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Corporations, 12 S. Ill. U. L.J. 809 (1987)

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Corporations

Diane S. Kaplan*

I. INTRODUCTION

The Illinois Appellate Court rendered over thirty opinions on corporate and securities topics during the 1987-1988 survey year. Issues addressed included long arm jurisdiction, fiduciary duties, attorneys fees, standing, contract interpretation, dissolution and securities regulation. This article reviews significant cases selected from among these topics.

II. LONG ARM JURISDICTION

The first district relied on the transaction of business and tortious act sections of the Illinois long arm statute¹ to exercise personal jurisdiction over a Japanese manufacturer in *Wyles v. Morita Iron Works Co.*² and to decline personal jurisdiction over a nonresident corporation in *Natural Gas Pipeline Company of America v. Mobil Rocky Mountain, Inc.*³

In *Wyles v. Morita Iron Works Co.*⁴, the Japanese defendant, Morita, designed and manufactured in Japan four forced air cell machines which were sold in Japan to plaintiff's employer, Astro Packaging Company.⁵ Astro subsequently sent two of these machines to its Illinois plant where one machine allegedly caused plaintiff's

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1. ILL. REV. STAT. ch. 110, ¶¶ 2-209 (a) (1) and (2) (1985):

Act submitting to jurisdiction—Process. (a) Any person, whether or not a citizen or resident of this State, who in person or through an agent does any of the acts hereinafter enumerated, thereby submits such person, and, if an individual, his or her personal representative, to the jurisdiction of the courts of this State as to any cause of action arising from the doing of any of such acts:

(1) The transaction of any business within this State;

(2) The commission of a tortious act within this State;

2. 152 Ill. App. 3d 782, 504 N.E.2d 942 (1st Dist. 1987).

3. 155 Ill. App. 3d 841, 508 N.E.2d 211 (1st Dist. 1987).

4. 152 Ill. App. 3d 782, 504 N.E.2d 942 (1st Dist. 1987).

5. *Id.* at 783, 504 N.E.2d at 943.

injury.⁶ Morita filed a motion to quash service for lack of personal jurisdiction which was granted by the trial court.⁷ The first district reversed, finding that Morita had failed to prove that it did not know of the machines' intended use in Illinois.⁸

Illinois law requires its courts to engage in a two step analysis when determining the propriety of exercising personal jurisdiction over a nonresident defendant.⁹ First, the plaintiff must establish that the defendant engaged in one of the acts enumerated in the long arm statute.¹⁰ Second, the plaintiff must convince the court that the exercise of long arm jurisdiction is consistent with due process as defined by prevailing constitutional standards.¹¹ In response to the first level of inquiry, the court found that Morita had transacted business in Illinois because its president had failed to deny knowledge of the machine's ultimate use in Illinois.¹² For example, the president's affidavit stated that two machines were purchased in Japan by the plaintiff who then transported the machines to Illinois.¹³ Although this statement was not countered by the plaintiff, the court rejected its averments because they were not substantiated by "shipping documents, delivery receipts, and other data which would support the conclusion that the sale and delivery of the machines was consummated in Japan."¹⁴ The court found, instead, that the ultimate use of the machines in Illinois was neither fortuitous nor unanticipated and, thus, the exercise of jurisdiction over Morita did not offend due process, especially since Morita had derived economic benefit from the transaction.¹⁵

The court's transaction of business analysis is flawed in many respects. Neither party contended, nor did the court find, that Morita had been physically present in Illinois or had engaged in either a course of dealing or a course of performance in Illinois. Rather, applying a *Gray v. American Radiator*¹⁶-style analysis, the court

6. *Id.*

7. *Id.* at 783-84, 504 N.E.2d at 944.

8. *Id.* at 785, 504 N.E.2d at 944.

9. *Green v. Advance-Ross Elec. Corp.*, 86 Ill. 2d 431, 427 N.E.2d 1203 (1981).

10. *Wyles*, 152 Ill. App. 3d at 785-86, 504 N.E.2d at 944.

11. *Id.* at 786, 504 N.E.2d at 945.

12. *Id.* at 784-85, 504 N.E.2d at 944.

13. *Id.*

14. *Id.* at 785, 504 N.E.2d at 944.

15. *Id.* at 787, 504 N.E.2d at 945.

16. *Gray v. American Radiator & Standard Sanitary Corp.*, 22 Ill. 2d 432, 176 N.E.2d 761 (1961).

inferred Morita's knowledge of the machines' ultimate use in Illinois from a silent record which neither confirmed nor denied such inference, and concluded therefrom that Morita had transacted business in Illinois.¹⁷ The court also failed to demonstrate how Morita's inferred knowledge that its machines were intended for ultimate use in Illinois constituted its "own purposeful conduct"¹⁸ or "'substantial connection' with the forum State"¹⁹ as required by Supreme Court case law since *International Shoe v. Washington*.²⁰

It is not without significance that this same approach was rejected in the recent Supreme Court case of *Asahi Metal Industry Co., Ltd. v. Superior Court of California*,²¹ which was pending concurrently with *Wyles* but is nowhere cited therein. Like *Wyles*, *Asahi* involved the question of the propriety of exercising personal jurisdiction over a Japanese component parts manufacturer whose products allegedly caused injury in this country.²²

Asahi manufactured tire valve assemblies in Japan which were sold to another Japanese company for assembly in Japan and eventual distribution throughout the world.²³ Affidavits indicated *Asahi's* knowledge that some of its products would be used in California.²⁴ In 1979, a product liability suit was brought in California arising from a motorcycle accident allegedly caused by defects in the tire.²⁵ The tire manufacturer cross-claimed seeking indemnification from *Asahi*.²⁶ Although the primary suit was settled, the California Supreme Court refused to quash service of summons on *Asahi*, the third party defendants. The court reasoned that by placing its products in the stream of commerce with the awareness that some products would be used in California, *Asahi* had engaged in sufficient purposeful activity to satisfy due process.²⁷ The United States Supreme Court reversed, finding that mere awareness or knowledge of the ultimate destination of the product, without activity deliberately

17. *Wyles*, 152 Ill. App. 3d at 786-90, 504 N.E.2d at 945.

18. *Hanson v. Denckla*, 357 U.S. 235, 253 (1958).

19. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985) (quoting *McGee v. International Life Ins. Co.*, 355 U.S. 220, 223 (1957)).

20. 326 U.S. 310 (1945).

21. 107 S. Ct. 1026 (1987).

22. *Id.* at 1027.

23. *Id.*

24. *Id.* at 1030.

25. *Id.* at 1029.

26. *Id.*

27. *Id.* at 1030.

directed toward the target's locale, did not constitute purposeful conduct sufficient to satisfy due process.²⁸ Applying the *Asahi* rationale to the *Morita* case, if record proof of knowledge does not provide a constitutional basis for personal jurisdiction then it is difficult to conceive how mere inferences of awareness can constitute a sufficient basis for personal jurisdiction.

Second, *Worldwide Volkswagen Corp. v. Woodson*²⁹ specifically excluded from the concept of purposeful conduct the unilateral acts of the plaintiff over which the defendant had no control. Just as the location of the trustee was found to be a "fortuitous" act beyond the control of the defendant trust company in *McGee v. International Life Insurance Co.*,³⁰ so are the location of Astro's plant in Illinois and Astro's shipping of the machines from Japan to Illinois unilateral acts of the plaintiff beyond the defendant's control—even if the defendant had knowledge of such acts.

Furthermore, the opinion fails to specify any act of the defendant having constitutional significance. There was no dispute that the entire transaction which was the subject of the motion to quash occurred outside of Illinois.³¹ The negotiations for, and design, manufacture and delivery of the product all occurred outside of Illinois.³² In fact, the only Illinois contact which the court could point to was the allegation that the transaction had "consequences" in Illinois.³³ "Consequences," without more, do not rise to the level of "substantial connection with"³⁴ or "conduct expressly aimed at"³⁵ the forum as required by recent Supreme Court rulings.

Third, the transaction of business section of the opinion is laced with derogatory comments about "[t]he influx of foreign products to our shores and the dominance of some of our major markets by foreign enterprises."³⁶ The court relied on such transnational economic concerns as the basis for Illinois' "'manifest interest' in providing its residents with a convenient forum for redressing injuries

28. *Id.* at 1033.

29. 444 U.S. 286 (1980).

30. 355 U.S. 220 (1957).

31. *Wyles*, 152 Ill. App. 3d at 787, 504 N.E.2d at 945.

32. *Id.*

33. *Id.* at 789, 504 N.E.2d at 947.

34. *Asahi*, 107 S. Ct. at 1033.

35. *Calder v. Jones*, 465 U.S. 783 (1984).

36. *Wyles*, 152 Ill. App. 3d at 786, 504 N.E.2d at 945 (citing State of the Union Address by President Reagan of January 27, 1987).

inflicted by out-of-State actors.”³⁷ Such statements create the erroneous impression that Illinois is hostile to the presence of foreign commerce within its borders. More importantly, such statements fly in the face of policy concerns set forth in *Asahi* which forewarned of economic balkanization resulting from the over-extension of “our notions of personal jurisdiction into the international field”³⁸:

The possibility of being haled into a California court as a result of an accident involving Asahi’s components undoubtedly creates an additional deterrent to the manufacturer of unsafe components; however, similar pressures will be placed on Asahi by the purchasers of its components as long as those who use Asahi components in their final products, and sell those products to California, are subject to the application of California tort law.³⁹

The court further admonished the states that over-reaching long arm statutes may be particularly unreasonable on an international basis given “[t]he unique burdens placed upon one who must defend oneself in a foreign legal system.”⁴⁰

In the second section of the opinion, that court found that Morita had committed “a tortious act within this State”⁴¹ because the injury had been felt there.⁴² This “last act” analysis is questionable in light of such cases as *Hanson v. Denckla*⁴³ and *Keeton v. Hustler Magazine*⁴⁴ which specifically repudiated the application of conflicts doctrine to personal jurisdiction questions.

In sum, Illinois’ exercise of personal jurisdiction under paragraphs 2-209(a)(1) and (2), based on inferred, rather than record knowledge, and the occurrence of an injury felt within the state, without more, constituted an unconstitutional over-extension of its long arm jurisdiction contravening constitutional standards as set forth from *International Shoe Co.*⁴⁵ to *Asahi*.⁴⁶

*Natural Gas Pipeline Co. of America v. Mobil Rocky Mountain, Inc.*⁴⁷ addressed the question of whether Illinois could exercise long

37. *Id.* at 789, 504 N.E.2d at 947.

38. *Asahi*, 107 S. Ct. at 1035 (quoting *United States v. First Nat’l City Bank*, 379 U.S. 378, 404 (1965) (Harlan, J., dissenting)).

39. *Id.* at 1034.

40. *Id.*

41. ILL. REV. STAT. ch. 110, ¶ 2-209(a)(2) (1985).

42. *Wyles*, 152 Ill. App. 3d at 790, 504 N.E.2d at 947.

43. 724 F.2d 235, 254 (1958).

44. 465 U.S. 770 (1984). *But see* *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

45. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

46. *Asahi Metal Ind. v. Superior Court*, 107 S. Ct. 1026 (1987).

47. 155 Ill. App. 3d 841, 508 N.E.2d 211 (1st Dist. 1987).

arm jurisdiction over the assignee of a contract involving no contacts in Illinois except that the plaintiff was a subsidiary of an Illinois corporation. The facts giving rise to the case involved a natural gas purchase contract between Anschutz, a corporation of unspecified origin and Natural Gas Pipeline Co., a Delaware corporation which was also a wholly owned subsidiary of an Illinois corporation.⁴⁸ Anschutz had partially assigned the contract to Mobil Rocky Mountain, Inc., a Delaware corporation.⁴⁹ When market conditions changed and the price of natural gas dropped below the contract price, Natural Gas brought a declaratory judgment action against Mobil challenging the quantity term of the contract.⁵⁰ Mobil filed a motion to quash service of process on the grounds that it had not committed an act submitting it to Illinois' personal jurisdiction.⁵¹ In a confused opinion, the circuit court granted Mobil's motion, finding that it had not transacted business in Illinois as required by the long arm statute⁵² even though the contract allegedly had "substantial economic impact on the commerce in Illinois"⁵³ and, therefore, satisfied the due process requirements of the Constitution.⁵⁴

Natural Gas appealed the long arm finding and Mobil appealed the due process finding. Natural Gas argued that Mobil was subject to Illinois' general jurisdiction because it indirectly exploited the Illinois market thus satisfying the "doing business" test of *Connelly v. Uniroyal, Inc.*⁵⁵ The court rejected as unprecedented the extension of *Connelly*, a products liability case, to the instant contract action.⁵⁶ The court also rejected the plaintiff's reliance on *Connelly*, a specific jurisdiction case, as precedent for the exercise of general jurisdiction over Mobil.⁵⁷ The difference between the two theories, the court explained, was that specific jurisdiction required a relationship between the facts giving rise to jurisdiction and the facts giving rise to the cause of action whereas general jurisdiction did not require such a relationship.⁵⁸ Analyzing Mobil's one forum-related activity—deliv-

48. *Id.* at 842, 508 N.E.2d at 211-12.

49. *Id.* at 842, 508 N.E.2d at 212.

50. *Id.*

51. *Id.*

52. ILL. REV. STAT. ch. 110, ¶ 2-209(a)(1) (1985).

53. *Natural Gas*, 155 Ill. App. 3d at 842-43, 508 N.E.2d at 212.

54. *Id.* at 843, 508 N.E.2d at 212.

55. *Id.* at 844, 508 N.E.2d at 213 (citing *Connelly v. Uniroyal, Inc.*, 75 Ill. 2d 393, 389 N.E.2d 155 (1979), *cert. denied*, 444 U.S. 1060 (1980)).

56. *Id.*

57. *Id.* at 844-45, 508 N.E.2d at 213.

58. *Id.*

ering gas outside of Illinois to a subsidiary of an Illinois corporation—the court found neither specific nor general jurisdiction, and thus, rejected the lower court's holding that Mobil had transacted business in Illinois.⁵⁹

The court also rejected Natural Gas's argument that the Mobil-Natural Gas contract constituted either a course of dealing or a course of performance in Illinois in satisfaction of the transacting business provision of the long arm statute.⁶⁰ The court rejected the course of dealing argument because Natural Gas never dealt directly with Mobil in Illinois. Rather, Mobil was an assignee of the contract that was negotiated and executed by Anschutz.⁶¹ The court rejected the course of performance argument because the contract was performed entirely outside of Illinois.⁶²

Finally, the court declined to address Mobil's due process arguments. As the court explained, Illinois may exercise personal jurisdiction over a nonresident defendant only when both the long arm and constitutional tests have been met. Mobil's failure to meet the long arm test rendered further analysis of the constitutional issues unnecessary.⁶³ Accordingly, although the appellate court rejected the circuit court's analysis, it agreed with its holding and thus, affirmed its judgment.⁶⁴

III. FIDUCIARY DUTIES

The breach of the fiduciary duty of loyalty was addressed in two separate cases. In *Lindenhurst Drugs, Inc. v. Becker*⁶⁵ the court found an egregious breach resulting in the usurpation of a corporate opportunity. In *Bio-Scientific Clinical Laboratory, Inc. v. Todd*⁶⁶ the court found a cognizable breach but affirmed its dismissal because it was framed as an individual rather than as a derivative action.

The case of *Lindenhurst Drugs, Inc. v. Becker*⁶⁷ clearly set forth Illinois's version of the usurpation of a corporate opportunity doctrine. Defendant Allen Becker, while still a shareholder, director and

59. *Id.* at 845, 508 N.E.2d at 213.

60. *Id.* at 845-46, 508 N.E.2d at 214.

61. *Id.* at 846, 508 N.E.2d at 214.

62. *Id.*

63. *Id.* at 847, 508 N.E.2d at 215.

64. *Id.*

65. 154 Ill. App. 3d 61, 506 N.E.2d 695 (2d Dist. 1987).

66. 149 Ill. App. 3d 845, 501 N.E.2d 192 (1st Dist. 1986).

67. 154 Ill. App. 3d 61, 506 N.E.2d 645 (2d Dist. 1987).

general manager of plaintiff Lindenhurst Drugs, Inc., was charged with purchasing the franchise of a competitor that Lindenhurst was interested in obtaining for itself.⁶⁸ In 1971, Lindenhurst entered into a leasing arrangement with the Linden Plaza Shopping Center which gave Lindenhurst the exclusive right to operate a pharmacy in the plaza until December 31, 1981.⁶⁹ In mid 1979, a Ben Franklin franchise, located in a larger space in the plaza, became available.⁷⁰ After considering the possibility of expanding into the larger space, Lindenhurst's shareholders authorized Becker to explore the possibility of acquiring the franchise.⁷¹ Based on such inquiries, Lindenhurst made an offer to purchase the franchise.⁷² The offer was rejected as inadequate.⁷³ Nonetheless, Lindenhurst expressed to Becker its continuing interest in purchasing the franchise.⁷⁴ In June of 1981, the Plaza informed Becker that Lindenhurst's lease would not be renewed after its expiration in December of that year.⁷⁵ Becker immediately commenced private negotiations with the Plaza which resulted in the purchase of the franchise on his own behalf and the transfer of Lindenhurst's exclusive pharmacy rights to that store.⁷⁶ Becker also transferred from Lindenhurst to the franchise \$45,000 in inventory and fixtures, the cash register, patient profile cards, and several employees.⁷⁷ Becker, however, never informed Lindenhurst that its lease would not be renewed, nor of his intention of leaving the corporation, nor of his acquisition of the franchise.⁷⁸ Once Lindenhurst learned of Becker's activities, it fired him and moved to another location in the same area.⁷⁹ The second store was unsuccessful and failed within six months.⁸⁰

Lindenhurst sued Becker for breaching his fiduciary duty of loyalty by acquiring for himself the franchise that he had been authorized to acquire for it.⁸¹ Becker countered that Lindenhurst's

68. *Id.* at 62, 506 N.E.2d at 646.

69. *Id.* at 63, 506 N.E.2d at 647.

70. *Id.*

71. *Id.*

72. *Id.* at 64, 506 N.E.2d at 647.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*, 506 N.E.2d at 648.

77. *Id.* at 65, 506 N.E.2d at 648.

78. *Id.* at 64-65, 506 N.E.2d at 647.

79. *Id.* at 65, 506 N.E.2d at 648.

80. *Id.*

81. *Id.* at 62, 506 N.E.2d at 646.

interest in the store lapsed once its first offer was rejected.⁸² The sole issue on appeal was whether Becker had usurped Lindenhurst's opportunity to acquire the franchise.⁸³

The court defined a corporate opportunity as one in which "a proposed activity is reasonably incident to the corporation's present or prospective business and . . . [in] which the corporation has the capacity to engage."⁸⁴ The court distinguished business opportunities that were freely available to corporate fiduciaries from corporate opportunities the taking of which resulted in a breach of fiduciary duty:

In determining whether an officer may take advantage of a business opportunity in which a corporation is interested, courts consider whether the corporation had an interest, actual or in expectancy, in the opportunity and whether the acquisition thereof by the officer would hinder or defeat plans and purposes of the corporation in carrying on or developing the legitimate business for which it was created. (*Comedy Cottage, Inc. v. Berk* (1986), 145 Ill. App. 3d 355, 360, 495 N.E.2d 1006; *Northwestern Terra Cotta Corp. v. Wilson* (1986), 74 Ill. App. 2d 38, 46, 219 N.E.2d 860.) Factors to be weighed in making the determination include the manner in which the offer was communicated to the officer, the good faith of the officer, the use of corporate assets to acquire the opportunity, the financial ability of the corporation to acquire the opportunity, the degree of disclosure made to the corporation, the action taken by the corporation with reference thereto, and the need or interest of the corporation in the opportunity. (*Paulman v. Kritzer* (1966), 74 Ill. App. 2d 284, 294-95, 219 N.E.2d 541; *aff'd* (1967), 38 Ill.2d 101, 230 N.E.2d 262).⁸⁵

Based on these factors, the court found that Lindenhurst had the interest and ability to acquire the franchise and that such acquisition was incident, if not necessary, to the continuation of Lindenhurst's business since its lease was not going to be renewed.⁸⁶ The court further found that Becker had breached his fiduciary duty of loyalty to Lindenhurst by failing to make timely disclosures of pertinent information he received as its general manager and then by

82. *Id.* at 66-67, 506 N.E.2d at 648-49.

83. *Id.* at 67, 506 N.E.2d at 649-50.

84. *Id.* at 67, 506 N.E.2d at 650 (citing *Peterson Welding Supply Co. v. Cryogas Prods., Inc.*, 126 Ill. App. 3d 759, 764, 467 N.E.2d 1068, 1072 (1st Dist. 1984)).

85. *Id.* at 68, 506 N.E.2d at 650.

86. *Id.*

using that information for his own benefit and to Lindenhurst's detriment.⁸⁷ Accordingly, the court affirmed the trial court's order for restitution of the misappropriated assets by the imposition of a constructive trust.⁸⁸

In *Bio-Scientific Clinical Laboratory, Inc. v. Todd*⁸⁹ the plaintiff filed a complaint against its former president and director, appellant Todd, its marketing director, John Todd, and Royal Crown Laboratories alleging that the parties had breached their fiduciary duty of loyalty to the plaintiff by forming Royal, a competitor of Bio, while still in Bio's employ.⁹⁰ Appellant Todd filed a counterclaim against Bio's management, count II of which alleged breaches of fiduciary duties owed to her as a substantial but minority shareholder. Count II of the counterclaim charged management with causing Bio to engage in a fraudulent scheme to perform unnecessary medical tests on public aid patients which placed Bio in jeopardy of civil and criminal liability and consequential loss of remunerative welfare programs.⁹¹

The issue on appeal was whether appellant's allegations set forth an individual or a derivative claim.⁹² The court found that the gravamen of count II was that the defendants had caused the corporation to engage in an illegal scheme from which they could personally benefit.⁹³ Todd argued that under *Galler v. Galler*⁹⁴ the duty to properly manage the corporation's affairs was owed to her individually because of her substantial but minority interest in the closely held corporation.⁹⁵

The court conceded that the allegations of the counterclaim properly set forth a cognizable claim of duty breached but refused to extend *Galler* to the instant action for several reasons. First, the court failed to find record proof that the corporation was closely held even though that allegation was never disputed.⁹⁶ Second, as a matter of pleading, the court found that the corporation was not

87. *Id.* at 68-70, 506 N.E.2d 652.

88. *Id.* at 71, 506 N.E.2d at 652.

89. 149 Ill. App. 3d 843, 501 N.E.2d 192 (1st Dist. 1986).

90. *Id.* at 847, 501 N.E.2d at 194.

91. *Id.*

92. *Id.* at 850, 501 N.E.2d at 196.

93. *Id.*

94. 32 Ill. 2d 16, 203 N.E.2d 577 (1964).

95. *Bio-Scientific*, 149 Ill. App. 3d at 850-51, 501 N.E.2d at 196.

96. *Id.* at 850, 501 N.E.2d at 196.

named as a party in any capacity in count II.⁹⁷ Third, the court refused to use *Galler's* recognition of the rights of minority shareholders as a vehicle for converting a derivative action into an individual action.⁹⁸ Without further explanation, the court concluded that the breaches alleged in the counterclaim could give rise to injuries suffered by the corporation and its shareholders as a whole but not as to any shareholder individually. Accordingly, the court affirmed the dismissal of count II of the counterclaim.⁹⁹

IV. ATTORNEY'S FEES

The court decided two cases involving the issue of attorney's fees. *Stanley v. Brassfield, Cowan & Howard*¹⁰⁰ addressed the question of the propriety of a fee award in a disqualification action. *Wencordic Enterprises, Inc. v. Berenson*¹⁰¹ addressed the issue of whether the issuance of stock constituted a gift or collateral for unpaid legal fees.

*Stanley v. Brassfield, Cowan & Howard*¹⁰² distinguished circumstances in which attorneys could and could not collect fees for representing both a corporation and its directors in the same action. In 1984, minority shareholder Stanley sued Stanley Enterprises, Inc., its directors, and majority block of shareholders for monies owed and an accounting.¹⁰³ The law partnership of Brassfield, Cowan & Howard was retained to represent both the corporation and the individually named directors in that action.¹⁰⁴ Two years later, the action was nonsuited on plaintiff's motion.¹⁰⁵ Shortly thereafter, plaintiff filed a second action against the partnership and the same directors named in the prior action seeking reimbursement by either set of parties for attorney's fees wrongfully paid in the first lawsuit and the partnership's disqualification from further representation of the corporation in the second suit.¹⁰⁶ As to the first action, the trial court found that the partnership's fees had been properly authorized

97. *Id.* at 848, 501 N.E.2d at 194-95.

98. *Id.* at 851, 501 N.E.2d at 196.

99. *Id.* at 852, 501 N.E.2d at 197.

100. 152 Ill. App. 3d 378, 504 N.E.2d 542 (3d Dist. 1987).

101. 158 Ill. App. 3d 913, 511 N.E.2d 913 (2d Dist. 1987).

102. 152 Ill. App. 3d 378, 504 N.E.2d 542 (3d Dist. 1987) (Appeal denied).

103. *Id.* at 379, 504 N.E.2d at 543.

104. *Id.*

105. *Id.*

106. *Id.*

and ratified by the corporation under the indemnification provisions of The Business Corporation Act of 1983.¹⁰⁷ The court further found that the partnership could not continue to represent itself, the corporation and its directors in the second action.¹⁰⁸ The issue on appeal was whether the partnership should have been disqualified from representing the corporation, its shareholders and directors in the past and pending actions and, if so, whether the award of attorney's fees in the first action was proper.¹⁰⁹

Stanley argued that the same attorneys could not represent the corporation, its shareholders and directors because of the inherent conflict of interest existing between such parties in a derivative suit.¹¹⁰ While not disputing the existence of such conflict in a derivative action, the court found that the first action was brought against, rather than on behalf of the corporation and, therefore, was not a derivative action giving rise to the conflict.¹¹¹ Accordingly, the court held that the partnership had not represented conflicting interests in the first action and, therefore, the award of attorney's fees had been proper.¹¹² The court found, however, that the second action was derivative since it sought judgment on behalf of the corporation and against the shareholders and directors and, therefore, the partnership's continuing representation of all such parties was improper.¹¹³

*Wencordic Enterprises, Inc. v. Berenson*¹¹⁴ addressed problems arising from an ambiguous pre-incorporation fee agreement. Attorney Irving Berenson agreed to perform unspecified legal services regarding the incorporation and development of a nursing home in exchange for one share of the entity to be formed.¹¹⁵ Pursuant to his retention, from 1968-1981, Berenson formed a limited partnership, incorporated its general partner, solicited investors, negotiated loans and procured favorable administrative agency rulings.¹¹⁶ Berenson also served as director and secretary/treasurer of Wencordic Inc., the general partner of the limited partnership.¹¹⁷ In 1968, Berenson received one

107. ILL. REV. STAT. ch. 32, ¶¶ 875(a)-(h) (1985).

108. *Stanley*, 152 Ill. App. 3d at 380, 504 N.E.2d at 544.

109. *Id.*

110. *Id.* at 380, 504 N.E.2d at 543.

111. *Id.* at 381, 504 N.E.2d at 544.

112. *Id.*

113. *Id.* at 380-81, 504 N.E.2d at 544.

114. 158 Ill. App. 3d 913, 511 N.E.2d 907 (2d Dist. 1987).

115. *Id.* at 915-16, 511 N.E.2d at 908.

116. *Id.* at 916, 511 N.E.2d at 909.

117. *Id.*

share of the limited partnership valued at \$10,000 for his legal work. In May of 1973, Berenson received forty shares of the nursing home's stock which he assumed to be a gift.¹¹⁸ Berenson believed, however, that the value of his services exceeded both the value of his limited partnership interest and the extent of the legal work he initially had agreed to perform.¹¹⁹ Accordingly, in June of 1973, Berenson allegedly submitted to Wencordic a bill for legal fees accruing from 1969 to 1973 in the amount of \$13,000.¹²⁰ Over the next eight years Berenson received approximately \$27,000 in dividends from his nursing home shareholdings.¹²¹ By 1981, Wencordic had fully remitted Berenson's fees and requested the return of the forty shares of the nursing home stock. Berenson refused.¹²²

The primary issue before the court was whether the forty shares of stock were issued to Berenson as a gift or as collateral for his unpaid legal fees.¹²³ The court placed the burden of proving donative intent on Berenson who, as the corporation's attorney, director and officer incurred the fiduciary duty of establishing the fairness of the business transaction.¹²⁴ On one hand, the court found that the defendant lacked the benefit of corporate documentation to substantiate his claim of donative intent.¹²⁵ On the other hand, the court questioned why stock dividends would have been paid to Berenson if the stock had been issued as a security interest.¹²⁶ Finding the evidence to be "merely conflicting," the court affirmed the judgment of the trial court that the stock had been issued as security for unpaid legal fees.¹²⁷

V. CONTRACT INTERPRETATION

The court was called upon to construe the terms "contingent liability" in *Climatrol Industries v. Fedders, Inc.*¹²⁸ and "net worth" in *Potter v. Potter*¹²⁹.

118. *Id.* at 917, 511 N.E.2d at 909.

119. *Id.*

120. *Id.* at 916, 511 N.E.2d at 909.

121. *Id.* at 917, 511 N.E.2d at 909.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* at 919, 511 N.E.2d at 911.

126. *Id.* at 919-20, 511 N.E.2d at 911.

127. *Id.* at 920, 511 N.E.2d at 912.

128. 149 Ill. App. 3d 533, 501 N.E.2d 292 (1st Dist. 1987).

129. 160 Ill. App. 3d 444, 513 N.E.2d at 423 (2d Dist. 1982).

The first district interpreted the meaning of "contingent liability" in a sales contract in *Climatrol Industries v. Fedders, Inc.*¹³⁰ Prior to 1970, Climatrol was wholly owned by Worthington Corp.¹³¹ In 1970, Worthington sold substantially all of Climatrol's assets to Fedders, Inc.¹³² Pursuant to the sales agreement, Fedders agreed to assume Climatrol's "disclosed liabilities" as defined by the following languages:¹³³

For the purposes of this Agreement, the term 'Disclosed Liabilities' as used herein means the aggregate of liabilities or obligations of Corporations of any nature whether accrued, absolute, contingent or otherwise, which exist on the Closing Date and are * * * (iii) those existing on the Latest Balance Sheet Date which are not included or reserved for on such Latest Balance Sheet in accordance with generally accepted accounting principles and practices and which are not required to be disclosed in this Agreement or the Lists, Documents or Exhibits delivered hereunder * * * .¹³⁴

In 1982, Worthington and Climatrol tendered to Fedders the defense of four product liability suits involving accidents allegedly due to products sold prior to 1970 but manufactured at a plant sold to Fedders in 1970.¹³⁵ Fedders rejected the tender of defense of all four suits.¹³⁶ Climatrol and Worthington then sought a declaratory judgment that Fedders was obligated under the sales agreement to assume the defense of the four suits.¹³⁷ Interpreting the sales agreement, the trial court found that Fedders had not assumed responsibility for any of these actions.

The issue on appeal revolved around the definition of "contingent liability." Climatrol and Worthington relied on an accounting definition of contingency which provides:

In accounting a contingency is an existing condition, situation or set of circumstances, involving a considerable degree of uncertainty, which may, through a related future event, result in the acquisition or loss of an asset, or the incurrence or avoidance of a liability, usually with the concurrence of a gain or loss. A commitment which

130. 149 Ill. App. 3d 533, 501 N.E.2d 292 (1st Dist. 1987).

131. *Id.* at 534, 501 N.E.2d at 293.

132. *Id.*

133. *Id.* at 534-35, 501 N.E.2d at 293.

134. *Id.* at 535, 501 N.E.2d at 293-94.

135. *Id.* at 534, 501 N.E.2d at 293.

136. *Id.*

137. *Id.*

is not dependent upon some significant intervening factor or decision should not be described as a contingency. (Financial Accounting Standards Board, Accounting Standards 88 (1973).).¹³⁸

The plaintiffs interpreted this language to mean that any product was a contingent liability once it was in existence and sold.¹³⁹ The court rejected this interpretation of contingent liability as so broad as to mean that Fedders had agreed to assume unlimited liabilities rather than “specifically disclosed liabilities.”¹⁴⁰ Instead, the court relied on the following distinction between a “contingency” and a “contingent liability”:

A contingent liability is one thing, a contingency the happening of which may bring into existence a liability is another . . . In the former case there is a liability which will become absolute upon the happening of a certain event. In the latter there is none until the event happens. The difference is simply that which exists between a conditional debt or liability and none at all.¹⁴¹

Pursuant to this distinction, the court found that Fedders had not agreed to incur contingent liability for any products which, although “in existence” at the time of the asset sale, had not yet caused injury.¹⁴² In essence, the court distinguished a contingent liability for accounting purposes from a contingent liability for legal purposes by requiring for the latter the actual accrual of a cause of action or the pendency of a claim during the requisite time period. Since no cause of action with respect to these four products had accrued by the time the sales agreement was executed, the court affirmed the trial court’s judgment for Fedders.¹⁴³

The issue in *Potter v. Potter*¹⁴⁴ concerned the interpretation of an ambiguous valuation clause of a buy-sell agreement. Two brothers, co-owners of a closely held corporation, entered into a buy-sell agreement which provided that upon the death of either, the survivor agreed to make a “satisfactory offer”¹⁴⁵ to purchase the decedent’s shares for an amount equal to the corporation’s “net worth as shown

138. *Id.* at 535, 501 N.E.2d at 294.

139. *Id.*

140. *Id.*

141. *Id.* at 536, 501 N.E.2d at 294 (quoting *Montgomery v. Phillips Petroleum Co.*, 49 S.W.2d 967, 973 (Tex. Civ. App. 1932) quoting *Fernald v. Johnson*, 71 Me. 437, 440 (1980)).

142. *Id.* at 537, 501 N.E.2d at 295.

143. *Id.*

144. 160 Ill. App. 3d 444, 513 N.E.2d 423 (2d Dist. 1987).

145. *Id.* at 452, 513 N.E.2d at 428.

on Federal income tax returns of the corporation for the fiscal year preceding the decedent's death."¹⁴⁶ Accordingly, upon the death of his brother, defendant Kenneth Potter offered to purchase the decedent's shares for one-half of \$54,086.95, the alleged net worth of the corporation as set forth in the relevant 1980 federal income tax return.¹⁴⁷

The decedent's executor posed several challenges to this figure, the most significant of which were that Kenneth Potter himself had recently listed the same property on the real estate market for \$275,000¹⁴⁸ and that the 1980 federal income tax return did not contain a line for net worth but did contain a line item which contemplated asset depreciation.¹⁴⁹ Since the term "net worth" was not defined in the agreement, and reference to the relevant tax return was unavailing, the court found the valuation term to be ambiguous¹⁵⁰ and proceeded to construe the reasonable and probable intent of the parties. The court consulted Black's Law Dictionary¹⁵¹ which defines "net worth" as the difference between the corporation's total assets and total liabilities but does not contemplate asset depreciation.¹⁵² In light of both the "satisfactory offer" and "net worth" terms of the agreement the court determined that the parties had intended to value the corporation's property at its actual rather than its depreciated value.¹⁵³ Accordingly, the court reversed the trial court's valuation of the corporation and remanded the case for further proceedings to determine the corporation's net worth.

VI. STANDING

*Lower v. Lanark Mutual Fire Insurance Co.*¹⁵⁴ raised troubling questions about the power of an insurance company to divest a complaining policyholder of standing to challenge fraudulent corporate activities. *Brown v. Tenney*¹⁵⁵ and *Saddle Hills Community Association v. Cavallari*¹⁵⁶ presented issues in which shareholders of

146. *Id.* at 447, 513 N.E.2d at 424.

147. *Id.* at 451, 513 N.E.2d at 426.

148. *Id.* at 454, 513 N.E.2d at 429.

149. *Id.* at 452, 513 N.E.2d at 427.

150. *Id.*

151. BLACK'S LAW DICTIONARY 542 (5th ed. 1983).

152. *Potter*, 160 Ill. App. 3d at 452, 513 N.E.2d at 427.

153. *Id.* at 453, 513 N.E.2d at 428.

154. 151 Ill. App. 3d 471, 502 N.E.2d 838 (2d Dist. 1986).

155. 155 Ill. App. 3d 605, 508 N.E.2d 347 (1st Dist. 1987).

156. 150 Ill. App. 3d 134, 501 N.E.2d 330 (2d Dist. 1986).

one corporation sought standing to challenge the actions of an affiliate corporation. *People ex rel. Hartigan v. Candy Club*¹⁵⁷ posed no issues of special concern but presented the court with an amusing factual diversion.

In *Lower v. Lanark Mutual Fire Insurance Co.*¹⁵⁸ a former multiple policyholder of Lanark insurance sought an accounting and damages from Lanark for the fraudulent transfer of funds to and by its secretary-treasurer Alma Dollinger from 1973-1987. Upon discovering the misappropriation, Lanark's board investigated and unanimously voted that the monies from 1978 be returned to Lanark but to allow Dollinger to keep the monies taken prior to 1978.¹⁵⁹ This resolution, and the agreements and arrangements subsequent thereto, were objected to by president Lower and his wife, plaintiff Mary Jean Lower.¹⁶⁰ Thereafter, the plaintiff filed this derivative action.¹⁶¹ In retaliation for the suit, Lanark cancelled Lower's one remaining policy but the cancellation was rescinded by the Illinois Department of Insurance.¹⁶² When the same policy expired in December of 1982, Lanark refused to renew it.¹⁶³ Lanark and six of its nine directors filed motions to dismiss contending that Lower lacked standing to maintain the derivative action because she was no longer a Lanark policyholder.¹⁶⁴ The trial court agreed with the defendants and dismissed the action.

The sole issue raised on appeal was whether the trial court erred in its determination that the plaintiff lacked standing to maintain the derivative action because she was not a policyholder throughout the pendency of the suit.¹⁶⁵ While not disputing this requirement, the plaintiff attempted to characterize the termination of her policyholder status as involuntary, analogous to situations where shareholders lost their shares due to freeze-outs or forced mergers.¹⁶⁶ The court disagreed with this analogy, finding that although the termination was

157. 149 Ill. App. 3d 498, 501 N.E.2d 188 (1st Dist. 1986).

158. 151 Ill. App. 3d 471, 502 N.E.2d 838 (2d Dist. 1986).

159. *Id.* at 473, 502 N.E.2d at 839.

160. *Lower v. Lanark Mut. Fire Ins. Co.*, 114 Ill. App. 3d 462, 463, 448 N.E.2d 940, 942 (2d Dist. 1983).

161. *Lower v. Lanark Mut. Fire Ins. Co.*, 151 Ill. App. 3d 471, 473, 502 N.E.2d 838, 839-40 (2d Dist. 1986).

162. *Id.* at 474, 502 N.E.2d at 840.

163. *Id.*

164. *Id.* at 473, 502 N.E.2d at 840.

165. *Id.*

166. *Id.* at 474, 502 N.E.2d at 840.

not voluntary from plaintiff's point of view, "neither was it 'involuntary' so as to reach the status of a involuntary freeze or merger so as to justify departure from the rule."¹⁶⁷

The *Lower* opinion raises more questions than it resolves. For example, why was this case resolved under federal rather than Illinois law? The Seventh Circuit case of *Portnoy v. Kawecki Beryko Industries*¹⁶⁸ construe Federal Rule of Civil Procedure 23.1 as requiring contemporaneous ownership of stock not only at the time of the action complained of but through out the pendency of the suit as well.¹⁶⁹ Section 7.80 of The Business Corporation Act, however, requires share ownership only at the time of the disputed action.¹⁷⁰ Presumably, had this case been resolved under Illinois rather than federal law, the plaintiff would have won since she could have established policyholder status at the relevant time, i.e., at the time of the disputed action.

A second issue which was not satisfactorily resolved by the court is whether an insured policyholder who had standing at the inception of the litigation can be divested of that standing by the insurance company's unilateral act of refusing to renew her policy. The *Lower* court may have been correct in refusing to accept the plaintiff's involuntary merger and freeze-out analogy under federal law, but in so doing it empowered mutual insurance companies to eliminate derivative actions by the simple expedient of refusing to renew the complainant's policy under Illinois law. It is questionable whether such result comports with the equitable principles governing derivative actions generally or the requirements of section 7.80 specifically. These issues could have been resolved by ordinary statutory construction and should have been based on Illinois rather than federal law.

Standing to file a double derivative action under section 7.80 of The Business Corporation Act¹⁷¹ arose as a matter of first instance in the case of *Brown v. Tenney*.¹⁷² In 1987, defendant Tenney and plaintiff Brown formed Pioneer Corporation with each owning 48.5% of its stock.¹⁷³ In 1982, Pioneer's shareholders formed T/B Holding Co. to act as Pioneer's parent.¹⁷⁴ The shareholders exchanged their

167. *Id.*

168. 607 F.2d 765, 766 (7th Cir. 1979).

169. *Lower*, 151 Ill. App. 3d at 473, 502 N.E.2d at 840 (citing *Portnoy*, 607 F.2d at 767).

170. ILL. REV. STAT. ch. 32, ¶ 780 (1985).

171. ILL. REV. STAT. ch. 32, ¶¶ 1.01-17.05 (1985).

172. 155 Ill. App. 3d 605, 508 N.E.2d 347 (1st Dist. 1987).

173. *Id.* at 606, 508 N.E.2d at 348.

174. *Id.*

Pioneer stock for an equal percentage of the T/B stock.¹⁷⁵ In 1983, Brown filed this action, individually and derivatively, charging Tenney with “a course of conduct that was wasting, diverting, and damaging the assets of Pioneer and T/B.”¹⁷⁶ The issue on appeal was whether Brown had standing to bring the double derivative action on behalf of both T/B and Pioneer.¹⁷⁷

Although there was no dispute that as one of its shareholders Brown had standing to bring a derivative action on behalf of T/B, Tenney contended that under the contemporaneous ownership requirement of section 7.80¹⁷⁸ Brown was not a shareholder of Pioneer and therefore lacked standing to bring a derivative action on its behalf.¹⁷⁹

The court defined a double derivative action as:

[O]ne in which a shareholder of a parent or holding corporation seeks to enforce derivatively the corporation's derivative right to sue on behalf of the subsidiary. . . . Stated differently, the shareholder is effectively maintaining the derivative action on behalf of the subsidiary, based upon the fact that the parent or holding corporation has derivative rights to the cause of action possessed by the subsidiary. . . . Generally, this type of action arises where, as in this case, a parent corporation owns and controls a subsidiary The wrong sought to be remedied by the complaining shareholder is not only that done directly to the parent corporation in which he or she owns stock but also the wrong done to the corporation's subsidiaries which indirectly, not actually, affects the parent corporation and its stockholders.¹⁸⁰

The court recognized the split of authority respecting the propriety of double derivative actions. Cases disallowing such actions cited strict adherence to the contemporaneous ownership rule which requires the plaintiff to be a shareholder of the corporation on whose behalf he is suing at the time of the disputed transaction.¹⁸¹ Finding

175. *Id.*

176. *Id.*

177. *Id.* at 607, 508 N.E.2d at 349.

178. ILL. REV. STAT. ch. 32, ¶ 7.80 (1985).

179. *Brown*, 155 Ill. App. 3d at 607, 508 N.E.2d at 349.

180. *Id.* at 607-08, 508 N.E.2d at 349 (citations omitted).

181. *Id.* (citing *Gaillard v. Natomas Co.*, 173 Cal. App. 3d 410, 219 Cal. Rptr. 74 (1985)); *Sheehan v. Municipal Light & Power Co.*, 54 F. Supp. 169 (S.D.N.Y. 1943); *Busch v. Mary A. Riddle Co. of Del.*, 283 F. 443 (D. Del. 1922); *Sabre v. United Traction & Elec. Co.*, 225 F. 601 (D. R.I. 1915)).

such authorities to be "rigid and outmoded,"¹⁸² the court chose instead to adopt the more progressive trend which permits double derivative actions under such theories as: the right of a subsidiary to seek specific performance of the parent's duty to redress injuries to the subsidiary;¹⁸³ the subsidiary's shareholders third party right to compel the parent to enforce the subsidiary's rights;¹⁸⁴ the duty of one corporation to redress wrongs to another corporation where both corporations are controlled by the same individuals;¹⁸⁵ and, situations where a double derivative action may be analogous to piercing the corporate veil.¹⁸⁶ Without further discussion of which of these theories applied to the instant case, the court found that since the prerequisites to bringing a single derivative action on behalf of the subsidiary had been satisfied under section 7.80, that the plaintiff also had standing to bring the double derivative action against the parent.¹⁸⁷

In *Saddle Hills Community Association v. Cavallari*,¹⁸⁸ the second district affirmed a trial court ruling that membership in one corporation did not give standing to challenge the internal procedures of an affiliate corporation. Defendant Samuel Cavallari was a member of Saddle Hills Community Association, Inc., an association of homeowners of property located within the Saddle Hills Estate subdivision.¹⁸⁹ The subdivision was owned by Saddle Hills Farms, Inc., which had created an architectural review committee to approve improvements on property located within the subdivision.¹⁹⁰

In September of 1983, Cavallari constructed a chain link fence on his property located within the subdivision.¹⁹¹ Plaintiff Gatewood, as president of the subdivision and sole member of the architectural review committee, sought and received an injunction ordering removal of the fence because of Cavallari's failure to receive prior committee

182. *Id.* at 609, 508 N.E.2d at 350.

183. *Id.* (citing Note, *Suits by a Shareholder in a Parent Corporation to Redress Injuries to the Subsidiary*, 64 HARV. L. REV. 1313, 1313-14 (1951); 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 5977, at 207 (perm. ed. 1984)).

184. *Id.* (citing *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir. 1944)).

185. *Id.* (citing *United States Lines, Inc. v. United States Lines Co.*, 96 F.2d 148 (2d Cir. 1944)).

186. *Id.* (citing *Hirshhorn v. Mine Safety Appliances Co.*, 54 F. Supp. 588 (W.D. Pa. 1944)).

187. *Id.* at 610, 508 N.E.2d at 351.

188. 150 Ill. App. 3d 134, 501 N.E.2d 330 (2d Dist. 1986).

189. *Id.* at 138, 501 N.E.2d at 333.

190. *Id.* at 135, 501 N.E.2d at 331.

191. *Id.*

approval for its construction.¹⁹² Cavallari claimed that as a member of the Saddle Hills Community Association, Inc. he had standing to challenge plaintiff's self-appointment to the review committee.¹⁹³ The second district disagreed, finding that Cavallari's membership in the subdivision's association did not give him standing to challenge the procedures of the corporate owner of the subdivision.¹⁹⁴ Accordingly, the judgment of the trial court was affirmed.

It is interesting that both the trial and appellate courts framed the issue in this case as whether the shareholder of one corporation had standing to sue an affiliate corporation. The court's denial of standing to Cavallari suggests the erroneous principle of law that only a corporation's own shareholders can challenge its internal procedures and acts. Apparently, both courts confused the concept of ultra vires with the well established right of third parties to challenge corporate procedures that directly injure them. Generally, the question of whether a corporation has exceeded its lawful powers can be raised only by one interested in the corporation or by the state.¹⁹⁵ Members of homeowner's associations, however, have always been afforded standing to challenge procedures of a corporate developer if the member's proprietary rights are being infringed.¹⁹⁶ Both *Cavallari* courts failed to distinguish a suit challenging the existence of a corporate power from a suit challenging the manner in which that power was exercised. Cavallari was not questioning whether Saddle Hills Farm, Inc. had the power to appoint an architectural review committee. Rather, he was challenging the procedure by which that power was exercised—Gatewood's self-appointment to the review committee. Under this doctrine, Cavallari should have had standing to sue the corporate owner of the subdivision. Notwithstanding the court's erroneous standing analysis, the result probably would not have been different since Cavallari had constructive notice of the restrictive covenants and failed to comply with known procedures.

*People ex rel. Hartigan v. Candy Club*¹⁹⁷ is perhaps more notable for its facts than its legal analysis. The Illinois Attorney General sued the estate of decedent Sidney Finzelbar who in life had incorporated and operated as a not-for-profit corporation an X-rated

192. *Id.*

193. *Id.* at 138, 501 N.E.2d at 333.

194. *Id.* at 135, 501 N.E.2d at 331.

195. ILL. REV. STAT. ch. 32, ¶ 157.8 (1983).

196. *Wolinsky v. Kadison*, 114 Ill. App. 3d 527, 449 N.E.2d 151 (1st Dist. 1983).

197. 149 Ill. App. 3d 498, 501 N.E.2d 188 (1st Dist. 1986).

dance and nude fashion show known as the Candy Club.¹⁹⁸ The complaint alleged that between 1978 and 1984, the Candy Club fraudulently violated its not-for-profit charter¹⁹⁹ by collecting entrance fees in excess of \$200,000 and that Finzelbar, as manager and operator of the club, had converted such fees to his own use.²⁰⁰ The State sought the club's dissolution and liquidation, and the distribution of its assets to charity or to the state.²⁰¹

The defendant challenged the standing of the Attorney General to bring the action. The Attorney General defended its standing under the liquidation provisions of the General Not For Profit Corporation Act²⁰² which empowers the Attorney General to involuntarily dissolve a not-for-profit corporation if it lacks bona fide membership and engages in ultra vires activities.²⁰³ The court found that the complaint contained the requisite allegations of fraud and abuse of authority to empower the Attorney General to bring the action and, accordingly, reversed the trial court's dismissal of the complaint.²⁰⁴

VII. DISSOLUTION

The capacity of a corporation to be subject to post-dissolution criminal proceedings arose in *People v. Boyce*²⁰⁵ and to post-dissolution civil proceedings in *de St. Aubin v. Johnson*.²⁰⁶ *Thomas v. Borgsmiller, Inc.*²⁰⁷ considered the propriety of damage remedies available to a creditor who failed to receive notice of a corporation's dissolution.

The movement to hold corporations criminally accountable suffered a setback in the case of *People v. Boyce*²⁰⁸ which overturned a corporation's conviction for violations of the Illinois Environmental Protection Act.²⁰⁹ On April 11, 1984, the Attorney General filed an indictment charging the defendant corporation with criminal deposit

198. *Id.* at 499, 501 N.E.2d at 189.

199. See ILL. REV. STAT. ch. 32, ¶ 163a49 (1983).

200. *Candy Club*, 149 Ill. App. 3d at 500, 501 N.E.2d at 189.

201. *Id.*

202. ILL. REV. STAT. ch. 32, ¶¶ 163a49, 163a54 (1983).

203. *Candy Club*, 149 Ill. App. 3d at 503, 501 N.E.2d at 191.

204. *Id.*

205. 156 Ill. App. 3d 1036, 509 N.E.2d 776 (2d Dist. 1986).

206. 151 Ill. App. 3d 184, 502 N.E.2d 360 (5th Dist. 1986).

207. 155 Ill. App. 3d 1057, 508 N.E.2d 1235 (5th Dist. 1987).

208. 156 Ill. App. 3d 1036, 509 N.E.2d 776 (2d Dist. 1986).

209. ILL. REV. STAT. ch. 111, ¶¶ 1044(b)(1), (d)(1)(a) (1983).

and use of hazardous waste.²¹⁰ That indictment was subsequently nolle prossed.²¹¹ On August 1, 1985, the Illinois Secretary of State involuntarily dissolved the same corporation for failing to file its annual report and pay franchise taxes.²¹² On August 13, 1985, the Attorney General filed a new indictment against the corporation again charging criminal deposit and use of hazardous waste.²¹³ The second indictment resulted in the corporation's conviction.²¹⁴ On appeal, the corporation challenged the authority of the state to prosecute the second indictment since it was filed after the corporation's dissolution.²¹⁵

Under Illinois law the dissolution of a corporation is analogous to the death of a person:²¹⁶ once existence is terminated, the corporation, like the deceased, loses its capacity to sue or be sued and all pending proceedings to which the corporation is a party are abated.²¹⁷ In an effort to save the indictment, the Attorney General argued that the prosecution was authorized under two provisions of The Business Corporation Act: section 12.80²¹⁸ which provides for survival of remedies after dissolution, and section 12.30(c)(5),²¹⁹ which provides for survival of proceedings pending on the date of dissolution.²²⁰ The court rejected the section 12.80 argument as contravening a well established Illinois Supreme Court ruling which limited that provision to civil actions only.²²¹ The court rejected the section 12.30 argument by finding that the indictment was filed twelve days after dissolution and, therefore, was not pending as of the date of dissolution.²²² The court admonished the State that the only way this prosecution could have been saved was to have proceeded under the April 1984 pre-dissolution indictment.²²³ Having failed to do so, the court concluded that the second indictment was untimely and the prosecution there-

210. *Id.*; *Boyce*, 156 Ill. App. 3d at 1039, 509 N.E.2d at 778.

211. *Boyce*, 156 Ill. App. 3d at 1039, 509 N.E.2d at 778.

212. *Id.*

213. ILL. REV. STAT. ch. 111, ¶¶ 1044(b), (d)(1)(a) (1983).

214. *Boyce*, 156 Ill. App. 3d at 1039, 509 N.E.2d at 778.

215. *Id.*

216. *Id.* (citing *People v. Mazzone*, 74 Ill. 2d 44, 48, 383 N.E.2d 947, 950 (1978)).

217. *Id.* (citing *Blankenship v. Demmler Mfg. Co.*, 89 Ill. App. 3d 569, 572, 411 N.E.2d 1153, 1155 (1st Dist. 1980)).

218. ILL. REV. STAT. ch. 32, ¶ 12.80 (1985).

219. ILL. REV. STAT. ch. 32, ¶ 12.30(c)(5) (1985).

220. *Boyce*, 156 Ill. App. 3d at 1040, 509 N.E.2d at 778-79.

221. *Id.* at 1041, 509 N.E.2d at 779 (citing *People v. Mazzone*, 74 Ill. 2d 44, 383 N.E.2d 947 (1978)).

222. *Id.* at 1042, 509 N.E.2d at 779.

223. *Id.* at 1044, 509 N.E.2d at 782.

under improper.²²⁴ Accordingly, the corporation's conviction was reversed.²²⁵

A contrary result was reached in *de St. Aubin v. Johnson*²²⁶ in which the fifth district determined the capacity of a dissolved Wisconsin corporation to be sued after the expiration of the applicable limitations period. Plaintiff Victor de St. Aubin was a former shareholder and creditor of Burlingshire, Inc., an unprofitable Wisconsin corporation.²²⁷ In an effort to improve profitability, Burlingshire's shareholders entered into a plan to convert the corporation into a limited partnership.²²⁸ The plan required the dissolution of the corporation which, under Wisconsin law, could be accomplished only "when all debts, liabilities and obligations of the corporation had been paid and discharged, or adequate provision . . . made therefore."²²⁹ De St. Aubin objected to this plan and after it was implemented refused to participate in the limited partnership or have any of his liabilities assumed by it.²³⁰ Three years later, he sued the general partner and the former directors and shareholders of Burlingshire for monies allegedly owed to him pursuant to the conversion plan.²³¹ The court found the action to be "time-barred" under section 180.787 of the Wisconsin Business Corporation Law which provides that "[t]he dissolution of a corporation shall not take away or impair any remedy available to or against such corporation, its directors, officers, or shareholders, for any right or claim existing or any liability incurred, prior to such dissolution if . . . commenced within 2 years after the date of such dissolution."²³² As each of de St. Aubin's claims arose more than two years prior to the filing of the complaint, the court concluded that the claims were barred and, hence, affirmed the trial court's decision.²³³

The *de St. Aubin* analysis is marred by some interesting ironies. The court construed section 180.787 of the Wisconsin Business Corporation Law as a statute of limitations barring the litigation of de St. Aubin's untimely claims. Section 180.787, however, is not a

224. *Id.* at 1045, 509 N.E.2d at 782.

225. *Id.*

226. 151 Ill. App. 3d 184, 502 N.E.2d 360 (5th Dist. 1986).

227. *Id.* at 185-86, 502 N.E.2d at 362.

228. *Id.* at 186-87, 502 N.E.2d at 363.

229. *Id.* at 186-89, 502 N.E.2d at 363-65 (citing WIS. STAT. § 180.765 (1976)).

230. *Id.* at 186-87, 502 N.E.2d at 362-63.

231. *Id.* at 187, 502 N.E.2d at 363.

232. *Id.* at 189, 502 N.E.2d at 365 (citing WIS. STAT. § 180.787 (1976)).

233. *Id.* at 189-90, 502 N.E.2d at 365.

statute of limitations which abates the right to relief. Rather it is a statutorily imposed period during which the dissolved corporation's life is extended for the limited purpose of resolving creditor's claims.

It is interesting to note that *de St. Aubin* is cited copiously in *West's Wisconsin Annotated Statutes* for the apparent reason that it is one of the few appellate cases in the United States to construe the 1980 Model Business Corporation Act provisions dealing with shareholder liability for the debts of a dissolved corporation.²³⁴ One of the other rare cases to construe these provisions was the Wisconsin Supreme Court case of *Bazan v. Kux Machine Company*,²³⁵ which relied heavily on the construction of a similar Illinois provision.²³⁶ The *Bazan* court first decided that the statutory law of the state of incorporation, Illinois, should govern the question of whether the life of a corporation could be prolonged for litigation purposes.²³⁷ The *Bazan* court then looked to Illinois' section 157.94, which was based on the same Model Business Act section 105 as Wisconsin's section 180.787, and concluded that these provisions were statutorily imposed periods extending the time during which the dissolved corporation retained the capacity to sue and be sued rather than limitations periods barring the right to relief.²³⁸ Ironically, the *de St. Aubin* court failed to acknowledge the *Bazan* ruling and in so doing failed to apply Wisconsin's own precedential analysis to the limitations issue. Since *Bazan's* analysis is weakened by the fact that it dealt with an Illinois rather than a Wisconsin corporation, the definitive construction of Wisconsin's section 180.787 is now *de St. Aubin*.

The case of *Thomas v. Borgsmiller, Inc.*²³⁹ addressed the issue of the proper measure of damages when a director and sole shareholder of a corporation fails to notify creditors of the corporation's dissolution. The parties had entered into a ten year lease agreement.²⁴⁰ The defendant corporation fell into financial distress, assigned the

234. See Model Business Corp. Act § 105 (1980).

235. 52 Wis. 2d 325, 190 N.W.2d 521 (1971).

236. *Bazan* involved an action by an injured worker against a dissolved Illinois corporation which was held not to be time-barred by the two-year provision for filing suits by or against a dissolved corporation. The *Bazan* decision cited to *O'Neill v. Continental Ill. Co.*, 341 Ill. App. 119, 93 N.E.2d 160 (1950) which construed ILL. REV. STAT. ch. 32, ¶ 157.94 (1949).

237. *Bazan*, 52 Wis. 2d at 334, 190 N.W.2d at 525.

238. *Id.* at 337-38, 190 N.W.2d at 526. See *O'Neill*, 341 Ill. App. 119, 93 N.E.2d 160.

239. 155 Ill. App. 3d 1057, 508 N.E.2d 1235 (5th Dist. 1987).

240. *Id.* at 1059, 508 N.E.2d at 1237.

lease to another corporation and voluntarily dissolved.²⁴¹ The assignee defaulted on the lease payments and subsequently declared bankruptcy.²⁴² The plaintiff sued the assignor corporation seeking damages in the amount of its lease indebtedness to him.²⁴³ The trial court found the defendant corporation personally liable on the remaining lease indebtedness.²⁴⁴ The appellate court reversed.

As a threshold matter, the court rejected the argument that a novation had occurred between the defendant and its assignee which legally bound the plaintiff to look solely to the assignee for satisfaction of the lease indebtedness.²⁴⁵ The court next determined whether the defendant's failure to give the plaintiff notice of dissolution rendered him personally liable for the corporate debt pursuant to section 42-6 of The Business Corporation Act which provides:

Notice of intent to dissolve. The directors of a corporation which fails to mail to a known creditor of such corporation, as provided in this Act, a notice of the filing by the Secretary of State of a statement of intent of such corporation to dissolve, shall be jointly and severally liable to such creditor for all loss and damage occasioned thereby.²⁴⁶

Plaintiff argued that a prima facie case for personal liability of a director is established once it is proven that the corporation failed to give a known creditor notice of the corporation's dissolution;²⁴⁷ thereafter, the burden shifts to the director to disprove the wrongful distribution of corporate assets by the dissolved corporation.²⁴⁸ The court accepted the first contention but rejected the second finding that the burden remained on the plaintiff to prove the existence of corporate assets at the time of dissolution and the wrongful distribution of such assets to non-creditors.²⁴⁹ Once liability is established, damages are to be measured by the value of the assets wrongfully distributed not, as plaintiff argued, by the amount of indebtedness

241. *Id.*

242. *Id.* at 1060, 508 N.E.2d at 1237.

243. *Id.* at 1060, 1065, 508 N.E.2d at 1237, 1240.

244. *Id.* at 1059, 508 N.E.2d at 1236.

245. *Id.* at 1060, 1063, 508 N.E.2d 1237, 1239.

246. *Id.* at 1064, 508 N.E.2d at 1240 (citing ILL. REV. STAT. ch. 32, ¶ 157.42-6 (1983)).

247. *Id.* at 1065, 508 N.E.2d at 1240.

248. *Id.*

249. *Id.* at 1065, 508 N.E.2d at 1241 (citing *Swager v. Couri*, 77 Ill. 2d 173, 191-92, 395 N.E.2d 921, 928-29 (1979); *State Bank v. Segovia*, 49 Ill. App. 3d 682, 364 N.E.2d 688 (2d Dist. 1977)).

to the creditor.²⁵⁰ Having failed to prove either the existence of corporate assets at the time of dissolution or any harm caused by their wrongful distribution, the court reversed the judgment in favor of the plaintiff and remanded the case for a new trial on the issue of the defendant's personal liability.²⁵¹

VIII. SECURITIES

The court decided three securities cases of interest. *Miller v. Smith*²⁵² addressed the definition of a stock nominee in a struggle to gain control over a closely held corporation. *Schuler v. Beers*²⁵³ re-evaluated the purchaser's rescission remedy in light of recent amendments to the 1953 Illinois Securities Law. *Saunders, Lewis and Ray v. Evans*²⁵⁴ examined the passive investor exception to the registration requirements of the 1953 Act.

The central issue in *Miller v. Smith*²⁵⁵ was the rightful ownership of a control block of stock. Plaintiff, Smith III, argued that he had purchased 100 shares of stock in the Call Publishing Company from the deceased Emma Weinberg, who had been an employee of the company at the time she acquired the stock but had never acquired the stock certificates, had never paid any consideration for the stock, and had never claimed an ownership interest in the stock.²⁵⁶ Defendants, trustees for the estate of Smith, Jr., argued that Weinberg really had been a nominee for Smith, Jr., a founding member of the company and the original payor of the stock. The court agreed with the defendants.²⁵⁷

Citing *Hanley v. Hanley*,²⁵⁸ the court implicitly found that the circumstances of Weinberg's shareholdership amounted to a resulting trust.²⁵⁹ Under the *Hanley* case, a resulting trust arises when it is proven by evidence that is clear, convincing and unmistakable,²⁶⁰

250. *Id.* (citing *Swager v. Couri*, 77 Ill. 2d 173, 192, 395 N.E.2d 921, 928-29 (1979)).

251. *Id.* at 1066, 508 N.E.2d at 1241.

252. 157 Ill. App. 3d 486, 510 N.E.2d 427 (5th Dist. 1987).

253. 157 Ill. App. 3d 97, 510 N.E.2d 48 (5th Dist. 1987).

254. 158 Ill. App. 3d 994, 512 N.E.2d 59 (4th Dist. 1987).

255. 157 Ill. App. 3d 486, 510 N.E.2d 427 (5th Dist. 1987).

256. *Id.* at 488-89, 510 N.E.2d at 428.

257. *Id.* at 489, 510 N.E.2d at 429.

258. 14 Ill. 2d 566, 152 N.E.2d 879 (1958).

259. *Miller*, 157 Ill. App. 3d at 489, 510 N.E.2d at 429.

260. *Hanley*, 14 Ill. 2d 566, 572, 152 N.E.2d 879, 883 (1958); *Scanlon v. Scanlon*, 6 Ill. 2d 224, 127 N.E.2d 435 (1955); *Tuntland v. Haugen*, 399 Ill. 595, 78 N.E.2d 308 (1948); *Cook v. Blazis*, 365 Ill. 625, 7 N.E.2d 291 (1937).

“and usually comes into existence where one person furnishes the consideration . . . for the purchase of the property while the title is taken in the name of another.”²⁶¹ It is unclear that *Miller* satisfies the first part of this test since the court’s opinion was based on insufficient and conflicting evidence rather than “clear, convincing and unmistakable” evidence.²⁶² Nonetheless, as there was no dispute that Smith, Jr. put up the original consideration for the stock, and that Weinberg’s estate disclaimed any interest in the stock ownership, the court concluded that the estate of Smith, Jr. was the rightful owner of the stock.²⁶³ As a result of the court’s holding, 199 shares were allocated to Smith, Jr.’s estate and one share was allocated to Smith III.²⁶⁴

The court in *Schuler v. Beers*²⁶⁵ found that the 1983 amendments to the Illinois Securities Law of 1953²⁶⁶ eliminated the purchaser’s right to rescind securities transactions which failed to meet the act’s reporting requirements.²⁶⁷ The plaintiff allegedly purchased stock based on material misrepresentations and omissions and, accordingly, sought rescission of the sale under the 1953 act.²⁶⁸ Analyzing the act, its amendments, and its legislative history, the court found that rescission was an “exceedingly harsh”²⁶⁹ remedy for failure to comply with the act’s ministerial reporting requirement, especially since the report was not available to the public²⁷⁰ and, therefore, could not affect a buyer’s decision to purchase.²⁷¹ The interpretive comments of the 1983 amendments supported this analysis, stating:

Section 4.G. is intended to aid small businesses by allowing them to raise capital on a limited basis without incurring the sizeable costs incident to registering a public securities offering. Many small businesses raise needed capital in an informal manner without benefit of counsel. Under section 4.G. prior to amendment, innocent defects in filing have had harsh and inequitable consequences.

To benefit small businesses, this exemption as amended has

261. *Hanley*, 14 Ill. 2d at 571-72, 152 N.E.2d at 882.

262. *Id.* at 572, 152 N.E.2d at 883.

263. *Miller*, 157 Ill. App. 3d at 490-91, 510 N.E.2d at 428-29.

264. *Id.* at 491, 510 N.E.2d at 430.

265. 157 Ill. App. 3d 97, 510 N.E.2d 48 (5th Dist. 1987) (this case has been settled).

266. ILL. REV. STAT. ch. 121 1/2, ¶¶ 137.1-137.19 (1983).

267. ILL. REV. STAT. ch. 121 1/2, ¶ 137.4(g) (1981).

268. ILL. REV. STAT. ch. 121 1/2, ¶¶ 137.1-137.19 (1983).

269. *Schuler*, 157 Ill. App. 3d at 101, 510 N.E.2d at 50.

270. ILL. REV. STAT. ch. 121 1/2, ¶ 137.4(g)(4) (1983).

271. *Schuler*, 157 Ill. App. 3d at 101, 510 N.E.2d at 50.

been designed to be available whether or not an issuer is aware of the report requirement. Under old section 4.G., a purchaser had a right to rescind a securities purchase for up to three years from the date of sale if the seller, despite full compliance with other provisions of Sec. 4(G) and without any fraud or misrepresentation, merely failed to file a report. The unnecessarily harsh consequences and arbitrary operation of the report filing requirement have been repealed to insure greater equity in the application of the Act and to eliminate what was a classic trap for the unwary.²⁷²

In light of these comments, the court found that the 1983 amendments effectively eliminated the purchaser's right to rescission where the issuer merely had failed to meet the reporting requirements of the 1953 Act.²⁷³

The "managerial" or "passive investor" exception to the registration requirements of the Illinois Securities Law of 1953²⁷⁴ were examined in *Saunders, Lewis & Ray v. Evans*.²⁷⁵ The plaintiff corporation charged the defendant law firm with failing to register and report a securities transaction which involved the transfer of a substantial interest in the corporation.²⁷⁶ The defendant argued that the transaction at issue was not a security as defined by *S.E.C. v. Howey Co.*²⁷⁷ since the purchaser was a corporate director capable of influencing corporate activities rather than a "passive investor" incapable of exercising control over his investment.²⁷⁸ The court agreed with the defendant. The purpose of the reporting requirement, the court explained, was to protect innocent investors from relying on misrepresentations and omissions of material information,²⁷⁹ not to protect members of corporate management who have access to reportable information prior to making their investments.²⁸⁰ Implicit in the court's analysis is the assumption that the purchaser could not have been damaged by material omissions since as a corporate manager he had access to such information and the capacity to exercise control over his investment. The securities fraud elements

272. *Id.* at 102-03, 510 N.E.2d at 50-51 (citing ILL. ANN. STAT. ch. 121 1/2, ¶ 137.4(g) (Smith-Hurd 1983) (interpretive comment)).

273. *Id.* at 103-05, 510 N.E.2d at 51-52.

274. ILL. REV. STAT. ch. 121 1/2, ¶ 137.5 (1979).

275. 158 Ill. App. 3d 994, 512 N.E.2d 59 (4th Dist. 1987).

276. *Id.*

277. 328 U.S. 293 (1946) ("passive investor" test).

278. *Saunders*, 158 Ill. App. 3d at 995, 512 N.E.2d at 61.

279. *Id.* at 996, 512 N.E.2d at 61.

280. *Id.* at 996, 512 N.E.2d at 62.

implicated in this approach are reliance and causation: a high ranking corporate insider would have knowledge of information material to his investment and, therefore, could not be damaged by its nondisclosure to the public.

There are two problems with this approach. First, the purchaser in this case was not a corporate insider or manager prior to making the disputed investment. Rather, he acquired his managerial status in the corporation after he acquired its stock. The opinion disregards this fact. Instead, it assumes the purchaser both controlled his investment and had access to material information before the investment was made. Second, the court need not have reached the reliance issue since the crux of its analysis was that the purchaser, as a corporate manager, was not a passive investor entitled to the protection of the Securities Law. That approach suggests that the plaintiff's securities fraud case failed not because the purchaser failed to rely on nondisclosed information, but because no duty was owed to the purchaser *qua* corporate manager.

IX. CONCLUSION

Many of the 1987-1988 Corporations survey cases demonstrate the Illinois Appellate Court's ability to construe legislative enactments in accordance with emerging trends. Other cases, however, indicate the unwillingness of the Illinois judiciary to properly apply precedent or to utilize available legal devices to arrive at appropriate and creative solutions to the problems confronting them.