casts serious doubt on whether Kenny Industries is actually party to both of the supposedly offsetting obligations. *See supra* Part II.A. Plus, *Gerry individually* is the debtor on the August 2010 judgment (BA SA 51-52), while *Gerry's Trust* is the creditor on the payments owed by Kenny Industries (KI A 25). *See Lincoln Towers*, 291 Ill. App. 3d at 970 (no mutuality and thus no set-off between amounts to be paid by party as trustee and amounts owed the same party individually); *Knowles v. Goodrich*, 60 Ill. App. 506, 510 (1st Dist. 1895) (same).

Finally, the debt trafficking that occurred in this case is particularly unworthy of judicial endorsement. Kenny Industries acquired the debt it wants to use as a set-off from a controlling group of its own shareholders, the Kenny Siblings. KI A 18-22. There is no indication that Kenny Industries exchanged anything of real value to acquire that debt. *Id.* And the transaction was a transparent effort by the Kenny Siblings to effectively rewrite the Contribution Agreement to obtain different security than they originally agreed to accept. BA SA 37. These factors, too, weigh strongly against giving any kind of priority to Kenny Industries' asserted set-off rights. *See, e.g.*, *Modern Settings, Inc. v. Prudential-Bache Sec., Inc.*, 936 F.2d 640, 648 (2d Cir. 1991) (expressing "considerable

doubt" whether "New York would allow a set-off of a claim acquired by assignment from a closely related corporation where the result would be to permit the assignor . . . to receive full payment on its claim" to the detriment of other creditors).

In sum, there are a host of legal and equitable reasons that Kenny Industries should not be allowed to circumvent Bank of America's prior perfected security interest by acquiring a debt for the sole purpose of manufacturing a set-off. The appealed orders thus should be affirmed.

CONCLUSION

For the foregoing reasons, Bank of America respectfully asks that the June 16, 2011 orders of the circuit court be affirmed.

January 24, 2012

Respectfully submitted,

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SUPPLEMENTARY APPENDIX

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CERTIFICATE OF COMPLIANCE WITH SUPREME COURT RULE 341

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a), is 26 pages.

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Joshua D. Yount

CERTIFICATE OF SERVICE

The undersigned, an attorney, hereby certifies that on January 24, 2012 he caused three copies of the foregoing **Brief and Supplementary Appendix of Intervenor-Appellee Bank of America, N.A.** to be placed with the U.S. Postal Service for first-class mail delivery to each of the addresses listed below.

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