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CORPORATE OPPORTUNITIES AND THE THIRD PARTY “REFUSAL TO DEAL” DEFENSE: POLICY AND PRACTICE LESSONS FROM ILLINOIS

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“[I]f a trustee, on the refusal to renew, might have a lease for himself, few estates would be renewed to *cestui que use*.”¹

I. INTRODUCTION

As Adam Smith recognized as long ago as 1776 in *The Wealth of Nations*, the division of labor to achieve specialization plays a key role in advancing both business enterprises and civilization itself.² All firms appreciate this reality and divide tasks accordingly, from senior management on down. So long as employees and agents of the firm remain loyal, this system works reasonably well and profitably, at least when compared to the alternative of a person going it alone.³ But agents placing their

* Partner, Baker & McKenzie, Chicago, Illinois. As always, this article is dedicated with love to my wife, Jane Reynolds Schaller, and my children, Alexandra, William, George and Samantha Schaller. A special thanks to my partners and pals, John M. Murphy and Peter P. Tomczak, great fiduciary duty lawyers and even greater friends. Despite their comments and criticisms, all errors are mine alone.

1. *Keech v. Sandford*, 25 Eng. Rep. 223 (1726) (quoted in 1 GEORGE E. PALMER, *THE LAW OF RESTITUTION* § 2.11, at 146 n.18).

2. ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 12 (Edwin Cannan Ed. 1994) (“It is the great multiplication of the productions of all the different arts, in consequence of the division of labour, which occasions, in a well-governed society, that universal opulence which extends itself to the lowest ranks of the people.”). This continual subdivision into narrower and narrower sub-specialties has prompted the medical school joke “that young physicians who want to be on the cutting edge of medicine today should try to learn more and more about less and less, until they know everything about nothing. Conversely, doctors who want to be generalists . . . are doomed to know less and less about more and more, until they know nothing about everything.” THOMAS H. LEE AND JAMES J. MONGAN, *CHAOS AND ORGANIZATION IN HEALTH CARE* 11-12 (2009).

3. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (Nov. 1937) (arguing that firms arise because their efficiencies result in lower transaction costs than strangers dealing at arm’s length); Thomas F. McInerney, *Implications of High Performance Production and Work Practices for Theory of the Firm and Corporate Governance*, 2004 *COLUM. BUS. L. REV.*

interests ahead of the firm can strain this system, and it can implode under the weight of the ultimate agency cost – secret competition by employees and other agents during the agency relationship.⁴ Smith himself recognized this danger: “The directors of [joint stock] companies . . . being the managers rather of other people’s money than their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.”⁵ The English decision in *Keech*, quoted above, recognized the same danger fifty years before Smith, as did Roman law long before *Keech*.⁶

The “refusal to renew” ruling in *Keech* represented much more than just the familiar biblical truth that “no man can serve two masters,”⁷ however. *Keech* subtly extended this fundamental principle by recognizing that fiduciary transactions with third parties lose none of their suspiciousness simply because they are preceded by a third party’s “refusal to renew” the same transaction with the fiduciary’s principal.⁸ As such, *Keech* offered a profound policy pronouncement of enduring significance to modern business law: a third party’s “refusal to deal” should not be a defense to corporate opportunity usurpation.

The problems with the refusal to deal defense are manifold. This simple but deceptive defense – that the diverted third-party trading partner would have refused to deal with plaintiff, independent of the fiduciary’s wrongdoing – introduces complex and irrelevant legal arguments under the rubrics of duty, proximate cause, and remedy.⁹ The refusal to deal defense also

135, 136 (2004) (arguing that the team production model of corporate governance explains the theory of the firm better than agency theory and transaction cost economics).

4. Frank H. Easterbrook and Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 277-81 (1986) (arguing for an *ex ante* contract response to agency costs within small firms); Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 959-62 (1984) (discussing the threat agency costs pose to the firm).

5. Smith, *supra* note 2, at 800. See also LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT (1914) (borrowing its title from Adam Smith’s famous observation).

6. Epstein, *supra* note 4, at 960, n.22 (arguing that Gaius’ *Institutes* recognized misappropriation of partnership opportunities as wrongful in Roman times); STEVEN G. MEDEMA, THE HESITANT HAND: TAMING SELF-INTEREST IN THE HISTORY OF ECONOMIC IDEAS 5-25 (2009) (describing the history of economic thought on self-interest from ancient Greece through Adam Smith).

7. See, e.g., *Dickson v. People ex rel. Brown*, 17 Ill. 191, 193 (1855) (quoting Matthew, Ch. 6, Verse 24).

8. Unsurprisingly, *Keech* is considered one of the foundational cases of the fiduciary duty of loyalty. See Leonard I. Rotman, *Fiduciary Law’s “Holy Grail”: Reconciling Theory and Practice in Fiduciary Jurisprudence*, 91 B.U. L. REV. 921, 922, 942-45 (2011) (discussing the importance of *Keech*).

9. See notes 41-159 and accompanying text, *infra*.

subtly shifts control over corporate opportunity litigation from the plaintiff-principal to the disloyal defendant. Indeed, it opens the door for the guilty fiduciary to seek summary judgment based upon the third party's "undisputed" and entirely predictable "no harm, no foul" / "never would have worked with plaintiff anyway" testimony, thereby leaving the fiduciary and third party free to work together happily ever after.¹⁰ But worst of all, the refusal to deal defense invites fraud by incentivizing fiduciaries and third parties to engage in prohibited transactions and then tempting them to fabricate testimony as a defense, since the defendant-fiduciary and the third party are invariably financially aligned, if not legally married, by the time of litigation and often well before.¹¹

Using Illinois law as a model, this is the third of three articles that collectively offer the first serious treatment of the third party refusal to deal defense in corporate opportunity cases. I began in my first article with a general overview of Illinois fiduciary principles, remedies, and proof burdens to show that they have a different focus than other laws: deterrence is their object, not simply compensation.¹² I then examined the Illinois Supreme Court's choice of the "line of business" test over other corporate opportunity standards, starting with *Kerrigan v. Unity Savings*

10. Complete Conference Coordinators, Inc. v. Kumon North America, Inc., 394 Ill. App. 3d 105, 915 N.E.2d 88 (2d Dist. 2009) (affirming summary judgment in favor of defendant, on tortious interference claim, based upon customer's supposed unwillingness to deal with plaintiff).

11. Victor Brudney & Robert Charles Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 1001, 1021 (1981) (If "third-party refusals to deal with the corporation are accepted as tests, the inevitable result will be to permit the diversion. This is true because courts must resolve the legal issues on the basis of a set of facts largely within the control of the diverter."); Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L.J. 279, 291, n.37 (1998) (noting courts have rejected third party refusal to deal defenses with "virtual unanimity, expressing wariness about the *verifiability* of such alleged incapacities and the concomitant incentive of the fiduciary to *claim* that such barriers existed (when in fact they did not)." (emphasis added)); Matthew R. Salzwedel, *A Contractual Theory of Corporate Opportunity and a Proposed Statute*, 23 PACE L. REV. 83, 115-16 (2002) (collecting third party refusal to deal cases and proposing a statute that would exclude this defense); Michael Begert, *The Corporate Opportunity Doctrine and Outside Business Interests*, 56 U. CHI. L. REV. 827, 835-36 (1989) (noting that modern corporate opportunity cases have generally required fiduciaries to disclose third party refusals to deal); CHARLES W. MURDOCK, 8 ILLINOIS PRACTICE: BUSINESS ORGANIZATIONS §14:12, at 209-10 (2010) ("What is Not a Corporate Opportunity") (noting third party refusals to deal as a defense to Illinois corporate opportunity actions); Philip J. Katauskas, *Representing the Non-Party Deponent Who Cares*, 34 LITIG 4, 18 (Summer 2008) (most non-party witnesses have an interest in the litigation in which they are testifying).

12. William Lynch Schaller, *Corporate Opportunities and Corporate Competition in Illinois: A Comparative Discussion of Fiduciary Duties*, 46 J. MARSHALL L. REV. 1 (2012).

Association.¹³ This choice – though poorly understood and widely misapplied by the Illinois Appellate Court – has important consequences: unless a fiduciary can show he disclosed *and* tendered the opportunity, he is foreclosed from seizing it under the prophylactic “line of business” test.¹⁴ Since full disclosure and timely tender almost never occur, the net effect of the *Kerrigan* line of business test should be to foreclose the third party refusal to deal defense as a matter of law.

This simple insight certainly has not been lost on the Illinois Supreme Court, but it generally has eluded other Illinois courts. To show this, my second article focused upon the role of third parties in Illinois corporate opportunity litigation,¹⁵ offering a chronological exploration by court, starting with the Illinois Supreme Court and then moving to the Illinois Appellate Court, the Seventh Circuit Court of Appeals, and finally the United States District Court for the Northern District of Illinois.¹⁶ In two major corporate opportunity decisions shortly after *Kerrigan*, the Illinois Supreme Court gave significant relief to victimized principals, and in both cases there was no proof the third parties were willing to deal with the principals, and indeed some proof they were unwilling to deal with the principals.¹⁷ Unfortunately, the court did not specifically offer a “rule” against third party testimony in these cases, and thus this dimension of its corporate opportunity jurisprudence has gone largely unnoticed in subsequent Illinois decisions. As noted, the result of this omission has been repeated attempts by guilty fiduciaries to escape liability through irrelevant third party testimony. Some have been successful and others have not, but all have managed to impose enormous cost, delay, and uncertainty on their opponents via this third party “defense.”

13. 58 Ill. 2d 20, 517 N.E.2d 30 (1974).

14. *Id.* at 28, 517 N.E.2d at 43-44.

15. William Lynch Schaller, *The Origin and Evolution of the Third Party “Refusal to Deal” Defense in Illinois Corporate Opportunity Cases*, 46 J. MARSHALL L. REV. 937 (2013).

16. In each instance, I worked through the particular court’s decisions chronologically, as this approach approximated the way the court itself experienced and contributed to doctrinal direction. *Cf.* Randy E. Barnett, *Three Federalisms*, 39 LOY. U. CHI. L. J. 285, 285-86 (2008) (“One reason we do not distinguish each of these versions [of federalism] from the others is that we teach Constitutional Law by doctrine or topic rather than chronologically by era. When taught chronologically, these different versions of federalism fairly leap off the page.”).

17. *Vendo Co. v. Stoner*, 58 Ill. 2d 289, 321 N.E.2d 1 (1974) (upholding \$7.2 million judgment and massive salary forfeiture against fiduciary, despite absence of evidence that third party would have dealt with plaintiff); *Mullaney, Wells & Co. v. Savage*, 78 Ill. 2d 534, 402 N.E.2d 574 (1980) (upholding \$800,000 constructive trust award against fiduciary, despite absence of evidence that third party would have dealt with plaintiff, and despite some evidence that third party would not have dealt with plaintiff).

In the present article, the third and last of the three, I examine the practice implications of eliminating the third party refusal to deal defense in Illinois corporate opportunity cases. While I think it should be obvious that a third party's refusal to deal is not a defense to liability under the categorical "line of business" test in Illinois, I maintain that it is also not a defense to proximate cause or any form of relief, whether the remedy is damages for plaintiff's loss, disgorgement of defendant's gain, a constructive trust requiring conveyance of property, an injunction prohibiting usurpation, or compensation forfeiture for disloyalty. Indeed, in my view, third parties should be defendants themselves in most of these cases, subject to secondary liability for encouraging the fiduciary's misconduct if they knew the defendant-fiduciary was in an agency relationship with the plaintiff-principal in connection with the transaction in issue. From a practice perspective, then, eliminating the third party refusal to deal would go a long way toward guaranteeing summary dispositions against all relevant wrongdoers in corporate opportunity cases. In my view, this would promote the deterrence rationale of Illinois corporate opportunity law far better than after-the-fact attempts to determine the motives of self-interested and potentially liable third parties.

In light of these serious shortcomings, I conclude that the third party refusal to deal defense should be explicitly eliminated in Illinois corporate opportunity cases as a matter of policy. It is not asking too much to require fiduciaries to disclose and tender corporate opportunities so that their principal's consent is clear at the outset. This comports with everyone's legitimate expectations and allows the market to take its orderly course with respect to the opportunity. Deterrence of fiduciary disloyalty is the primary function of the corporate opportunity doctrine in Illinois, not simply compensation of victims, and thus to ask whether plaintiff has "lost" something – as the third party refusal to deal defense does – is to ask the wrong question.

II. DUTY, BREACH, PROXIMATE CAUSE, AND REMEDY: DOES THE THIRD PARTY REFUSAL TO DEAL DEFENSE HAVE A ROLE?

In canvassing Illinois corporate opportunity cases, I found no Illinois Supreme Court or Illinois Appellate Court decision that assigned a specific legal role to the third party refusal to deal defense using the traditional taxonomy of duty, breach of duty, proximate cause, or remedy. The Illinois Supreme Court has simply ignored third party refusals to deal as irrelevant under *Kerrigan* and its progeny, *Vendo Co. v. Stoner*¹⁸ and *Mullaney*,

18. 58 Ill. 2d 289, 321 N.E.2d 1 (1974).

Wells & Co. v. Savage.¹⁹ The Illinois Appellate Court, on the other hand, has generally treated this defense as a question of fact without assigning it to a particular legal slot. Illinois federal courts have largely followed the Illinois Appellate Court's path, although *Durasys, Inc. v. Lebya*²⁰ invoked the City of Chicago's refusal to deal as a remedy defense on both damages and injunctive relief, albeit inconsistently.

In this section, I dissect the different roles the third party refusal to deal defense could be argued to play. I find its elimination easily accomplished within established Illinois law, with only discrete remedy issues presenting difficulties. For ease of analysis, I organize my comments below in tort terms, focusing on duty, breach of duty, proximate cause, and remedy. While this is a familiar model, a word of caution is in order: breach of fiduciary duty is not a "tort" in Illinois, and deploying tort labels tends to mask the distinct policies and remedies of Illinois fiduciary duty law in general and Illinois corporate opportunity law in particular. With these concerns in mind, I start with the tort-equity dichotomy.

A. *Fiduciaries*

1. *Tort or Equity?*

As noted, the tort formulation of "duty/breach/proximate cause/damages" is not the proper conceptual framework for corporate opportunity cases in Illinois. Illinois is one of the few states that views fiduciary duty claims as falling outside of the tort realm.²¹

The appropriate starting point is *Kinzer v. City of Chicago*.²² In that case, City of Chicago officials funded the summer entertainment festival then known as "Chicago Fest" (now known as "Taste of Chicago") without a prior appropriation by the City Council. A taxpayer, Kinzer, sued one of the government officials, Grimm, for breach of fiduciary duty based upon this apparent violation of the Illinois Municipal Code, and Grimm defended in

19. 78 Ill. 2d 534, 402 N.E.2d 574 (1980).

20. *Durasys, Inc. v. Lebya*, 992 F.2d 1465 (7th Cir. 1993).

21. See Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. REV. 851, 852, n. 7 (2011) (noting that not all states treat breach of fiduciary duty as a tort after the fashion of the Restatement of (Second) of Torts and citing *Kinzer* as an example). The Illinois Supreme Court's thoroughly traditional view in *Kinzer* seems odd only because law schools gradually ceased teaching equity as a substantive field after the merger of law and equity via the adoption of the Federal Rules of Civil Procedure in 1937. Some have recognized this singular omission and proposed adding fiduciary law as a foundational course in law school. See generally Rafael Chodos, *Fiduciary Law: Why Now? Amending the Law School Curriculum*, 91 B. U. L. REV. 837 (2011).

22. 128 Ill. 2d 437, 539 N.E.2d 1216 (1989).

part on the ground of immunity under the Local Governmental and Governmental Employees Tort Immunity Act. The Illinois Supreme Court rejected this defense, holding that breach of fiduciary duty is not a “tort” under Illinois law. To support this ruling, the court pointed out that it had not accepted Section 874 of the Restatement (Second) of Torts as the basis of fiduciary duty liability and that it had long “regarded breach of fiduciary duty as controlled by the substantive laws of agency, contract and equity.”²³

The Illinois Supreme Court reaffirmed this view in *Armstrong v. Guigler*,²⁴ a case in which the court held that the five year “catch-all” statute of limitations, rather than the ten year written contract statute of limitations, applies to Illinois fiduciary duty claims. In so holding, the court noted the “unique” nature of fiduciary duty claims²⁵ and offered the following important analysis:

By way of contrast, where a party advances a breach of duty that arises by operation of law, the action is no longer contractual in nature, but delictual. Stated otherwise, a claim for a breach of a legal duty, as opposed to a breach of a contractual promise, is in essence an action *ex delicto*. The difference between the two breaches lies, in historical terms, in the distinction between an action in *assumpsit* and an action in *case*. See, e.g., *Fidelity Trust Co. v. Poole*, 136 Ill. App. 266, 273 (1907) (“For a breach of the duty an agent owes to his principal, the action may be in *assumpsit* for the breach of the implied promise, or in *case* for the breach of the implied duty”).

* * *

A breach of an implied fiduciary duty is not an action *ex contractu* simply because the duty arises by legal implication from the parties’ relationship under a written agreement. In fact, a fiduciary relationship is founded on the substantive principles of agency, contract and equity. Because a fiduciary relationship is an amalgamation of various aspects of legal jurisprudence, a purely contractual statute of limitations is inapplicable to a breach thereof. Only the five-year statute of limitations for all civil actions not otherwise provided for is truly consonant with the distinctive characteristics of breach of an implied fiduciary duty, regardless of the fact that the fiducial relationship arose from a written contract.²⁶

The holdings in *Kinzer* and *Armstrong*, although departures from the Restatement (Second) of Torts, are in fact consistent with the Restatement (Second) of Agency, which stresses the “*sui generis*” nature of agency contracts in its Introductory Note to

23. *Id.* at 445, 539 N.E.2d at 1220 (citations omitted).

24. 174 Ill. 2d 281, 673 N.E.2d 290 (1994).

25. *Id.* at 294, 673 N.E.2d at 297.

26. *Id.* at 291-92, 293-94, 673 N.E.2d at 295-96 (emphasis in original).

Chapter 13.²⁷ This point is worth noting since Chapter 13, Title C, subtitled “Duties of Loyalty,” is the home of Sections 387 to 407, the relevant Restatement (Second) of Agency principles that have dominated Illinois fiduciary duty case law in the areas of corporate opportunity and corporate competition claims and remedies. One need only read *Vendo* and *Mullaney* to see this.²⁸ Indeed, Illinois corporate opportunity decisions have almost all involved agents, and the predominant relief awarded has been equitable – constructive trusts, accountings, and injunctions. Thus, *Kinzer* and *Armstrong* are quite consistent with Illinois corporate opportunity jurisprudence. And this jurisprudence, in turn, is consistent with the historical divide between law and equity,²⁹ as trusts and

27. The Introductory Note offers the following commentary:

Agency is both a consensual and a fiduciary relation. Normally it is the result of a contract between the parties. Where this is true, the agent’s duties include the performance of any contractual obligations; failure to perform these, if without excuse, is a breach of contract. Thus, in determining the existence and extent of the agent’s duties to the principal, the normal rules of contractual obligations come into play with reference to the requirements of mutual manifestations, of consideration, the effect of a breach by one party or the other, of fraud or duress, of illegality of the Statute of Frauds, of incapacity, and all the other rules which make up the subject known as contracts.

However, although the agency relation normally involves a contract between the parties, it is a special kind of contract, since an agent is not merely a promisor or a promisee but is also a fiduciary. Because he is a fiduciary and is subject to the directions of the principal, the rules as to his duties to the principal are unique. Substituting for the terms of the trust the will of his principal, his fiduciary duties are similar to those of a testamentary trustee to the beneficiaries. Further, since the contract of employment, if there is one, is ordinarily not spelled out in detail but depends for its interpretation upon evidence as to the customary way of doing business, the generalizations which can be drawn concerning the agent’s duties are inferences of fact which are permissible only in the absence of a specific understanding otherwise. In the absence of fraud, duress or illegality, any agreement between the parties will be enforced, at least to the extent of granting a cause of action for its breach. Even specific agreements, however, must be interpreted in the light of the principles which are applicable to the relation of principal and agent. The existence of the fiduciary relation between the parties, and the duty of the agent not to act for the principal contrary to orders, modify all agency agreements and create rules which are *sui generis* and which do not apply to contracts in which one party is not an agent for the other.

28. See *Vendo*, 58 Ill. 2d at 305, 321 N.E.2d at 10 (citing Restatement (Second) of Agency §§ 387, 389, 391, 393 and 394); *Mullaney*, 78 Ill. 2d at 546-47, 402 N.E.2d at 580 (citing Restatement (Second) of Agency §§ 387, 393).

29. See S.F.C. MILSOM, HISTORICAL FOUNDATIONS OF THE COMMON LAW 74-87 (1969) (describing the rise of equity as a system separate from and at times superior to common law); James Oldham, *A Profusion of Chancery Reform*, 22 LAW & HIST. REV. 609, 609 (2004) (“That a right in itself purely legal cannot be the proper subject of discussion in a jurisdiction purely equitable, and that a right purely equitable, cannot be the proper subject of a purely legal jurisdiction, are axioms that cannot be denied.” (quoting 1 J.J.

fiduciary duties have long been the principal concerns of equity courts.³⁰ Ironically, *Prodromos v. Everen Securities, Inc.*,³¹ which I have criticized considerably on other grounds, reflects perhaps the most salient feature of this history – the absence of jury trial rights for fiduciary duty claims, which were equity actions unknown at common law.³²

On the other hand, when fiduciaries commit true torts, Illinois Supreme Court decisions depart from *Kinzer* and *Armstrong*. Two decisions in particular come to mind: *Neade v. Portes*³³ and *Martin v. Heinold Commodities, Inc.*³⁴ In *Neade*, the problem was failure to disclose physician incentives in the context of a wrongful death allegedly resulting from medical malpractice. The trial court found that the defendant physician's financial motive was not relevant to whether he violated the applicable standard of care in treating the decedent. The Illinois Supreme Court acknowledged that the physician-patient relationship is a fiduciary one but dismissed the fiduciary duty claim as duplicative of plaintiff's negligence claim. The supreme court in *Neade* distinguished other fiduciary duty cases, including the corporate opportunity decision in *Levy v. Markal Sales Corp.*,³⁵ on the ground that *Levy* and these other cases did not involve plaintiffs bringing causes of action sounding in both breach of fiduciary duty

POWELL, ESSAY UPON THE LAW OF CONTRACTS AND AGREEMENTS viii (1790)); JAMES OLDHAM, ENGLISH COMMON LAW IN THE AGE OF MANSFIELD 103 (2004) (alluding to the distinct administration of law and equity); JAMES R. STONER, JR., COMMON LAW LIBERTY: RETHINKING AMERICAN CONSTITUTIONALISM 11 (2003) (discussing enforcement of common law in the Court of Common Pleas and King's Bench and throughout the realm in local courts, as opposed to the administration of equity in the Court of Chancery and adherence to civil law principles in ecclesiastic and admiralty courts).

30. *Cigna Corp. v. Amara*, 131 S. Ct. 1866, 1879 (2011) ("Trusts are, and always have been, the bailiwick of the courts of equity") (quoting 4 A. SCOTT W. FRATCHER, & M. ASCHER, TRUSTS § 24.1, 1654 (5th ed. 2007)); *Janowiak v. Tiesi*, 402 Ill. App. 3d 997, 1009, 932 N.E.2d 569, 582 (1st Dist. 2010) ("Thus, it can be said that a trustee is held to an even more intense duty of loyalty than in any other fiduciary relationship. We find no support for the assertion that a trustee would not be subject to the same, if not more intense, duties of loyalty and disclosure of information as other fiduciaries."); 1 DAN B. DOBBS, LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION § 2.3(1), at 64 (2d ed. 1993) ("Likewise the modern law of fiduciary and confidential relationships, of supreme importance in a wide range of contemporary decisions, is a product of equity's role in the law of trusts"); PALMER, *supra* note 1, Vol. 1, §1.1, at 1-2 ("It has been traditional to regard tort and contract as the two principal sources of civil liability at common law, although liability arising out of a fiduciary relationship has developed largely outside these two great categories").

31. 389 Ill. App. 3d 157, 906 N.E.2d 599 (1st Dist. 2009).

32. *Id.* at 157, 906 N.E.2d at 599 (collecting fiduciary duty cases rejecting jury trial rights).

33. 193 Ill. 2d 433, 739 N.E.2d 496 (2000).

34. 163 Ill. 2d 33, 643 N.E.2d 734 (1994).

35. 268 Ill. App. 3d 355, 643 N.E.2d 1206 (1st Dist. 1994).

and negligence. “Thus,” the *Neade* court held, “the courts in the cited cases [including *Levy*] did not determine whether the plaintiffs’ injuries were sufficiently addressed by traditional negligence claims.”³⁶ *Neade*, then, was little more than a standard tort negligence case masquerading as a fiduciary duty claim.³⁷

Martin presented more sophisticated problems than *Neade*. *Martin* was cited in *Neade* as requiring plaintiff to allege “that a fiduciary duty exists, that the fiduciary duty was breached, and that such breach proximately caused the injury of which the plaintiff complains,”³⁸ and *Martin* does indeed contain language loosely capturing this traditional tort formulation in the context of the investment loss causation issue that arose under the fraudulent misrepresentation claim there – a traditional tort.³⁹ The investment loss question, however, was accompanied by a separate issue over wrongful gains derived from fake foreign service fees the defendant charged plaintiffs in connection with their investments. This wrongful gains issue, which triggered constructive trust relief, presented a *Kinzer*-type fiduciary duty claim of the “agency-contract-equity” variety. The court did not impose a “proximate cause” requirement as a condition for recovering the fake fees under a fiduciary duty unjust enrichment theory. Thus, *Martin* actually involved both a true tort claim and a true fiduciary duty claim, with each yielding different results from a conceptual and remedial standpoint. Unfortunately, the *Martin* court did not explicitly distinguish between the fake fee and investment loss claims for proximate cause purposes, nor did the court discuss or even cite its earlier decision in *Kinzer*. Adding to the confusion, the Illinois Supreme Court failed to note *Martin* in its statute of limitations opinion in *Armstrong*, which was decided just a few months after *Martin*.

Properly understood, then, *Neade* and *Martin* just stand for the unremarkable proposition that fiduciaries and non-fiduciaries alike can be guilty of certain torts, like negligence in *Neade* and intentional misrepresentation in *Martin*, and therefore fiduciaries should be held to the same standards as non-fiduciaries for such claims.⁴⁰ It does not follow, though, that every breach of fiduciary

36. *Neade*, 193 Ill. 2d at 450, 739 N.E.2d at 505.

37. See also *Martinez v. Elias*, 397 Ill. App. 3d 460, 922 N.E.2d 457 (1st Dist. 2009) (under *Neade*, evidence of a physician’s financial incentives may be relevant to attack his credibility in a negligence claim).

38. *Id.* at 444, 739 N.E.2d at 502.

39. *Doe v. Dilling*, 228 Ill. 2d 324, 343, 888 N.E.2d 24, 30 (2008) (fraudulent misrepresentation has been “historically treated as purely an economic tort under which one may only recover damages for pecuniary harm”); *Hassan v. Yusuf*, 408 Ill. App. 3d 327, 944 N.E.2d 895 (1st Dist. 2011) (affirming fraudulent misrepresentation finding against fiduciary defendant).

40. *E.g.*, *Mueller Industries, Inc. v. Berkman*, 399 Ill. App. 3d 456, 471, 927 N.E.2d 794, 809 (2d Dist. 2010) (citing *Prodromos* and noting that intentional breach of fiduciary duty is analogous to the tort of fraud for purposes of the

duty claim gives rise to a “tort” merely because a fiduciary happens to be involved. Illinois fiduciary duty law is instead preoccupied with a distinct set of rights and remedies, as the corporate opportunity, corporate competition, and self-dealing director cases all demonstrate.

2. Duty

The tort-equity distinction makes its presence felt at the outset of every corporate opportunity case: determining duty. Under the tort construct, the duty debate would be framed in terms of what a reasonable person would do under the circumstances. This would then open the discovery and evidentiary floodgates as to expert testimony on obligations, as occurred in *LID Associates v. Dolan*.⁴¹ But the Illinois Appellate Court properly rejected the trial court’s expert testimony approach in *Dolan* and held that fiduciary duties present questions of law solely for the court to determine.⁴²

This certainly is the approach the Illinois Supreme Court took in *Kerrigan* with respect to corporate opportunities. To repeat, under *Kerrigan*, a fiduciary has a duty to disclose and tender an opportunity within or reasonably incident to the corporation’s line of business. Disclosure and tender *by the fiduciary* almost never occur; at best, the fiduciary points to the principal’s existing knowledge of the opportunity and the fact that the third party has made the opportunity available to the principal, as in *Patient Care Services v. Segal*.⁴³ Neither is a substitute for informing the principal that the fiduciary *himself* is seeking the opportunity, and neither is a substitute for the fiduciary *himself* tendering the opportunity.

“Disclosure” means disclosure *by the fiduciary* of all material facts *known to the fiduciary*, not disclosure by some third party of facts known to the third party. This includes disclosure *by the fiduciary* of the one fact that matters most – the fiduciary’s secret interest. This was Stoner’s problem in *Vendo*. When *Vendo* asked Stoner about his involvement with third party Phillips, Stoner told *Vendo* “the relationship had been confined to loans and that these had since been paid by another person. Stoner did not disclose that this other person was [Stoner’s] sister-in-law.”⁴⁴ This “disclosure,” the supreme court stressed, “was far from complete.”⁴⁵ Stoner’s lack of full disclosure later came home to roost when *Vendo* directed Stoner to acquire the Lektro-Vend from third party Phillips:

crime-fraud exception to the attorney-client privilege).

41. 324 Ill. App. 3d 1047, 756 N.E.2d 866 (1st Dist. 2001).

42. *Id.* at 1058-60, 756 N.E.2d at 876-77.

43. 32 Ill. App. 3d 1021, 337 N.E.2d 417 (1st Dist. 1975).

44. *Vendo*, 58 Ill. 2d at 300, 321 N.E.2d at 7.

45. *Id.*

Stoner had a foot in each camp. Not only did his undisclosed interest in controlling the further development and ultimately the manufacture and sale of the Lektro-Vend create the possibility of his taking an unfair advantage of plaintiff, but the evidence gives strong indication that he actually misled plaintiff while he was purportedly acting as plaintiff's agent with regard to plaintiff's possible acquisition of the Lektro-Vend. The information given plaintiff that Phillips wanted a price of \$1,500,000 for the Lektro-Vend came only from Stoner. Whether Phillips might have been willing to sell at a lower figure acceptable to plaintiff is unknown.⁴⁶

There is a second and often-overlooked point to be considered here: "disclosure" is not "tender." The definition of tender is "to present formally for acceptance,"⁴⁷ which is precisely the sense in which the *Kerrigan* court used the term – a *per se* requirement.⁴⁸ The *Kerrigan* court imposed the "tender" obligation on fiduciaries for a "prophylactic" reason: to make it incumbent on fiduciaries to ascertain from the principal itself – not from some third party – what the principal has decided to do, including the principal's formal acceptance or rejection of the tendered opportunity. Until the principal formally advises the fiduciary that it has decided to decline the tendered opportunity, the fiduciary acts at his peril in pursuing the opportunity for himself, as the fiduciaries learned in *Kerrigan* and *Anest v. Audino*.⁴⁹ Had the appellate court in *Patient Care Services* simply invoked the meaning of "tender," its reasoning would have been far simpler: Segal disclosed but certainly did not "tender" the hospital contract opportunity to Patient Care Services when he embarked upon his open pursuit of it for himself.

The implications of the tender condition are crucial. The fact that a third party has made the opportunity available to the principal and the third party has rejected the principal, does not

46. *Id.* at 304, 321 N.E.2d at 9-10.

47. See <http://dictionary.reference.com/browse/tender>.

48. *Cf. Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 157-58 (1996) (rejecting *per se* formal tender requirement under Delaware corporate opportunity test that differs substantially from the Illinois "line of business" test); Richard A. Epstein, *Contract and Trust in Corporate Law: The Case of Corporate Opportunity*, 21 DEL. J. CORP. L. 5 (1996) (discussing corporate opportunity law against the backdrop of the difficult facts presented in *Broz*).

49. 332 Ill. App. 3d 468, 773 N.E.2d 202 (2d Dist. 2002). See CHARLES W. MURDOCK, 8 ILLINOIS PRACTICE: BUSINESS ORGANIZATIONS §14.13, at 212-15 (2010) ("The Importance of Tendering the Opportunity to the Corporation"):

Since the test for the existence of a corporate opportunity is so broad – an activity "that is reasonably incident to its present or prospective operations" [quoting *Kerrigan*] – prudence certainly dictates tendering any possible transaction that may involve a corporate opportunity to the corporation. However, when counseling this approach to a client, the response often is "what if the corporation might want it?" Such a response answers the basic question: if the director hesitates to tender the opportunity, it very likely is an opportunity.

give the fiduciary a green light to begin bidding on his own, as the courts rightly held in *Patient Care Services*,⁵⁰ *Comedy Cottage v. Berk*,⁵¹ *Lindenhurst Drugs v. Becker*,⁵² *Regal-Beloit Corp. v. Drecoll*,⁵³ and *Foodcomm International v. Barry*.⁵⁴ A fiduciary must tender because it is up to the principal – and the principal alone – to decide how to proceed; this will often include the principal’s attempt to persuade the third party to change its mind, as in *Patient Care Services*, *Comedy Cottage*, *Lindenhurst Drugs*, *Levy*, *Regal-Beloit*, *Foodcomm* and *LCOR v. Murray*.⁵⁵ The “tender” and “disclosure” requirements of *Kerrigan* and *Vendo* thus complement one another and are reinforced by *Mullaney*, where the Illinois Supreme Court held that a fiduciary cannot “begin to act on his own” without his principal’s consent.⁵⁶

Clearly, then, a third party’s real or imagined refusal to deal with the principal does not somehow allow a fiduciary to stand silent under *Kerrigan*, let alone to begin secretly competing. The usual role of the third party refusal to deal defense – eliminating any “interest or expectancy” on the principal’s part and thereby discharging any duty on the fiduciary’s part – simply has no place in the duty analysis under modern Illinois corporate opportunity law.

3. Breach of Duty

If a third party’s refusal to deal does not trump a fiduciary’s disclosure and tender duties under *Kerrigan*, a breach of fiduciary duty should be a given when the opportunity falls within the principal’s “line of business.” A third party’s actions or inactions do not somehow negate a fiduciary’s failure to meet his *Kerrigan* obligations⁵⁷ – neither does the principal’s independent discovery and pursuit of the opportunity. The principal is always entitled to the fiduciary’s full disclosure and tender so that the principal remains in control of the opportunity vis-à-vis its fiduciary.

So understood, in most cases a liability finding for breach should be a summary determination. Finding a breach summarily is important independent of whether the principal has suffered a loss or the fiduciary has obtained a gain. Even if no gain or loss has occurred, a fiduciary breach may trigger forfeiture of the

50. 32 Ill. App. 3d 1047, 756 N.E.2d 866 (1st Dist. 2001).

51. 145 Ill. App. 3d 355, 495 N.E.2d 1006 (1st Dist. 1986).

52. 154 Ill. App. 3d 61, 506 N.E.2d 645 (2d Dist. 1987).

53. 955 F. Supp. 849 (N.D. Ill. 1996).

54. 328 F.3d 300 (7th Cir. 2003).

55. 1997 U.S. Dist. LEXIS 3373 (N.D. Ill. March 19, 1997).

56. *Mullaney, Wells & Co.*, 78 Ill. 2d at 549, 402 N.E.2d at 581.

57. *Cf. Prodomos v. Everen Securities, Inc.*, 341 Ill. App. 3d 718, 725-26, 793 N.E.2d 151, 157 (1st Dist. 2003) (rejecting agent’s argument that his fiduciary duties in connection with assisting plaintiff to buy a bank were negated by plaintiff’s alleged duty to inform defendant of vital facts regarding plaintiff’s fitness to run a bank).

fiduciary's compensation for the period of disloyalty, depending upon the severity of the disloyalty. Moreover, if the fiduciary has actually seized an opportunity, constructive trust relief should follow automatically from a finding of breach, as should an accounting order and a prejudgment interest award with respect to the fiduciary's profits earned prior to the property being turned over to the principal.

4. *Proximate Cause*

At first blush, proximate cause appears to be a natural fit for the third party refusal to deal defense. If the third party would not have dealt with the principal regardless of the fiduciary's wrongdoing, then a "no proximate cause" defense would seem to arise under a "no harm, no foul" rationale.⁵⁸ This seems especially true when the third party claims its refusal to deal with the plaintiff-principal was and remains "unalterable," as the third parties asserted in *Peterson Welding Supply Co. v. Cryogas Products, Inc.*,⁵⁹ *Regal-Beloit*, and *Foodcomm*. The superficial appeal of these arguments breaks down once they are deconstructed, however.

The third party "refusal to deal" proximate cause defense implicitly assumes loss of the ultimate deal with the third party, rather than loss of the opportunity to pursue the deal unfettered by the fiduciary, is the object of the *Kerrigan* regime. But *Kerrigan* plainly was concerned with the loss of opportunity alone, as the Illinois Supreme Court emphasized in *Kerrigan* itself:

If the doctrine of business opportunity is to possess any vitality, the corporation or association must be given the opportunity to decide, upon full disclosure of the pertinent facts, whether it wishes to enter into a business that is reasonably incident to its present or prospective operations. If directors fail to make such a disclosure and to tender the opportunity, the prophylactic purpose of the rule imposing a fiduciary obligation requires that the directors be foreclosed from exploiting that opportunity on their own behalf.⁶⁰

Indeed, the supreme court in *Kerrigan* specifically *reversed* the appellate court's order remanding the case for a determination as to whether Unity could "in fact" engage in the business of insurance.⁶¹ The high court held that no trial was required on this

58. That is, a "sole proximate cause" defense under Illinois tort law. *See, e.g.,* *Ready v. United/Goedecke Serv., Inc.*, 238 Ill. 2d 582, 939 N.E.2d 417 (2010) (analyzing "sole proximate cause" defense under Illinois tort law).

59. 126 Ill. App. 3d 759, 467 N.E.2d 1068 (1st Dist. 1984).

60. *Kerrigan*, 58 Ill. 2d at 28, 317 N.E.2d at 43-44.

61. *Kerrigan*, 58 Ill. 2d at 31, 317 N.E.2d at 45. In particular, after determining that Unity always had the legal ability to organize or invest in either a subsidiary or a service corporation to provide insurance agency services to its borrowers, the appellate court remanded for a trial over whether Unity could "in fact" (as opposed to "in law") engage in the business of selling

issue “in the view we take of this case”⁶² – namely, the directors were foreclosed from contesting Unity’s ability to capitalize on the opportunity because of their failure to disclose and tender it to Unity. Thus, under the express holding of *Kerrigan*, plaintiff does not have to prove it would “in fact” have landed the deal with the third party but for the fiduciary’s wrongdoing.

The Illinois Supreme Court took exactly the same approach in *Vendo*, holding that third party Phillips’ willingness to deal with Vendo was irrelevant due to Stoner’s failure to disclose his conflict before serving as Vendo’s intermediary with Phillips. In particular, after emphasizing Stoner’s conflict of interest and failure to make complete disclosure to Vendo, the court observed:

The information given plaintiff that Phillips wanted a price of \$1,500,000 for the Lektro-Vend came only from Stoner. Whether Phillips might have been willing to sell at a lower figure acceptable to plaintiff is unknown.

We recently had occasion in *Kerrigan* [citation omitted] to consider the obligation upon a director or officer to make full disclosure to his corporation. In that case, involving the appropriation of a business opportunity, the defense was made that the plaintiff, a savings and loan association, lacked the legal power to engage in the business which defendants were carrying on, which was the operation of an insurance agency. We rejected that defense for the reason that the association had never been given the opportunity to decide that question for itself.⁶³

This passage from *Vendo* is conclusive on any argument that a third party’s refusal to deal constitutes a proximate cause defense. Vendo did not have to prove third party Phillips’ willingness to deal with Vendo because Vendo had never been given the opportunity to negotiate with Phillips free from Stoner’s conflict. The *Kerrigan* rule thus foreclosed Stoner from arguing Phillips’ unwillingness to deal as a defense.

Casting a third party’s refusal to deal as a proximate cause defense also cannot be reconciled with the evidence and outcomes in *Kerrigan*, *Vendo*, and *Mullaney*. There was no evidence the third party borrower-customers were willing to deal with Unity Savings for insurance purposes; there was no evidence third party Phillips was willing to deal with Vendo, and some evidence he was unwilling to deal with Vendo; and there was no evidence third party Blossman was willing to deal with Mullaney, Wells & Co., and some evidence he had no desire to deal with Mullaney, Wells & Co. (at least in the end, when Blossman sought to escape the lucrative Savage option altogether). Yet, in all three cases, the

fire and casualty insurance. *Kerrigan v. Unity Savings Assoc.*, 11 Ill. App. 3d 766, 773, 297 N.E.2d 699, 704 (1st Dist. 1973).

62. *Kerrigan*, 58 Ill. 2d at 31-32, 317 N.E.2d at 45.

63. *Vendo*, 58 Ill. 2d at 304-05, 321 N.E.2d at 9-10.

Illinois Supreme Court ordered relief against the fiduciaries without remanding for fact findings as to whether the third parties were willing to deal with the plaintiff-principals.

The asset misappropriation test, the alternative liability standard under *Kerrigan*, leads even more strongly to the conclusion that a third party's refusal does not pose a proximate cause defense. When a fiduciary uses corporate assets to pursue an opportunity, he is barred from contesting the corporation's ability to take the opportunity, a result which is simply a particular application of constructive trust tracing principles, as explained in *Graham v. Mimms*.⁶⁴ While *Graham* itself did not involve a third party refusal defense, the *Graham* estoppel rule did come into play in a third party setting in *Anest*. The thrust of the defense in *Anest* was that third party BLM International required a letter of credit that Precision Pour could not post without a capital infusion from fiduciary Anest, and therefore, Precision Pour lacked the financial capacity to take the BLM International exclusive distributorship opportunity. The court hinted that Audino might have been able to find the necessary funds on his own given his past experience in raising capital,⁶⁵ but the court cut off this inquiry on remand – and hence any remand inquiry into third party BLM International's willingness to deal with Precision Pour – by holding that Audino was estopped from arguing “that Precision Pour was financially incapable of accepting the [BLM International] distributorship offer.”⁶⁶

Although the defective decisions in the *Prodromos* drama addressed proximate cause in the “usurpation” context, they did so using the wrong rules for purposes of our inquiry. At bottom, the appellate court implicitly assumed *Prodromos* had to prove he would have won the Home Bank deal in order to recover. This view is plainly contrary to *Kerrigan*, *Vendo*, and *Mullaney*, as demonstrated above. Under these controlling Illinois Supreme Court “usurpation” authorities, it was irrelevant that “there was no evidence ‘whatsoever’ that Home [Bank] would have accepted plaintiff's offer” and that “there was no evidence Home [Bank] would still have been on the market in 12 to 18 months.”⁶⁷ It was loss of the opportunity, not loss of the deal, that *Prodromos* had to prove, as *Prodromos* properly argued, albeit under *Kirkruff v. Wisegarver*⁶⁸ rather than *Kerrigan*, *Vendo*, and *Mullaney*. And there was no denying the opportunity: Home Bank was willing, if not eager, to deal, as reflected in its quick marriage to State Financial after a courtship of only three months.

The “loss of opportunity, not loss of deal” distinction also was

64. 111 Ill. App. 3d 751, 444 N.E.2d 549 (1st Dist. 1982).

65. *Anest*, 332 Ill. App. 3d at 473, 773 N.E.2d at 207.

66. *Id.* at 478, 773 N.E.2d at 211.

67. *Prodromos*, 389 Ill. App. 3d at 169, 906 N.E.2d at 609.

68. 297 Ill. App. 3d 826, N.E.2d 406 (4th Dist. 1998).

not addressed in *Martin v. Heinold Commodities, Inc.*,⁶⁹ the opinion *Prodromos I* and *Prodromos II* relied upon for their “no proximate cause” holdings. As noted, for proximate cause purposes, *Martin* was a straightforward fraudulent misrepresentation tort case against a fiduciary, not a corporate opportunity case. Nevertheless, in attempting to justify its tort proximate cause analysis, *Martin* purported to find a proximate cause holding in *Vendo*:

[*Vendo*] involved an employee of plaintiff who violated his contract and principles of agency by helping fund and launch a company to compete against his employer. Defendant helped this new company develop a better machine, which damaged plaintiff’s business. The issue was damages. Plaintiff argued for its lost profits while defendants argued for the money their machine made. This court found the appropriate amount of damages to be plaintiff’s lost profits because plaintiff had proven that defendants’ actions actually, or proximately, caused those losses.⁷⁰

This passage from *Martin* is simply wrong: the phrase “proximate cause” nowhere appears in *Vendo*, nor has the Illinois Supreme Court imposed any such requirement in its corporate opportunity decisions. But I do agree with the *Martin* court that proximate cause happened to have been proven in *Vendo*, as Stoner had “actually, or proximately,” caused *Vendo* not to have a fair chance at acquiring the Lektro-Vend from third party Phillips as a result of Stoner’s lack of full disclosure. The same is true in all corporate opportunity cases: the principal is impeded by its fiduciary’s actions or inactions, and the injury suffered by the principal is thus “the natural and not merely a remote consequence of the defendant’s act.”⁷¹ In this respect, it is helpful here to recall the prudential purpose of proximate cause, whether for an award of plaintiff’s losses or defendant’s gains. On this point, *Prodromos I* and *Prodromos II* provide sound guidance:

Proximate cause generally is a fact question [citation omitted], but may be determined as a matter of law when the facts not only are undisputed but allow no difference in the judgment of reasonable men as to the inferences to be drawn therefrom.⁷²

* * *

Because the consequences of every action stretch forward endlessly through time and the causes of every action stretch back to the

69. 163 Ill. 2d 33, 643 N.E.2d 734 (1994).

70. *Id.* at 65, 643 N.E.2d at 749-50.

71. *Id.* at 58, 643 N.E.2d at 746 (quoting *Town of Thornton v. Winterhoff*, 406 Ill. 113, 119, 92 N.E.2d 163, 166 (1950)). *Cf.* *United States v. Martinez*, 588 F.3d 301, 319 (6th Cir. 2009) (discussing enhanced federal criminal sentence where crime results in death, with the operative test being whether death was the natural and probable consequence of the defendant’s criminal conduct).

72. *Prodromos*, 341 Ill. App. 3d at 727, 793 N.E.2d at 159.

dawn of human history, the concept of proximate cause was designed to limit the liability of the wrongdoer to only those injuries reasonably related to the wrongdoer's action. [Citation omitted.] Therefore, one manner of determining proximate cause is through the remoteness doctrine or "direct-injury" test, which holds that there must be "some direct relation between the injury asserted and the injurious conduct alleged."⁷³

As these teachings suggest, proximate cause can exist as a matter of law, and I contend it is conclusively demonstrated in all cases in which a fiduciary fails to tender and disclose in compliance with *Kerrigan*, and certainly in all cases in which a fiduciary successfully diverts an opportunity to himself. In such cases there is nothing remote at all about causation; in fact, it could hardly be more direct and immediate. Insufficient fiduciary disclosure and tender under the *Kerrigan* "line of business" test always cause a principal to lose its "opportunity" to negotiate fully and fairly with the third party, which is precisely why "proximate cause" was not even mentioned in *Vendo*. The same result is even more obvious under the *Kerrigan* and *Graham* "asset misappropriation" test: the fiduciary is equitably estopped from denying that the corporation could have seized the opportunity, thereby mooting any proximate cause defense to the effect that the third party would have turned down the corporation. Viewed another way, on either of these incontestable fact patterns, proximate cause presents a question of law and therefore no trial is needed,⁷⁴ as the fiduciary necessarily produces his principal's injuries – in the form of loss of opportunity, rather than loss of the ultimate deal – under the *Kerrigan* rule.⁷⁵

A simpler way to understand the irrelevance of proximate cause, however, is found in the Delaware Supreme Court's decision in *Cede & Co. v. Technicolor*.⁷⁶ In that case, corporate directors of Technicolor failed to inform themselves fully concerning all

73. *Prodromos*, 389 Ill. App. 3d at 171, 906 N.E.2d at 612. See also *Flava Works, Inc. v. Gunter*, 689 F.3d 754, 759 (7th Cir. 2012) (Posner, J.) ("An injury will sometimes have a cascading effect that no potential injurer could calculate in deciding how carefully to act. The effect is clear in hindsight – but only in hindsight.")

74. *Seef v. Ingalls Mem'l Hosp.*, 311 Ill. App. 3d 7, 19, 724 N.E.2d 115, 124 (1st Dist. 1999) ("Proximate cause 'is ordinarily a question of fact to be determined from all the attending circumstances, and it can only be a question of law when the facts are not only undisputed but are also such that there can be no difference in the judgment of reasonable men as to the inferences to be drawn from them'") (quoting *Merlo v. Public Serv. Co.*, 381 Ill. 300, 318, 45 N.E.2d 665, 675 (1942)).

75. See ILLINOIS PATTERN JURY INSTRUCTION 15.01 ("When I use the expression 'proximate cause,' I mean a cause that, in the natural or ordinary course of events, produced the plaintiff's injury. [It need not be the only cause, nor the last or nearest cause. It is sufficient if it combines with another cause resulting in the injury.]").

76. 634 A.2d 345 (1993).

material information before approving a merger agreement.⁷⁷ The Delaware Court of Chancery found the directors breached their fiduciary duty of due care, but then denied relief on the ground that the plaintiff-shareholder “was required to prove it had suffered a monetary loss from such breach and to quantify that loss.”⁷⁸ The Delaware Supreme Court reversed, holding that a tort action does not control a breach of fiduciary duty claim in Delaware.⁷⁹ The Delaware Supreme Court explicitly rejected the notion that plaintiff in a fiduciary duty action must prove “resultant injury or loss” – that is, must prove proximate cause and damages – in order to prevail. Rather, once plaintiff shows directors failed to use due care, the burden shifts to the accused directors to show the transaction was entirely fair.⁸⁰ The court went on to say that any recoverable loss under the entire fairness standard was not necessarily limited to the difference between the price offered and the “true” appraisal value as determined under appraisal proceedings. Instead, the court emphasized, “the Chancellor may ‘fashion any form of equitable and monetary relief as may be appropriate, including rescissory damages.’”⁸¹ Thus, as in Illinois, the fiduciary duty of due care in the corporate transaction context is not a “tort” at all in Delaware; it is, in fact, “*sui generis*,” with its own set of rules and remedies that are context-specific. Under this non-tort regime, tort-type “proximate cause” has no role.⁸²

Further support for rejecting a tort “proximate cause” approach can be found in another Delaware Supreme Court decision, *Thorpe v. CERBCO*.⁸³ In *Thorpe*, George and Robert Erikson were directors of CERBCO who also owned the controlling stock interest in that company. INA approached the Eriksons, as directors of CERBCO, about the possibility of acquiring its

77. *Id.* at 371.

78. *Id.* at 358. Specifically, the Court of Chancery ruled that, “as in any case in which the gist of the claim is negligence, plaintiff bears the burden to establish that the negligence shown was the proximate cause of some injury to it and what that injury was.” *Id.* at 368-69.

79. *Id.* at 370.

80. *Id.* at 371.

81. *Id.* (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983)).

82. *Cf.* *CSX Transp., Inc. v. McBride*, 131 S. Ct. 644 (2010) (holding that common law proximate cause is not required to establish a carrier’s liability under the Federal Employers’ Liability Act; relaxed standard of proximate cause, focusing on whether employer’s negligence played any part in employee’s injury, governs FELA proximate cause questions); *Nolan v. Weil-McLain*, 233 Ill. 2d 416, 910 N.E.2d 549 (2009) (reaffirming the “frequency, regularity and proximity” test favoring asbestos plaintiffs, but holding that this test does not create a “presumption” of causation); Sandra F. Sperino, *Discrimination Statutes, the Common Law, and Proximate Cause*, 2013 U. Ill. L. Rev. 1 (2013) (arguing against importing common law tort concept of proximate cause into statutory discrimination actions).

83. 676 A.2d 436 (Del. 1996).

subsidiary, CERBCO East. The Eriksons, however, insisted that INA acquire the Eriksons' controlling stake in CERBCO instead – a transaction that was good for them but bad for the holders of CERBCO East. The Delaware Court of Chancery sided with the Eriksons on the ground that their controlling stock interest in CERBCO gave them an absolute right, as shareholders, to veto any CERBCO East deal. The Delaware Supreme Court reversed, holding that the Eriksons were guilty of disloyalty because they were competing against CERBCO East for the affections of INA.⁸⁴ In other words, under Delaware fiduciary duty law, it didn't matter that the proximate cause of the CERBCO East holders' loss was the Eriksons' rightful exercise of their power as controlling shareholders of CERBCO, a proximate cause view fully supported by the more recent Delaware law fiduciary duty decisions in *CDX Liquidating Trust v. Venrock Assoc.*⁸⁵ and *Kahn v. Kolberg Kravis Roberts & Co., L.P.*⁸⁶ dispensing with proximate cause in the ordinary sense. The results in *Thorpe*, *CDX*, and *Kahn* are very much in line with the Illinois Appellate Court's decision in *Anest*, in which the fiduciary's corporate control did not excuse his corporate opportunity usurpation.

Does such an “anti-refusal to deal” rule, preempting tort-style proximate cause as a matter of policy, square with the philosophy behind causation and responsibility?⁸⁷ It certainly does when the fiduciary induces the third party's refusal; this is causation in any sense of the word.⁸⁸ Yet the same is true even when the third party

84. *Id.* at 442 (“The fundamental proposition that directors may not compete with the corporation mandates the finding that the Eriksons breached the duty of loyalty”).

85. 640 F.3d 209 (7th Cir. 2011) (Posner, J.) (reversing district court's “proximate cause” summary judgment ruling in favor of the defense in Delaware duty of loyalty case).

86. 23 A.3d 831 (Del. 2011) (reversing Court of Chancery's ruling that shareholder plaintiff must show harm to the corporation as a condition to bringing a Delaware duty of loyalty claim against directors).

87. MICHAEL S. MOORE, CAUSATION AND RESPONSIBILITY: AN ESSAY IN LAW, MORALS, AND METAPHYSICS (2009) (examining interplay between causation and responsibility in the contexts of criminal law and tort law); H.L.A. HART & TONY HONORÉ, CAUSATION IN THE LAW (2002) (exhaustive discussion of causation and responsibility in the contexts of philosophy, morality, and tort, contract, and criminal law – but offering no discussion of equity or fiduciary duty law); PETER RABINS, THE WHY OF THINGS: CAUSALITY IN SCIENCE, MEDICINE, AND LIFE (2013) (discussing multiple models of causation in philosophy, history, narratives, statistics, physical science, biological science, social science, religion, medicine, and law); Menno Hulswit, *A Short History of Causation*, available at <http://www.library.utoronto.ca/see/SEED/Vol4-3/Hulswit.htm> (reviewing philosophy of causation espoused by Aristotle, the Stoics, Aquinas, Descartes, Hobbes, Spinoza, Leibniz, Locke, Newton, Mill, Hume, and Kant).

88. MOORE, *supra* note 87, at 84-106 (discussing the legal usage of cause-in-fact and proximate cause and the problems of over-inclusiveness, under-inclusiveness, and counterfactuals).

approaches the fiduciary individually, whether before or after the third party asserts its refusal. In both cases, the third party is obviously interested in an asset of the principal, the fiduciary; thus, the fiduciary's attitude and actions plainly make a difference to the outcome.

In short, a third party's refusal to deal under the *Kerrigan* "line of business" paradigm does not present a tort proximate cause defense. Treating proximate cause as an essential element of a corporate opportunity claim, after the fashion of a standard tort, runs completely counter to the "prophylactic" *Kerrigan* disclosure and tender regime, which conclusively presumes the principal would have prevailed on the opportunity, at least as against the fiduciary, when an opportunity falls within the corporation's present or expected line of business. In addition, "proximate cause," in the tort sense of proving actual loss, undercuts the principal purpose of fiduciary duty law in general and the corporate opportunity law in particular: deterrence. Thus, there is a good reason no Illinois corporate opportunity decision had even mentioned "proximate cause" until *Prodromos*: tort conceptions of "proximate cause" fit poorly, if at all, within the deterrence-based fiduciary duty structure of Illinois corporate opportunity law.⁸⁹

5. Remedies

A third party's refusal to deal also should not be a defense to any form of relief. The question is settled under *Mullaney* as to disgorgement and settled under *Vendo* as to damages and compensation forfeiture. The question should also be settled as to injunctive relief, given the total deterrence rationale of *Kerrigan*, but cases have yielded conflicting injunction results thus far. More difficult questions are posed under constructive trust principles, as it is unclear to what extent a court of equity can re-write a bargain between a fiduciary and a third party as part of a turnover order in favor of the principal.

a. Compensation Forfeiture

As noted, the deterrence rationale of fiduciary duty law gives rise to compensation forfeiture independent of any gain on the fiduciary's part or any loss on the principal's part. Competition for a corporate opportunity should automatically command compensation forfeiture, as it did in *Vendo*. Such conduct is inherently inimical to the principal's interests: the fiduciary is, in fact, seeking to affirmatively defeat the principal through his competition. This conduct is willful by any measure.

Competition is not a prerequisite to compensation forfeiture,

⁸⁹ See Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. REV. 851, 854 (2011) ("The nature of a fiduciary's undertaking of loyal service should shape how the law assesses causation.").

however.⁹⁰ In *Levy*, for example, Markal Sales was deprived of the opportunity to take on representation of Apple, but Markal Sales itself was not actually seeking the Apple opportunity at the time. Of course, Markal Sales' failure to pursue it was due to the fact that Gust and Bakal controlled Markal Sales and were diverting the opportunity to themselves through their new entity, G/B Sales. While one could think of this as competition in a sense, the court ordered compensation forfeiture because Gust and Bakal were up to much else besides just diverting the Apple opportunity, including paying G/B Sales salaries with Markal Sales' money and using Markal Sales' employee time for G/B Sales purposes. And all of this came on the heels of their termination of Levy as an employee of Markal Sales, a legitimate act as an abstract matter, but more likely a prelude to their gutting of Markal Sales (in which Levy still held an ownership interest) in favor of G/B Sales (in which Levy had no ownership interest).

Although every corporate competition case should give rise to compensation forfeiture, not every corporate opportunity case should do so. In those cases in which a fiduciary had a legitimate but erroneous reason for believing the opportunity was not within his principal's line of business, a court might impose line of business liability yet find sufficient good faith to deny compensation forfeiture.⁹¹ *Kerrigan* itself furnishes an example, to the extent the directors held a good faith but erroneous belief that Unity as a savings and loan could not engage in insurance agency work. This view also squares with *In re Marriage of Pagano*,⁹² a post-*Vendo* case in which the Illinois Supreme Court held that not every fiduciary breach triggers compensation forfeiture. This position makes sense when one remembers that Section 456 of the Restatement (Second) of Agency calls for compensation forfeiture only for "willful" misconduct on the agent's part.⁹³ One should also remember that "compensation" for forfeiture purposes means compensation the principal paid the fiduciary during the period of disloyalty; compensation the fiduciary earns from the usurped opportunity itself – such as fees and profits – are subject to

90. *White Gates Skeet Club, Inc. v. Lightfine*, 276 Ill. App. 3d 537, 541-42, 658 N.E.2d 864, 868 (2d Dist. 1995) (ordering compensation forfeiture for defendant's corporate opportunity usurpation).

91. *Cf. Adams v. Lockformer Co.*, 167 Ill. App. 3d 93, 520 N.E.2d 1177 (1st Dist. 1988) (rejecting claim that *Vendo* required compensation forfeiture where defendants attempted to buy a rival business without telling their employer, their employer discovered this arguable breach, but then their employer allowed the fiduciaries to remain as employees for eight months before firing them for their earlier nondisclosure).

92. 154 Ill. 2d 174, 607 N.E.2d 1242 (1992).

93. *See LID Assoc.*, 324 Ill. App. 3d at 1071, 756 N.E.2d at 886-87 (willful and deliberate breach of fiduciary duty requires compensation forfeiture as a matter of public policy; non-willful conduct does not).

disgorgement and constructive trust relief, as discussed below.⁹⁴ There is no “willfulness” qualification as to these amounts for forfeiture purposes.

b. The Fiduciary’s Gains

Illinois law has long given the victimized plaintiff-principal the choice of the higher of the fiduciary’s gains or the principal’s losses,⁹⁵ a choice also recognized in Section 407 of the Restatement (Second) of Agency.⁹⁶ The Illinois Supreme Court has routinely impressed a constructive trust on benefits a breach of fiduciary duty has conferred on a fiduciary under this unjust gains deterrence principle.⁹⁷ The corporate opportunity context provides but one example of the application of this rule.

Mullaney directly addressed the “gains” component in connection with the profit disloyal agent Savage made on the diverted Blossman stock options. Somewhat simplified, Savage exercised the Blossman options on March 29, 1961, the day after he resigned from Mullaney, Wells & Co.⁹⁸ Mullaney, Wells & Co.

94. *E.g.*, *Lightfine*, 276 Ill. App. 3d at 541-42, 658 N.E.2d at 868 (impressing a constructive trust on management fees disloyal defendant earned from diverted property).

95. *Williams Electronics Games, Inc. v. Garrity*, 366 F.3d 569, 577 (7th Cir. 2004) (Posner, J.) (extended discussion of gains and losses and the role of equitable relief in fiduciary wrongdoing cases, while noting that “fiduciary obligations were an invention of the English chancery court”); *Raintree Homes, Inc. v. Vill. of Long Grove*, 209 Ill. 2d 248, 257-58, 807 N.E.2d 439, 445 (2004) (“Damages [differ] from restitution in that damages [are] measured by the plaintiff’s loss; restitution is measured by the defendant’s unjust gains” (quoting *DOBBS*, *supra* note 30, § 3.1 at 278)); *City of Chicago ex rel. Cohen v. Keane*, 64 Ill. 2d 559, 567-69, 357 N.E.2d 452, 457 (1976) (holding that “monetary damage” to the principal is not a condition to recovery of an agent’s wrongful gain) (citing Restatement (Second) of Agency §§ 388, 395, and 404A); *Hill v. Names and Addresses, Inc.*, 212 Ill. App. 3d 1065, 1084-86, 571 N.E.2d 1085, 1096-98 (1st Dist. 1991) (calculating and then awarding alternative remedies of counter-defendant’s gains or counter-plaintiff’s losses).

96. Section 407 provides:

(1) If an agent has received a benefit as a result of violating his duty of loyalty, the principal is entitled to recover from him what he has so received, its value, or its proceeds, and also the amount of damage thereby caused; except that, if the violation consists of the wrongful disposal of the principal’s property, the principal cannot recover its value and also what the agent received in exchange therefore.

(2) A principal who has recovered damages from a third person because of an agent’s violation of his duty of loyalty is entitled nevertheless to obtain from the agent any profit which the agent improperly received as a result of the transaction.

97. *E.g.*, *Martin*, 163 Ill. 2d at 55-56, 643 N.E.2d at 745 (quoting RESTATEMENT OF RESTITUTION § 160 and comment c, and impressing a constructive trust on fraudulent “foreign service fees” fiduciary charged its principals).

98. Savage’s explanation for his sudden resignation and immediate exercise of the Blossman options was a wonderment: “Had Miller [Savage’s boss] remained [after confronting Savage about Savage’s apparent disloyalty],

did not realize until nearly two years later that the options had been exercised, and it promptly sued at that point. During this two year intervening period, Savage had transferred the option proceeds repeatedly through a series of complex transactions, and ultimately these option proceeds were forfeited as part of a loan transaction. The appellate court concluded that Mullaney, Wells & Co. could not trace the option proceeds as a result of these intervening transactions and therefore denied constructive relief.

The Illinois Supreme Court took a very different view. The supreme court began by commenting that the “Blossman stock is significant here because of its value to the plaintiff in 1961,” not its subsequent value as of 1963.⁹⁹ The court then held that when property has been acquired in violation of fiduciary duties, “a subsequent loss of the property, like a subsequent diminution in its value, does not reduce the amount to which the plaintiff had become entitled.”¹⁰⁰ The supreme court also rejected the appellate court’s view that plaintiff’s right to restitution required a tracing of the trust property into its product: “The plaintiff was entitled to recover a money judgment for the value of the Blossman stock, and it was not required to pursue the trust property.”¹⁰¹ Obviously, third party Blossman’s dislike of both Savage and Mullaney, Wells & Co. did not change this outcome.

This “gains” holding in *Mullaney* was consistent with the earlier decisions in *Kerrigan* and *Vendo*. Just as Savage kept and cashed out the Blossman stock options in *Mullaney*, it was undisputed in *Kerrigan* and *Vendo* that the guilty fiduciaries gained on account of their insufficient disclosure and tender: the directors ended up with the insurance business generated by Unity Savings’ loans in *Kerrigan*, and Stoner ended up with the revolutionary Lektro-Vend machine in *Vendo*. On any view, these gains were on account of fiduciary wrongdoing, and therefore deterrence of fiduciary misconduct and prevention of unjust enrichment was necessary.¹⁰²

The third party refusal to deal defense obviously has the least

he would have found out that Savage was terminating his contract for the reasons that (i) the Blossman option was about to be exercised, Blossman’s resistance was expected, and Savage had no intention of involving Mullaney, Wells in a purely personal matter and (ii) Savage would henceforth have to devote his full attention to his new career adventure.” Supreme Court Brief of Defendant-Appellee/Cross-Appellant Savage, at 84.

99. *Mullaney, Wells & Co.*, 78 Ill. 2d at 552, 402 N.E.2d at 583.

100. *Id.* (citing RESTATEMENT OF RESTITUTION § 161 (1937)).

101. *Id.* (citing GEORGE T. BOGERT, TRUSTS AND TRUSTEES § 867 (2d ed. 1962)). *Accord*, *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill. 2d 305, 317, 500 N.E.2d 22, 27 (1986) (fiduciary must make restitution even if there is no identifiable *res*).

102. *Cf. Smithberg v. Illinois Mun. Ret. Fund*, 192 Ill. 2d 291, 299, 735 N.E.2d 560, 565 (2000) (although some form of wrongdoing is generally required for the imposition of a constructive trust, wrongdoing is not always a necessary element, as in the case of a mistake).

force in the “gains” context.¹⁰³ To pretend that the third party’s refusal to deal with the plaintiff-principal somehow absolves the fiduciary and allows him to keep his wrongful gains would negate the “prophylactic” purpose of the corporate opportunity doctrine in Illinois. Such a result would also be directly contrary to the holdings in *Kerrigan*, *Vendo*, and *Mullaney*.

c. The Principal’s Losses

Vendo is the leading Illinois case on a principal’s losses arising from corporate opportunity usurpation.¹⁰⁴ As noted, Stoner served as the intermediary between Vendo and third party Phillips, and there was no evidence that Phillips was willing to sell the Lektro-Vend machine to Vendo at a price below \$1,500,000. Despite the absence of any proof of Phillips’ willingness to deal with Vendo, the Illinois Supreme Court upheld the \$7.3 million judgment against Stoner for Vendo’s loss of the Lektro-Vend, treating proof of Phillips’ willingness to deal as irrelevant.

Faced with this usurpation liability, Stoner tried to argue that Vendo’s damages for its losses were capped at the amount of Stoner’s gains, which presumably were little or nothing since the Stoner/Phillips operation was a start-up. The supreme court roundly rejected this argument as a matter of policy:

103. As Professor Palmer has observed:

When a fiduciary profits through breach of fiduciary obligation, he will be held accountable to his principal without regard to whether or not the profit is at the expense of the principal. The principle is applied most frequently when the fiduciary violates his duty of loyalty to his principal, a duty based upon the avoidance of a conflict of interest. The retention of the benefit is clearly unjust, there is no one else who has a valid claim, and the only feasible means of preventing the unjust enrichment is to grant restitution in favor of the principal. The duties of a fiduciary are among the most important known to the law, it is indispensable that there be some sanction for their breach, and often the only effective sanction is restitution in favor of the principal of gains realized by the fiduciary. Sometimes a breach causes loss to the principal but frequently it does not, and in these circumstances there is no satisfactory remedy except restitution.

PALMER, *supra* note 1, §2.11, at 141 (1978).

104. *Levy v. Markal Sales Corp.*, 268 Ill. App. 3d 355, 643 N.E.2d 1206 (1st Dist. 1994), in which plaintiff was awarded \$500,000 for the value of his stock in Markal Sales Corporation, is the only other post-*Kerrigan* Illinois corporate opportunity case in which damages for loss, rather than disgorgement of the fiduciary’s monetary gains or some other equitable relief, was awarded. *Henry’s Drive-In, Inc. v. Anderson*, 37 Ill. App. 2d 113, 185 N.E.2d 103 (1st Dist. 1962), also resulted in an award of lost profits, but it preceded *Kerrigan* and *Vendo* and relied upon a “good faith” corporate opportunity test. The damages award in *Grace v. E.J. Kozin Co.*, 538 F.2d 170, 175 (7th Cir. 1976), a post-*Kerrigan* case, was reversed and replaced with the fiduciary’s gains. Similarly, the “damages” award in *Nordhem v. Harry’s Café, Inc.*, 175 Ill. App. 3d 392, 529 N.E.2d 988 (1st Dist. 1988) was based on the *defendants’* actual net profits – meaning the fiduciaries’ gains – rather than the principal’s losses.

Plaintiff was not, as defendants urge, limited to the recovery of the profits which accrued to Lektro-Vend. (See *Restatement (Second) of Agency* secs. 399, 401, 407 (1958).) The limitation on a plaintiff's recovery proposed by defendants would mean that a fiduciary could violate his duty without incurring any risk. For if his misconduct were discovered the most that he could lose would be the profit gained from his illegal venture; the law would have operated only to restore him to the same position he would have been in had he faithfully performed his duties.¹⁰⁵

Under the *Vendo* vision of "losses," plaintiff is entitled to the amount plaintiff would have made had plaintiff had the benefit of the usurped opportunity. Thus, the \$7.3 million judgment was comprised of profits Vendo lost between 1962 and the trial in June 1969, during the period of Stoner's breach (\$2.1 million), and the diminution in value of Vendo's business as of June 1969, attributable to Stoner's activities (\$5.2 million).¹⁰⁶

As with the fiduciary's gains, the third party refusal to deal defense has nothing to do with the principal's losses. The principal's losses are calculated by comparing its performance and value with and without the benefit of the opportunity,¹⁰⁷ as the Illinois Supreme Court did in *Vendo*. This necessarily negates any role for the third party refusal to deal defense by assuming it away.¹⁰⁸

d. Preliminary and Permanent Injunctive Relief

The corporate opportunity injunction cases have been inconsistent, perhaps owing to the absence of an Illinois Supreme Court injunction opinion in the corporate opportunity context. Some, like *Comedy Cottage*, reached the right result but struggled with the third party's refusal to deal testimony. Others, like *Regal-Beloit* and *Durasys*, attached great weight to the third party's refusal to deal with the plaintiff principal, without recognizing that their limitations on or complete denials of injunctive relief were inconsistent with the total deterrence rationale of *Kerrigan*.

Only *LCOR* and *Foodcomm* gave this issue the straightforward treatment it deserves: the court in each case

105. *Vendo*, 58 Ill. 2d at 305-06, 321 N.E.2d at 10.

106. *Id.* at 311-12, 321 N.E.2d at 13.

107. See *Dowd & Dowd, Ltd. v. Gleason*, 352 Ill. App. 3d 365, 381, 816 N.E.2d 754, 767-68 (1st Dist. 2004) (rejecting argument that third-party Allstate's right to terminate its relationship with plaintiff was a defense to damages: "[U]ntil terminated, the relationship created by an at-will contract will presumptively continue in effect so long as the parties are satisfied, and, therefore, such a relationship is sufficient to support an action for tortious interference.").

108. See also *id.* at 382, 816 N.E.2d at 769 (holding that defendants' breach of fiduciary duty and tortious interference "precluded [third-party customer] Allstate from having a free and unfettered choice regarding keeping its business with [plaintiff] Dowd.").

enjoined the fiduciary outright and left the third party otherwise free to do as it wished. Indeed, *Foodcomm* took the principal-protection rule to its logical conclusion by granting injunctive relief in the face of a third party's undisputed refusal to deal – exactly the result that should routinely obtain in all Illinois corporate opportunity cases. The third party's interests are irrelevant in these injunction disputes.¹⁰⁹ No one is seeking to compel the third party to do anything; they are seeking to stop the fiduciary from gaining by virtue of his wrong – the most basic public policy of all.¹¹⁰

If the third party's interests are irrelevant, it follows that permanent injunctive relief of unlimited duration should be the norm. A “head start” limitation merely invites the fiduciary and third party to wait out the injunction, thereby undercutting the deterrence rationale of Illinois fiduciary duty law.¹¹¹ A “head start” restriction also fails to account for the mutually exclusive outcomes that define true corporate opportunities. If the principal lands the deal, such as purchasing a building from the third party, the fiduciary will not be able to make the same purchase a few months or years later. Finally, market disruption is irrelevant. In all but the rarest cases, there are plenty of fish in the sea; both the third party and the market as a whole are barely affected by the loss of a single participant, and shortages will be met by new entrants, as the Illinois Supreme Court has recognized in the analogous context of restrictive covenants.¹¹²

109. *Grede v. Bank of New York Mellon*, 598 F.3d 899, 903 (7th Cir. 2010) (“It is a basic principle that litigants can't invoke the rights of third parties”).

110. *Gunn v. Sobucki*, 216 Ill. 2d 602, 618-19, 837 N.E.2d 865, 874 (2005) (“Few principles of equity are more basic than the doctrine that one seeking the aid of the courts is prohibited from taking advantage of his own wrongdoing”).

111. Indeed, courts have had no difficulty in crafting broad preliminary and permanent injunctions to prevent evasions by wrongdoers. *See, e.g., McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 192 (1949) (a broad injunction is appropriate where “a proclivity for unlawful conduct has been shown”); *Hartford-Empire Co. v. United States*, 323 U.S. 386 (1944) (ordering dissolution of trade association and permanently enjoining corporate defendants from forming or joining any such trade association for five years to remedy antitrust violations); *Russian Media Grp., LLC v. Cable Am., Inc.*, 598 F.3d 302, 307 (7th Cir. 2010) (“The district court may even enjoin certain otherwise lawful conduct when the defendant's conduct has demonstrated that prohibiting only unlawful conduct would not effectively protect the plaintiff's rights against future encroachment”); *ILG Indus., Inc. v. Scott*, 49 Ill. 2d 88, 273 N.E.2d 393 (1971) (prohibiting trade secret defendant from producing certain fans altogether, rather than just prohibiting use of plaintiff's fan component part drawings); *Burt Dickens & Co. v. Bodi*, 144 Ill. App. 3d 875, 494 N.E.2d 817 (1st Dist. 1986) (granting preliminary injunction preventing trade secret defendant from calling on plaintiff's customers altogether, rather than just prohibiting use of plaintiff's customer list).

112. *Canfield v. Spear*, 44 Ill. 2d 49, 254 N.E.2d 433 (1969) (rejecting patient hardship as a ground for voiding restrictive covenant where patients

e. Constructive Trust

The most complex questions surround the most common form of relief – constructive trusts. At one level, constructive trust awards are as straightforward as disgorgement of a fiduciary's gains or injunctive relief blocking a fiduciary from seizing an opportunity: all three rob the fiduciary of his ill-gotten gains and thereby discourage such misconduct. But difficulties arise when the victimized principal is unable or unwilling to stand in the fiduciary's shoes due to the deal terms between the fiduciary and the third party.

Constructive trusts with respect to diverted real estate interests offer a prime example of the problem in a form that is easy to rectify. About half of all Illinois corporate opportunity cases have involved real estate diversions, and in every case the plaintiff wanted the real estate rather than cash, no doubt because of the unique nature of the diverted property. To the extent the property was already sold, the simple solution was for the court to order the fiduciary to transfer the property to the victim in whole or in part, with the victim paying its fair share to reimburse the wrongdoer's out-of-pocket costs and the wrongdoer accounting to the victim for any profits. Examples previously covered in this and my earlier articles include the real estate sales in *Bakalis v. Bressler*,¹¹³ *Paulman v. Kritzer*,¹¹⁴ *White Gates Skeet Club v. Lightfine*,¹¹⁵ and *Mile-O-Mo Fishing Club v. Noble*.¹¹⁶ These were relatively easy cases because the victimized principals apparently did not complain about the terms struck between their fiduciaries and the third-party sellers. Presumably the principals found the sale terms satisfactory and the third-party sellers, having parted with their interests, lacked standing to complain about the court-ordered transfers.

Potentially more complex constructive trusts questions could have emerged with respect to the lease diversions in *Consumers Co. v. Parker*,¹¹⁷ *Comedy Cottage*, and *Lindenhurst Drugs*, given that in each case the third party landlord by definition retained an ongoing interest in the property and thus faced the prospect of having a new tenant and new terms forced upon it by the court. In each case, however, plaintiff was apparently willing to accept the fiduciary's lease terms and the landlord apparently was willing to

had reasonable alternatives); *Bauer v. Sawyer*, 8 Ill. 2d 351, 134 N.E.2d 329 (1956) (same holding); *Abbott-Interfast Corp. v. Harkabus*, 250 Ill. App. 3d 13, 20, 619 N.E.2d 1337, 1343 (2d Dist. 1993) (“[A] non-compete [agreement] restriction can be reasonable when there are a large number of other competitors with which the general public is free to do business.”).

113. 1 Ill. 2d 72, 115 N.E.2d 323 (1953).

114. 38 Ill. 2d 101, 230 N.E.2d 262 (1967).

115. 276 Ill. App. 3d 537, 658 N.E.2d 864 (2d Dist. 1995).

116. 62 Ill. App. 3d 50, 210 N.E.2d 12 (5th Dist. 1965).

117. 227 Ill. App. 552 (2d Dist. 1923).

accept plaintiff as a substitute tenant. For example, the issue was averted in *Comedy Cottage* by the third party landlord's agreement to be bound by the judgment in return for plaintiff dropping its civil conspiracy charge against the landlord.¹¹⁸ The issue was also averted in *Lindenhurst Drugs*, as the court awarded a constructive trust at plaintiff's request and the landlord was not a party to the appeal.¹¹⁹

Consumers came closest to wrestling with the question, but it too skirted the issue in the main. The appellate court reversed the trial court's dismissal of plaintiff's complaint and "remanded with instructions to enter a decree in accordance with the prayer of the bill in this cause,"¹²⁰ which had requested that the trial court "direct the assignment and delivery" of the lease to plaintiff by the fiduciary Parker and his secret partner Mitchell.¹²¹ But the appellate court did not face a substantive conflict between plaintiff and the third party landlord. The landlord had no previous objection to plaintiff; only price had divided the landlord and plaintiff on the lease renewal; and there was no difference in terms (other than price) between plaintiff's proposed lease and the usurped lease of Parker and Mitchell.¹²² The appellate court evidently thought the landlord was offering pretexts when the landlord first professed concern over plaintiff's previous failure to use the premises and then asserted that plaintiff had let the premises "decay to a considerable extent."¹²³

Assuming the principal is satisfied with the fiduciary's lease, but the landlord objects to the principal succeeding to it, constructive trust law should side with the principal in this context. The leading treatise on equity contends that, under constructive trust principles, it is "wholly immaterial" whether "the landlord would or would not have granted a new lease" to the principal.¹²⁴ Constructive trust relief "does not in the slightest degree depend upon the terms and provisions of the original lease,

118. *Comedy Cottage*, 145 Ill. App. 3d at 358, 495 N.E.2d at 1010.

119. *Lindenhurst Drugs*, 154 Ill. App. 3d at 62, 67, 71, 506 N.E.2d at 646, 649, 652 (noting that "other defendants were not parties to this appeal" and affirming the trial court's constructive trust in favor of plaintiff upon the property and any profits the fiduciary derived from the property).

120. *Consumers Co.*, 227 Ill. App. at 572.

121. *Id.* at 557.

122. *Id.* at 570 ("It must be kept in mind that the question here to be determined is to whom does the lease belong? At no time did the [landlord] make any complaint with reference to the use of the property made by [plaintiff]; nor did [the landlord] hesitate to offer [plaintiff] a new lease. This offer was not accompanied by any condition with reference to the future use of the property, the only difference between the parties throughout the negotiation being in reference to the amount of rent to be paid.").

123. *Id.* at 560.

124. IV JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE AS ADMINISTERED IN THE UNITED STATES OF AMERICA § 1050, at 109 (5th Ed. 1941).

nor upon the attitude of the landlord.”¹²⁵ Rather, a constructive trust operates against the fiduciary by treating him as holding legal title for the benefit of his principal. Thus, “if a condition inserted in such lease against assigning should prevent the relief of an actual assignment, it will not in the least prevent the court from enforcing the trust by compelling the partner to hold legal title for the benefit of all.”¹²⁶

But what about the situation in which the fiduciary and third party strike a bargain that is unattractive or unacceptable to the principal? Whose interests should trump for constructive trust purposes – the principal’s, the fiduciary’s or the third party’s? For example, suppose the principal seeks to lease ten floors in a third-party’s building, but its fiduciary sneaks in and rents those floors for himself plus two more. Should the principal be required to take all twelve floors, or can the court impose a constructive trust covering just the ten floors the principal was seeking, leaving the fiduciary stuck with two floors of his own? Or, as another and more complex example, suppose the principal offers to buy the third-party target’s business via an asset purchase without assuming the liabilities, only to have its fiduciary surreptitiously buy the third-party target’s business via a stock purchase (which, in practical effect, assumes the liabilities). Should the principal be stuck with taking the fiduciary’s stock as its sole constructive trust remedy, or can the court order the assets held in trust for the principal with the fiduciary left holding the liabilities? In other words, does constructive trust law require the principal to take the fiduciary’s deal, or can the court tailor the constructive trust remedy to approximate the deal the principal was seeking?

No Illinois corporate opportunity case to date has explored the limits of constructive trust relief along these lines. Professor Dobbs argues as a general matter that courts in fashioning equitable relief should balance the equities and hardships among the principal, the fiduciary, and the third party.¹²⁷ In Professor Dobbs’ view, good faith, ethics, fault, and motive should all play roles, as should hardship to the principal versus hardship to the fiduciary and third party.¹²⁸

Assuming these are the proper criteria, the recurring fact pattern in Illinois has been one of fiduciary deception and bad faith happily abetted by third parties looking for a better deal than the victimized principals were offering. Indeed, only in *Glasser v. Essaness Theatre Corp.*¹²⁹ and *Northwestern Terra Cotta v.*

125. *Id.*

126. *Id.* at 108-09.

127. DOBBS, *supra* note 30 § 2.4(5), at 108-23 (“Balancing Equities, Hardships and Public Interests”).

128. *Id.* at 111-12.

129. 414 Ill. 180, 111 N.E.2d 124 (1953).

*Wilson*¹³⁰ did the fiduciaries seriously claim they acted in good faith, as shown by their “tender” of the opportunities to their principals, and only in *Mile-O-Mo Fishing Club v. Noble*¹³¹ did the third party seriously claim it acted in good faith, because the fiduciary told the third party that he was purchasing the property for the benefit of his principal.¹³² These exceptional circumstances aside, there are no equities to balance with respect to fiduciaries and third parties in these cases,¹³³ and any “harm” a constructive trust may inflict upon them is entirely of their own making.¹³⁴ Thus, the balance of equities and harms should tip decisively in favor of the plaintiff-principal in most Illinois corporate opportunity cases, unless the constructive trust would not be useful to plaintiff¹³⁵ – a nonstarter, to be sure, when the opportunity falls within the plaintiff’s line of business.

Professor Bogert offers a more concrete discussion of these principles in the constructive trust context. He recognizes the court’s authority to require the plaintiff-principal to reimburse the guilty fiduciary:

A wronged party seeking the aid of a court of equity in establishing a constructive trust must himself do equity. The court will exercise its discretion in deciding what acts are required of the plaintiff as conditions precedent to the securing of a decree. For example, if the defendant has obtained title to property of the plaintiff by means of fraud, the plaintiff will be required to return any consideration received from the defendant, just as he would if he proceeded on the theory of rescission. And if the defendant has, during his period of wrongful retention of the property, expended money for the preservation or protection of the property, for example, by paying taxes or the principal or interest on a mortgage, reimbursement may well be required of the plaintiff. If the defendant has made improvements or performed services in managing the property,

130. 74 Ill. App. 2d 38, 219 N.E.2d 860 (1st Dist. 1966).

131. 62 Ill. App. 3d 50, 210 N.E.2d 12 (5th Dist. 1965).

132. These cases are discussed in greater detail in my second article, *The Origin and Evolution of the Third Party “Refusal to Deal” Defense in Illinois Corporate Opportunity Cases*, 46 J. Marshall L. Rev. 937, 946-49, 971-75 (2013).

133. See *ABC Trans Nat’l Transp., Inc. v. Aeronautics Forwarders, Inc.*, 62 Ill. App. 3d 671, 682-83, 379 N.E.2d 1228, 1236 (1st Dist. 1978) (holding in preliminary injunction context that the balance of equities is inapplicable where the defendant’s “actions were done with full knowledge of the plaintiff’s rights and with an understanding of the consequences which might ensue”) (quoting *Wilson Concrete Co. v. Cnty. of Sarpy*, 189 Neb. 312, 316, 202 N.W.2d 597, 599 (1972)).

134. *Id.* at 687, 379 N.E.2d at 1239 (“It is hard to see how anyone can claim immunity for a tort on the ground that it was innocently done, when at the time of doing it he knew his right to do it was disputed by the person affected.”) (quoting *Welton v. 40 East Oak St. Bldg. Corp.*, 70 F.2d 377, 381 (7th Cir. 1934)).

135. DOBBS, *supra* note 30, §2.4(5), at 110 (commenting that “courts should not impose costs on one party without securing benefits for the other”).

some courts have been induced to require the plaintiff to compensate the defendant to the extent that the plaintiff will secure a benefit from these acts if he secures a constructive trust, especially in cases where the defendant was not an intentional wrongdoer but rather acted under mistake or ignorance.

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The decree establishing a constructive trust will require the defendant to deliver possession and convey title to the property and to pay to the plaintiff profits received or rental value during the period of wrongful holding, and otherwise to adjust the equities of the parties after taking an accounting.¹³⁶

Support for Professor Bogert's views can be readily found in Illinois precedent. Illinois examples requiring the plaintiff-principal to reimburse the defendant-fiduciary as to the purchase price of usurped property can be found in *Bakalis*, *Paulman*, *Lightfine*, and *Mile-O-Mo Fishing Club*, as noted above.¹³⁷ *Lightfine* also serves as an example of a case in which reimbursement of the fiduciary's incidental expenses in maintaining the trust property was a condition to constructive trust relief, although the court on public policy grounds denied the fiduciary interest on the purchase price payment.¹³⁸ *Graham*, in turn, mentioned in passing the possibility of equitable compensation in favor of the fiduciary,¹³⁹ although the proposition

136. GEORGE T. BOGERT, HORNBOOK ON THE LAW OF TRUSTS, § 77, at 288-89 (6th ed. 1987) (internal footnotes omitted). See also *Mattel, Inc. v. MGA Entertainment, Inc.*, 616 F.3d 904, 911 (9th Cir. 2010) (holding that constructive trust as to all subsequent improvements and profits of misappropriated Bratz Doll ideas swept too wide: "When the value of the property held in trust increases significantly because of a defendant's efforts, a constructive trust that passes on the profit of the defendant's labor to the plaintiff usually goes too far."); *Leigh v. Engle*, 858 F.2d 361, 363 (7th Cir. 1988) (trial court properly denied multi-million dollar ERISA claim and limited recovery to \$6,704 where profits were not the result of fiduciary's misuse of trust funds); Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. Rev. 851, 857-58 (2011) ("Over-determination can compound quantification problems when the fiduciary's own efforts legitimately contributed to the profit.").

137. Other examples of courts ordering defendants to convey rights upon receiving reimbursement from plaintiffs are collected in PALMER, *supra* note 1, §2.8, at 109 (1978) (reviewing trade secret and unfair competition cases).

138. *Lightfine*, 276 Ill. App. 3d at 540, 542, 658 N.E.2d at 867, 868 (noting that plaintiff conceded defendants were entitled to be reimbursed "for any expenses incurred for the maintenance and preservation of the property," and later reciting the rule that reimbursement is appropriate for "expenses incident to the preservation of [the] trust or for the benefit thereof") (quoting *David v. Russo*, 119 Ill. App. 3d 290, 297, 456 N.E.2d 342, 347 (1st Dist. 1983)).

139. *Graham*, 111 Ill. App. 3d at 768, 444 N.E.2d at 560 ("Furthermore, plaintiffs agree that Mimms was entitled to reasonable compensation for his efforts in developing the usurped opportunities [see DOBBS, *supra* note 30, at 243] and the court also erred in imposing a constructive trust on all the

seems seriously doubtful in light of the strong Illinois public policy requiring fiduciary compensation forfeiture for disloyalty as expressed in *Lightfine* and many other cases.¹⁴⁰ Again, however, none of these cases explicitly dealt with the problem of tailoring the constructive trust remedy to approximate the deal the principal was seeking, nor does Professor Bogert's hornbook.

Another, and I think better, way to look at the issue is simply to treat corporate opportunities as "property" belonging to the principal, at least as against the fiduciary. This was, in fact, the way the Illinois Appellate Court characterized the corporate opportunity doctrine in *Graham*.¹⁴¹ Under this "property" view, the constructive trust question is conceptually straightforward and indeed categorical: "[t]he rule has been established that property which has been appropriated by another, and upon which a trust has been fixed, may in equity be followed either in its original or its altered form, so long as it can be identified, and so long as superior rights of third parties have not intervened."¹⁴² Under this theory, the court should have full authority to impress a constructive trust upon the "altered form" of the usurped property, subject to whatever adjustments, if any, the court deems equitable.¹⁴³ In other words, as per the equitable maxim, "equity

compensation Mimms received from Wyclif") (emphasis in original).

140. *Lightfine*, 276 Ill. App. 3d at 541-42, 658 N.E.2d at 868 (ordering forfeiture of property management fee defendant LaReno paid himself for managing the usurped property).

141. *Graham*, 111 Ill. App. 3d at 762, 444 N.E.2d at 556 ("In addition to this proscription against misappropriating corporate property, the corporate opportunity doctrine prohibits a corporation's fiduciary from taking advantage of business opportunities which are considered as 'belonging' to the corporation (at least as far as the fiduciary is concerned).").

142. *Winger v. Chi. City Bank & Trust Co.*, 394 Ill. 94, 111, 67 N.E.2d 265, 276-77 (1946) (citing POMEROY, *supra* note 124, at 148). As Professor Pomeroy observed in his treatise passage cited in *Winger*:

§ 1058c. *Following Property into Its Product*.—No change in the form of the trust property, effected by the trustee, will impede the rights of the beneficial owner to reach it and to compel its transfer, provided it can be identified as a distinct fund, and is not so mingled up with other moneys or property that it can no longer be specifically separated. So long as the trust property can be traced and followed into other property into which it has been converted, it remains subject to the trust. The product or substitute has the nature of the original imparted to it. Thus one who has purchased or improved real property with funds of another, under circumstances which ordinarily would entitle such other person to enforce a constructive trust in, or equitable lien against, the property, cannot defeat the right to enforce the trust or lien on the ground that it is homestead property and exempt from the claims of creditors.

Id. at 148-49 (internal footnotes omitted) (citing, among other cases, *Moore v. Taylor*, 251 Ill. 468, 96 N.E. 229 (1911) (discussing trust tracing rules)).

143. *Cf. Triple Five of Minnesota, Inc. v. Simon*, 404 F.3d 1088, 1099-00 (8th Cir. 2005) (holding that Mall of America general partner Simon usurped corporate opportunity by acquiring limited partner TIAA's interest in Mall of America instead of sharing the TIAA interest opportunity with Simon's co-

regards as done that which ought to be done.”¹⁴⁴

The case for forcing the transfer on the principal’s terms is particularly compelling when the fiduciary and the third party structure their deal precisely in order to defeat the principal’s interests.¹⁴⁵ This is always the scenario when fiduciaries compete for corporate opportunities: they make topping offers to induce the third party to go their way. If a court lacks authority to rearrange deal terms when faced with such intentional wrongdoing, then fiduciaries and third parties will escape with their prize in all but the rare case where an “apples to apples” comparison can be made between the principal’s proposed deal and the fiduciary’s final deal. Such an outcome runs directly contrary to the “prophylactic purpose” of the corporate opportunity doctrine in Illinois as laid down in *Kerrigan*. Such an outcome also ignores Judge Cardozo’s famous observations that “constructive trust is the formula through which the conscience of equity finds expression”¹⁴⁶ and

general partner Triple Five; ordering Simon removed and replaced by Triple Five as managing general partner of Mall of America; and rejecting third party TIAA’s objections on the ground “that TIAA’s hands were not exactly unsullied with regard to the 1999 [Simon/TIAA sale] transaction, especially when [TIAA] failed to notify Triple Five of its negotiations with [Simon] as demanded by Herbert Simon in 1988. In this equitable action, we take this into account.”); *McGovern v. General Holding, Inc.*, 2006 Del. Ch. LEXIS 93, *78-84 (Del. Ch. May 18, 2006) (holding that general partner usurped corporate opportunity by keeping title to new technologies; ordering removal of general partner, dissolution of limited partnership, and appointment of a receiver to sell the new technologies; and further ordering general partner not to bid on the new technologies or to compete for three years, in order to avoid chilling the bidding on the new technologies during the sale process).

144. *Smithberg*, 192 Ill. 2d at 300, 735 N.E.2d at 566 (2000).

145. *Cf. DOBBS*, *supra* note 30, §9.3(3), at 592-93 (discussing plaintiff’s general duty of restoration). Specifically, Professor Dobbs has observed:

The plaintiff must also account for gains in the value of the property now being restored to the plaintiff and due to the defendant’s payments or improvements. For example, if the defendant made mortgage payments on the property while it was in his name, the plaintiff is enriched by reason of those payments and the defendant is entitled to appropriate credits for them in adjusting his liability to the plaintiff. Similarly, if the plaintiff recovers a business sold to the defendant and is entitled to recover profits earned in the business while it was in the defendant’s hands, he must credit the defendant with the value of the defendant’s time and effort in the business.

However, the plaintiff must account to the defendant only for actual benefits received when the transaction is avoided. The plaintiff owes nothing for expenditures made by the defendant unless those expenditures result in an unearned benefit to the plaintiff. The plaintiff owes nothing for the defendant’s expenditures that do not improve the property taken back by plaintiff; and he owes nothing for improvements on the property which he does not want.

Id. (internal footnotes omitted).

146. *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380, 386, 122 N.E. 378, 380 (1918) (Cardozo, J.).

that “the equity of the transaction must shape the measure of relief.”¹⁴⁷

6. “Adequate Remedy at Law”

Apart from its bearing on proximate cause, the tort-equity distinction in favor of the *Kinzer/Armstrong* “agency-contract-equity” view has important implications from a remedies standpoint as well. Given its historical treatment as an equitable rather than legal claim, a breach of fiduciary duty cause of action should not be subject to an “adequate remedy at law” defense, particularly when constructive trust relief is sought, as is generally true in corporate opportunity cases. As Professor Dobbs has explained:

Certain claims in equity were traditionally dismissed if the chancellor thought the plaintiff would have an adequate remedy at law. Claims subject to the adequacy rule were claims based on rights the law courts recognized or created in the first place. The plaintiff in such cases resorted to equity only in the hopes of a more effective remedy for a legal right. The constructive trust claim is different. It is not a claim based on a legal right. On the contrary, constructive trusts are needed because legal title is in the defendant. The plaintiff seeking a constructive trust does not assert a legal right but an equitable interest. In this setting, the adequacy of legal remedy seems irrelevant. Professor Palmer concludes that the adequacy rule has no effect when the claim is against a fiduciary, so that the case may proceed in equity even if there is an adequate remedy at law; but when the defendant is not a fiduciary, he believes the results are unpredictable.¹⁴⁸

147. *Id.* at 389, 122 N.E. at 381.

148. DOBBS, *supra* note 30, § 4.3(2), at 595. Professor Dobbs goes on to note the historical basis for the tension between chancery and common law courts, illustrated by the famous Coke-Ellesmere dispute over the King’s Bench judgment for Richard Glanvill in a jewel sale case, followed by the judgment against and jailing of Glanvill by Chancery in the same contest, followed by Glanvill’s habeas corpus release by King’s Bench, followed by Glanvill’s further imprisonment by Chancery. *Id.* § 2.5(1), at 124 n.3 (discussing the dispute, which Chancery won, as detailed in John P. Dawson, *Coke and Ellesmere Disinterred: The Attack on the Chancery in 1616*, 36 ILL. L. REV. 127 (1941)). See also *People v. Lawton*, 212 Ill. 2d 285, 306-08, 818 N.E.2d 326, 339-40 (2004) (Fitzgerald, J., dissenting) (describing various writs – all descended from the Coke-Ellesmere dispute – used to overturn Illinois judgments prior to the adoption of § 2-1401 of the Illinois Code of Civil Procedure and its statutory predecessors); PAUL D. HALLIDAY, *HABEAS CORPUS: FROM ENGLAND TO EMPIRE*, at 88-93 (2010) (discussing the Coke-Ellesmere dispute, and the distinct jurisdictions of common law and equity, in the course of examining the history of the writ of habeas corpus as an avenue for escaping final judgments in criminal cases); Sir John Baker, *The Common Lawyers and the Chancery: 1616*, reprinted in ALLEN BOYER, *LAW, LIBERTY AND PARLIAMENT: SELECTED ESSAYS ON THE WRITINGS OF SIR EDWARD COKE*, at 254-81 (2004) (discussing the Glanvill case in detail and Coke’s attempt to use *res judicata* to block Ellesmere’s subsequent chancery encroachment on

Professor Dobbs' insights find strong support in *Martin*, where the Illinois Supreme Court explicitly rejected an "adequate remedy at law" defense to the fake foreign service fee / fiduciary duty constructive trust claim.¹⁴⁹ Thus, the corporate opportunity decisions in *Allstate Amusement Co. of Illinois, Inc. v. Pasinato*¹⁵⁰ and *Graham v. Mimms*¹⁵¹ and the business breakup decision in *Hagshenas v. Gaylord*¹⁵² were simply wrong in holding that the fiduciary duty / equitable relief claims therein were subject to an "adequate remedy at law" defense.¹⁵³ Not surprisingly, none of these cases cited Illinois Supreme Court fiduciary duty precedent in support of its erroneous holdings; all three preceded *Martin*, and hence all three are not good law for their oxymoronic "adequate remedy at law" assertions.¹⁵⁴ *Pasinato*, *Graham*, and *Hagshenas* obviously turn fiduciary duty law on its head from a

the initial common law judgment in favor of Glanvill); HAROLD J. BERMAN, LAW AND REVOLUTION II: THE IMPACT OF THE PROTESTANT REFORMATIONS ON THE WESTERN LEGAL TRADITION 309-15 (2003) (discussing the expansion of royal prerogative courts, including the Court of Chancery, during the Tudor-Stuart periods, and then the ultimate triumph of the common law courts following the English Revolution and the abolition of prerogative courts in 1640); PHILIP HAMBURGER, LAW AND JUDICIAL DUTY 124-25 (2008) (noting the "conflict between equitable and legal visions of judicial duty reached its depths during the chancellorship of the irascible Lord Ellesmere" and quoting Ellesmere's declaration that he had "an absolute and uncontrollable Power" in contrast to the limited power of common law judges).

149. *Martin*, 163 Ill. 2d at 78-79, 643 N.E.2d at 756 (constructive trust for breach of fiduciary is not an action at law subject to trial by jury; in addition, an action for an accounting for breach of fiduciary duty is not subject to an adequate remedy at law defense, since breach of fiduciary duty has traditionally been an action in equity).

150. 96 Ill. App. 3d 306, 308, 421 N.E.2d 374, 375-76 (1st Dist. 1981).

151. 111 Ill. App. 3d 751, 444 N.E.2d 549 (1st Dist. 1982).

152. 199 Ill. App. 3d 60, 78, 557 N.E.2d 316, 328 (2d Dist. 1990).

153. Cf. Jared Goldstein, *Equitable Balancing in the Age of Balancing*, 96 VA. L. REV. 485, 491-505 (2010) (rejecting the common assumption that equitable balancing in injunction cases is an ancient doctrine and arguing that such balancing began in the early 1800s in England and then first appeared in America in an 1868 Pennsylvania nuisance case).

154. For example, in reversing the trial court's award of constructive trust relief for corporate opportunity usurpation, the Illinois Appellate Court in *Graham* cited as its sole "adequate remedy at law" authority *Sta-Ru Corp. v. Mahin*, 64 Ill. 2d 330, 356 N.E.2d 67 (1976), a taxpayer case that did not involve fiduciaries. *Hagshenas*, too, reversed constructive trust relief on "adequate remedy at law" grounds in a fiduciary duty case, citing *Graham* as its sole authority and thereby perpetuating *Graham's* monumental error. *Pasinato* preceded *Graham* but committed the same sin: in denying injunctive relief as to the usurped lease at issue it cited no fiduciary duty decision as authority for its "adequate remedy at law" holding. The "adequate remedy at law" cases it did cite, *G.H. Sternberg & Co. v. Cellini*, 16 Ill. App. 3d 1, 305 N.E.2d 317 (5th Dist. 1973) and *Hall v. Orlikowski*, 24 Ill. App. 3d 60, 321 N.E.2d 23 (2d Dist. 1974), were plainly not on point: *Cellini* involved a contractor's breach of contract claim against a government agency, and *Hall* involved a homeowner's breach of contract claim against a contractor over home repairs.

remedial standpoint.

Understanding the inapplicability of the “adequate remedy at law” defense is important in corporate opportunity cases for several reasons. First, absent undue delay, the victimized principal should always have the choice of pursuing equitable or legal relief under Section 407 of the Restatement (Second) of Agency.¹⁵⁵ Having this choice matters: proving plaintiff’s damages is usually more difficult than proving the fiduciary’s gains, as one can easily see in cases like *Nordhem v. Harry’s Café, Inc.*,¹⁵⁶ *Hill v. Names and Addresses, Inc.*,¹⁵⁷ or the agonizing trilogy in *Zokoych v. Spalding*.¹⁵⁸ Second, forcing plaintiff to pursue its “adequate remedy at law” in the form of damages invites enormous litigation cost and delay in larger courts. For example, in the Circuit Court of Cook County, a case may start in the Chancery Division for preliminary injunction purposes and then be transferred to the Law Division for a jury trial many years later on damages, as illustrated by the 15 year corporate opportunity ordeal in *Lozman v. Putnam*.¹⁵⁹ Third, compelling plaintiff to pursue its “adequate remedy at law” allows the fiduciary to use diverted deal profits to fund his defense of the corporate opportunity charges against him, in effect using plaintiff’s money to defeat plaintiff instead of preserving that money under injunction. Fourth and most important, depriving plaintiff of its right to recover the defendant’s gains under the “adequate remedy at law” excuse negates the deterrence rationale of fiduciary duty law. Without first knowing the fiduciary’s gain, the court cannot determine whether the

155. See *supra* note 96 and accompanying text.

156. 175 Ill. App. 3d 392, 529 N.E.2d 988 (1st Dist. 1988) (rejecting plaintiff’s lost profits claim under *Vendo*, but awarding defendants’ profits).

157. 212 Ill. App. 3d 1065, 571 N.E.2d 1085 (1st Dist. 1991) (calculating and then awarding alternative remedies of counter-defendant’s gains or counter-plaintiff’s losses).

158. 36 Ill. App. 3d 654, 344 N.E.2d 805 (1st Dist. 1976) (reversing Judge Cohen’s ruling, after first trial, that plaintiff’s stock in Ample Tool & Mfg., Inc. was worthless after corporate opportunity usurpation and corporate competition removed all company assets), *appeal after remand*, 84 Ill. App. 3d 661, 405 N.E.2d 1220 (1st Dist. 1980) (reversing Judge Berg’s ruling, after second trial, that plaintiff’s stock in Ample was only worth \$19,000), *appeal after further remand*, 123 Ill. App. 3d 921, 463 N.E.2d 943 (1st Dist. 1984) (affirming Judge Curry’s ruling, after third trial, that plaintiff’s stock in Ample was worth \$240,000, but reversing prejudgment interest award of \$127,000).

159. The *Lozman* case began in the Chancery Division in 1999, traveled to the Illinois Appellate Court in 2002, returned for a jury trial in the Law Division in late 2005, and then ended in a second trip to the Illinois Appellate Court in 2008. See *Lozman v. Putnam*, 328 Ill. App. 3d 761, 767 N.E.2d 805 (1st Dist. 2002), *later appeal*, 379 Ill. App. 3d 807, 884 N.E.2d 756 (1st Dist. 2008). At the time this article went to press in 2014, the *Lozman* case was still being litigated before the Illinois Appellate Court on a §2-1401 petition to vacate the defense judgment that was affirmed in 2008. See *Lozman v. Putnam*, No. 1-13-0104 (1st Dist. 2014).

defendant's gain exceeds plaintiff's loss, leaving the fiduciary free to profit from his wrong even after paying a damages award.

Every trapped fiduciary and third party attempts this "one-two punch," first arguing that damages is the sole remedy and then bitterly contesting every damages assumption and projection through years of jury trial damages litigation, with the third party taking every opportunity to highlight its "refusal" as a damages defense. The third party refusal to deal defense should not be allowed to dictate the place and pace of corporate opportunity cases; as noted, it should play no role at all.

7. *Jury Instructions*

Two interrelated points arise with respect to the third-party refusal to deal defense in jury cases. First, because corporate opportunity cases are "equitable" in nature, they should not be subject to jury trials, at least in Illinois state courts. Second, to the extent a jury trial is sought without contest in Illinois state court or is pursued as a matter of right in Illinois federal court, the trial court should be asked to give a preemptory jury instruction telling the jury, in effect, that the third party's willingness or unwillingness to deal with plaintiff is irrelevant.

Illinois state and federal courts reach opposite results on the jury trial right question because the state and federal constitutional tests differ. Illinois Appellate Court decisions have held that fiduciary duty claims were unknown at common law and therefore are not subject to jury trial rights under the Illinois Constitution.¹⁶⁰ The Illinois Supreme Court left this question unanswered in *Martin v. Heinold Commodities, Inc.*,¹⁶¹ holding that the relief awarded in that case was equitable in nature and therefore did not warrant a jury trial in any event.¹⁶² Federal courts, conversely, follow a two-part test focusing predominantly on the type of relief sought, with money damages requests generally triggering Seventh Amendment jury trial rights.¹⁶³

Assuming jury trials are available, the question becomes how to instruct the jury on the irrelevance of the third party's refusal to deal. The plaintiff-principal should be permitted to seek a preemptory instruction so that jurors do not assume a third party's

160. *Prodromos*, 389 Ill. App. 3d at 169, 906 N.E.2d at 609 (collecting Illinois state court decisions).

161. 163 Ill. 2d 33, 77-78, 643 N.E.2d 734, 755 (1994).

162. See also *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill. 2d at 317, 500 N.E.2d at 27 (defendants had no jury trial rights since the fiduciary duty claim therein sounded in equity).

163. *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 214 (2002) ("for restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant's possession"); *Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2006) (holding that jury trial rights in fiduciary duty cases depend primarily upon the relief requested).

willingness or unwillingness to deal with plaintiff somehow negates or limits plaintiff's damages recovery. In practice, this problem would present itself almost as a matter of course in retelling the events that led to the lawsuit: (1) in most cases, the third party at some point turned its back on plaintiff's bid and gave the deal to the fiduciary, and thus the evidence suggests the third party was unwilling to deal with plaintiff; or (2) in the rare case, the principal never bid because it never learned of the opportunity, and thus no evidence is offered to show the third party was willing to deal with the plaintiff. A proper preemptory instruction solves this problem by telling the jury that the court has determined the third party's willingness or unwillingness to deal with plaintiff is irrelevant to the case. This may be a fiction in a given case, but at least it is a fiction with a policy purpose.¹⁶⁴

Preemptory instructions are governed by a discreet set of rules. In general, the instruction must "contain all the facts and be complete within itself."¹⁶⁵ If any substantial facts are omitted or misstated, the preemptory instruction will mislead the jury and will give rise to reversible error.¹⁶⁶ Of course, as a necessary corollary, instructions that accurately convey the law and facts to the jury are perfectly appropriate.

No Illinois case has dealt with a third party "refusal to deal" jury instruction, which is hardly surprising since to date all reported Illinois corporate opportunity decisions other than *Vendo* have involved bench trials. One corporate competition case, *H. Vincent Allen & Associates, Inc. v. Weis*,¹⁶⁷ concerning a fiduciary who diverted customers, did involve a preemptory instruction, but it was given for the defense and it did not address a "refusal to deal" argument. Another Illinois corporate competition case, *Pros v. Mid-America Computer Corp.*,¹⁶⁸ concerned a mass walk-out organized (or at least permitted) by an executive who was unhappy with his compensation scheme, but the instructional

164. In re Walter J. Schmidt & Co., 298 F. 314, 316 (S.D.N.Y. 1923) (Learned Hand, J.) ("when the law adopts a fiction, it is, or at least it should be, for some purpose of justice").

165. *H. Vincent Allen & Assoc's, Inc. v. Weis*, 63 Ill. App. 3d 285, 295, 379 N.E.2d 765, 772 (1st Dist. 1978) (quoting *Duffy v. Cortesi*, 2 Ill. 2d 511, 516, 119 N.E.2d 241, 244 (1954)).

166. *Kelly v. C. Iber & Sons, Inc.*, 17 Ill. App. 2d 388, 150 N.E.2d 372 (2d Dist. 1958) (peremptory instruction was improper because it failed to recite proximate cause requirement).

167. 63 Ill. App. 3d 285, 296, 379 N.E.2d 765, 772 (1st Dist. 1978) (disapproving defense's proposed peremptory jury instruction because it "limited liability to one area and omitted reference to [defendant's] fiduciary responsibilities and interference with the [plaintiff's] studio business").

168. 142 Ill. App. 3d 453, 463, 491 N.E.2d 851, 858 (2d Dist. 1986) ("However, the mandatory direction the jury must find there has been a breach of fiduciary duty absent evidence that a corporate officer did not affirmatively discourage an employee walkout finds no semblance of support from any source").

error there involved a misstatement of the executive's fiduciary duties under Delaware law, not a refusal to deal defense.

If one assumes a third party's unwillingness to deal with the plaintiff is not a defense in an Illinois corporate opportunity case, an appropriate preemptory instruction might be as follows:

In this case, the plaintiff-principal [Jones Company] contends it would have profited by having the benefit of the corporate opportunity [to buy XYZ Company], had the defendant-fiduciary [Smith] disclosed and tendered the opportunity to the plaintiff-principal [Jones Company]. I instruct you here that a third party's willingness or unwillingness to deal with the plaintiff-principal is irrelevant under the law. I therefore instruct you that you must accept as a fact that the third party here [XYZ Company] would have agreed to sell itself to the plaintiff-principal [Jones Company] but for the failure of the defendant-fiduciary [Smith] to disclose and tender the opportunity to the plaintiff-principal.

Although jury instructions are usually given at the end of the case, plaintiff should consider asking the trial court to give an instruction like this one at the outset of the case.¹⁶⁹ Establishing this fact early in the proceedings will clarify the jury's understanding of how to interpret the remaining evidence that will almost certainly revolve around the third party's testimony.¹⁷⁰

8. Summary

As a matter of Illinois precedent, then, corporate opportunity claims should not be subject to the same standards as ordinary tort claims; in fact, they should not be subject to tort standards at all. Treating corporate opportunity claims as part of the *Kinzer/Armstrong* fiduciary duty regime governed by the "agency-contract-equity" inquiry is the better approach, and it carries with

169. *E.g.*, AMERICAN BAR ASSOCIATION PRINCIPLES FOR JURIES AND JURY TRIALS, Principle 6(C)(1) (recommending preliminary jury instructions); Katherine A. Wittenberg, *Seventh Circuit Jury Project Confirms Innovations*, ABA LITIGATION NEWS (Nov. 25, 2008) (reporting positive results of pilot project's use of preliminary jury instructions, which involved providing jurors with substantive instructions—including an explicit description of the claims, the requisite elements of proof, and the other essential law governing the case — before any evidence was presented at trial), *available at* http://www.abanet.org/litigation/litigationnews/top_stories/article-jury-project.html.

170. For example, under Illinois Supreme Court Rule 431(b), a criminal defendant's right to a fair trial is protected by the trial court asking prospective jurors if they understand and accept that (1) the defendant is presumed innocent, (2) the state must prove the defendant is guilty beyond a reasonable doubt, (3) the defendant is not required to present evidence on his behalf, and (4) the defendant's failure to testify cannot be held against him. *See People v. Zehr*, 103 Ill. 2d 472, 469 N.E.2d 1062 (1984) (establishing the basis for Rule 431(b)); *People v. Calabrese*, 398 Ill. App. 3d 98, 924 N.E.2d 6 (2d Dist. 2010) (rejecting defense argument that each of the *Zehr* questions must be asked and answered individually).

it important implications for the third party refusal to deal defense. Eliminating jury trials ends the opportunity for sympathy and confusion arising out of the third party's pro-defense testimony. Eliminating the adequate remedy at law defense underscores plaintiff's right to choose its remedy and leads to expedited and comprehensive recoveries via constructive trust and injunctive relief, both of which are directed to the defendant, not the third party. Eliminating the tort conception of proximate cause, of course, makes it clear that plaintiff is entitled to at least some relief once a breach of duty has been established, regardless of the third party's willingness to deal with plaintiff. And focusing on the fiduciary's duties reminds the court that the third party's interests and expectations are irrelevant. Streamlining the inquiries in this manner is the best way to deter fiduciary misconduct.

B. Third Parties

By my count, at least 29 Illinois state and federal court corporate opportunity decisions have been influenced directly or indirectly by third parties, with the most egregious turning on "refusal to deal" defenses. Yet surprisingly enough, despite this profusion of cases, few involved third parties named as defendants, and none analyzed claims against such third parties asserting a refusal to deal,¹⁷¹ with the exception of *Foodcomm International v. Barry*.¹⁷² The practical reason for this paucity of authority, I assume, is the understandable reluctance of all firms to sue their customers and other trading partners, especially with a deal hanging in the balance. But some corporate opportunity cases warrant action against third parties, and a few may even

171. *Regal-Beloit Corp.*, 955 F. Supp. at 867, n.13 ("Thus, while it is unclear whether [nominal defendant] Brad Foote is subject to any legal liability for its conduct, Brad Foote was not truly an innocent third-party – it knew or should have known of the impropriety of the Individual Defendants' [fiduciary] conduct and did nothing"); *Lightfine*, 276 Ill. App. 3d at 539, 658 N.E.2d at 866 (noting question of whether plaintiff failed to meet its burden of proof by failing to name the legal owner of the diverted property, but then resolving the issue in the unpublished, non-precedential portion of its opinion); *Lindenhurst Drugs, Inc.*, 154 Ill. App. 3d at 62, 506 N.E.2d at 646 (noting plaintiff had sued Becker "and other defendants not parties to this appeal," presumably referring to the third party landlord and the third party franchisor); *Comedy Cottage, Inc.*, 145 Ill. App. 3d at 358, 495 N.E.2d at 1010 (noting Comedy Cottage sued third-party landlord Swanson for civil conspiracy with Berk, but Swanson settled by agreeing to take a "neutral position" in the litigation and to be bound by the court's decision regarding the right to lease and possess the premises); *Patient Care Services, Inc.*, 32 Ill. App. 3d at 1023, 337 N.E.2d at 474 (noting that Patient Care Services had named third-party Little Company of Mary Hospital as a defendant earlier in the litigation, but offering no legal analysis of Little Company's actions and failing to identify the cause of action against it).

172. 463 F. Supp. 2d 818 (N.D. Ill. 2006).

require it.

Examining potential claims against third parties is important to dispel what I believe is an unspoken but powerful myth that quietly sways the outcome in many corporate opportunity cases: “the customer is always right.” Actually, in my view, “the customer is always wrong” is closer to the truth, at least when the customer or other third party knows the fiduciary is betraying his principal. Customers and other third parties enjoy no special immunity from secondary liability when knowingly participating in or benefiting from fiduciary wrongdoing. Understanding this simple point goes a long way toward eliminating the misguided third party “refusal to deal” defense and establishing the third party’s proper role as a co-defendant.

1. Secondary Liability

Illinois law gives an injured principal a variety of secondary liability theories it can claim against third parties caught assisting fiduciary wrongdoers. These include tortious interference with employment, civil conspiracy, aiding and abetting, and collusion. The effect of these theories is to make third parties jointly or vicariously liable for others’ fiduciary sins when third parties know or have reason to know wrongdoing is afoot.¹⁷³

Mullaney is the only modern Illinois Supreme Court corporate opportunity decision to analyze secondary liability for a fiduciary’s opportunity usurpation, although *Dowd & Dowd v. Gleason* approved such secondary claims in principle.¹⁷⁴ To revisit *Mullaney* for a moment, Savage diverted the Blossman stock option opportunity from his employer, Mullaney, Wells & Co., to his secret partner, Williams, and then they later transferred the option sale proceeds to Glen Ellyn Corporation, an entity Savage and Williams controlled. The supreme court thought the operative secondary liability principles so self-evident that it felt no need to

173. *E.g., LCOR Inc.*, 1997 U.S. Dist. LEXIS at *27 (“Under Illinois law, any third party that has ‘colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom,’ is liable to that fiduciary’s principal”) (quoting *Kenroy*, 78 Ill. 2d at 565, 402 N.E.2d at 186); *Adcock v. Brakegate, Ltd.*, 164 Ill. 2d 54, 62, 645 N.E.2d 888, 894 (1994) (“The function of a conspiracy claim is to extend liability in tort beyond the active wrongdoer to those who have merely planned, assisted or encouraged the wrongdoer’s act”); *Paul H. Schwendener, Inc. v. Jupiter Elec. Co.*, 358 Ill. App. 3d 65, 829 N.E.2d 818 (1st Dist. 2005) (director of insolvent company owed fiduciary duty to creditors; banks induced director’s breach of fiduciary duty by participating in transaction that drained the corporation of assets); *Thornwood, Inc. v. Jenner & Block*, 344 Ill. App. 3d 15, 799 N.E.2d 756 (1st Dist. 2003) (recognizing action against law firm for aiding and abetting client’s breach of fiduciary duty).

174. *Dowd & Dowd v. Gleason*, 181 Ill. 2d 460, 485-86, 693 N.E.2d 358, 371-72 (1998) (holding that civil conspiracy claim against start-up law firm, to impose vicarious liability upon it for past fiduciary wrongdoing by its founders, was a valid claim that had been prematurely dismissed).

cite authority for its holdings:

We turn next to the question whether the defendants Williams and Glen Ellyn were also liable for the actions of Savage, a point the appellate court did not reach. The master found that Williams and Savage were partners in the Blossman transaction, and that Williams thus became jointly and severally liable for the acts of Savage. Although Savage and Williams did not have a formal partnership agreement, each of them testified that they had an oral understanding that there would be a 50-50 sharing of profits; each of their names appeared on the stock options; and Williams actively participated in the negotiations from an early stage.

Williams was necessarily aware that the plaintiff would not be a participant in the Blossman transaction. The master also found that Williams' prior contact with Savage in a transaction handled through the plaintiff put Williams on notice of Savage's relationship to the plaintiff, and that he should have inquired of the plaintiff as to whether it had any interest in the Blossman transaction. The master accordingly concluded that Williams was liable to the plaintiff for Savage's breach of fiduciary obligations.

As for Glen Ellyn, since Savage and Williams were its president and vice-president, respectively, and also two of its three directors, the third being their attorney, and since the benefits to it from the Blossman transaction were not received as a bona fide purchaser without notice, the master found Glen Ellyn liable as well.

We agree with the conclusions reached by the master with regard to both Williams and Glen Ellyn.¹⁷⁵

Mullaney was matter-of-fact about the secondary liability issues, and rightly so. The third party liability facts in *Mullaney* were relatively easy, in as much as Williams was Savage's partner and Glen Ellyn was their joint creation. Williams obviously knew what was going on and was only too happy to participate in the profits. But it is important to note that the Illinois Supreme Court's holdings concerning Williams' "awareness" and "notice" did not depend upon Williams' legal knowledge. Rather, it was his knowledge of Savage's *agency* relationship with Mullaney, Wells & Co. and his knowledge of Savage's *betrayal* of his principal's interests that doomed Williams.

The same result can be found in another disloyal agent case, *Beaton & Associates, Ltd. v. Joslyn Manufacturing & Supply Co.*¹⁷⁶ Fearing a strike at its plant, Joslyn Manufacturing in early 1979 turned to Washburn, its vice president and director of industrial relations, to make arrangements for appropriate plant security. A few weeks later, Washburn resigned his positions with Joslyn but remained employed by Joslyn as an advisor and consultant to its president. In his written consulting agreement, Washburn

175. *Mullaney, Wells & Co.*, 78 Ill. 2d at 550, 402 N.E.2d at 582.

176. 159 Ill. App. 3d 834, 512 N.E.2d 1286 (1st Dist. 1987).

promised to do nothing detrimental to Joslyn, and Washburn thereafter formed his own labor consulting firm, J.W. Associates, with Joslyn's knowledge. One of Washburn's responsibilities continued to be planning security in case of a strike, and to this end he considered three security firms before choosing one, Beaton & Associates, to guard Joslyn's plant on an hourly-rate basis.

The problem in this otherwise routine relationship was that Beaton, filled with gratitude over its Joslyn contract, decided to pay Washburn "referral fees" tied to the hours Washburn assigned Beaton and its supervisor, McGinley. This incentive arrangement – called a kickback in less polite company – was entered into on the same day as the Joslyn-Beaton contract, but it was not disclosed to Joslyn. When Joslyn discovered this secret side deal, it refused to pay Beaton's bill on fraud grounds. The appellate court sided with Joslyn, offering the following analysis:

The record in the instant case shows that Washburn was an agent for Joslyn, planning security services for Joslyn's plant on Joslyn's behalf. The trial court, therefore, correctly found that Washburn committed a fraud on Joslyn by accepting plaintiff's referral fee without informing Joslyn.

Plaintiff and McGinley do not escape liability. If a third party "accepts the fruits of fraud knowing of the means by which they were obtained he is liable even though he did not personally participate in the fraud." [Citation omitted.] Plaintiff and McGinley accepted the fruits of Washburn's fraud; they received the Joslyn plant security project from Washburn. * * * Plaintiff and McGinley additionally argue that they did not know, and that a court should not have expected them to know, that Washburn was Joslyn's agent, owing fiduciary duties to Joslyn. Thus, plaintiff and McGinley argue, they did not receive the Joslyn project based on Washburn's fraud.

The record shows, however, that plaintiff and McGinley knew that Washburn acted on behalf of Joslyn. Washburn contacted plaintiff and negotiated with it[.] The trial court's finding that plaintiff received the Joslyn security project as a result of its referral fee to Washburn, whom plaintiff and McGinley knew to be Joslyn's agent, was not against the manifest weight of the evidence.¹⁷⁷

The holding in *Beaton* was certainly congruent with *Mullaney*; both decisions looked to the third party's knowledge of the fiduciary's agency status and betrayal, rather than knowledge of the legality of the agent's conduct, as their touchstones. *Beaton* was also closer to the third party facts of most of the corporate opportunity cases surveyed here, in the sense that *Beaton* was a third party which otherwise had a legitimate right to act primarily for its own interests in dealing with plaintiff, absent its participation in Washburn's fiduciary wrongdoing. But factually,

177. *Id.* at 843, 512 N.E.2d at 1291.

Beaton was not quite on point for purposes of our inquiry, because Beaton was not claiming a right to choose between Joslyn and Washburn as bidders competing for Beaton's favor.

Still closer to the mark is *Stathis v. Geldermann, Inc.*¹⁷⁸ In that case, Gus Stathis funded and owned an options clearing firm, Star Clearing, run by his son, James. Geldermann sought to purchase Star Clearing, and James handled the sale. The net effect of the transaction was the transfer of all personnel, customers, and other assets from Star Clearing to a new Geldermann subsidiary, with James remaining at the helm of the new entity. Gus then emerged claiming James lacked authority to sell Star Clearing to Geldermann, and Gus charged Geldermann with conspiring with James to divert a corporate opportunity. Specifically, Gus alleged "that it was Geldermann which presented the corporate opportunity, found a way to acquire it without paying for it, and did so by conspiring and acting in concert with the manager [James] who owed a fiduciary duty to plaintiff, which was allegedly well known to Geldermann."¹⁷⁹ On any reading, *Stathis* stands for the proposition that the third party whose deal is at issue can be secondarily liable to the victimized principal, so long as the disloyal agent is acting without authorization.¹⁸⁰

I also pressed this issue directly on behalf of Foodcomm in *Foodcomm* following the Seventh Circuit's injunction opinion.¹⁸¹ My argument was that third party Empire Beef was a co-conspirator of Foodcomm fiduciaries Leacy and Barry and as such was vicariously liable for their disloyalty in diverting the Empire Beef redistribution opportunity away from Foodcomm. More precisely, my argument was that Empire Beef was indirectly liable to Foodcomm in tort even though it could not be directly liable to Foodcomm in contract. The district court found that sufficient evidence showed Empire Beef was aware of the fiduciary misconduct of Leacy and Barry at the time Empire Beef joined in their actions and therefore denied Empire Beef's summary judgment motion. The district specifically held that Empire Beef did not have to form a legal conclusion that Leacy and Barry were breaching their fiduciary duties in order for Empire Beef to be liable.¹⁸² Rather, the court observed, under Illinois civil conspiracy

178. 258 Ill. App. 3d 690, 630 N.E.2d 926 (1st Dist. 1994).

179. *Id.* at 701, 630 N.E.2d at 934.

180. At trial, it emerged that Gus had written a letter fully authorizing James to do the sale, and James had given the letter to Geldermann – prompting the jury to side with Geldermann on the claims. *See Stathis*, 295 Ill. App. 3d at 856, 692 N.E.2d at 807 ("A jury reasonably could conclude from the language of the letter [from Gus to James] that James had actual, express authority to enter into the 1986 [sale] agreement with Geldermann, by which Gus agreed to be bound.").

181. Schaller, *supra* note 15, at 1022.

182. *Foodcomm Int'l v. Barry*, 463 F. Supp.2d 818 (N.D. Ill. 2006). *Cf. Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715, 747 and n.

law, “[a] defendant who understands the general objectives of the conspiratorial scheme, accepts them, and agrees, either explicitly or implicitly to do its part to further those objectives[,] is liable as a conspirator.”¹⁸³ The district court then offered the following pertinent analysis:

Empire and Outback must have simply understood “the general objectives” of the civil conspiracy scheme to breach the alleged fiduciary duties, accept those objectives, and agree with the objectives, either explicitly or implicitly, to further the objectives of breaching the alleged fiduciary duties. Simply because Empire and Outback did not understand the legal terminology or the details of the law, they are not shielded from liability.

Empire and Outback also argue that the individuals responsible for hiring Barry and Leacy “had no idea that Barry and Leacy allegedly owed fiduciary duties to Foodcomm.” (Mem. DSJ 6). Additionally, Empire and Outback contend that the individuals responsible for hiring Barry and Leacy “did not have any occasion to explore the duties of Barry and Leacy to Foodcomm because, as Levine testified, he was ‘hiring two good salesmen to sell meat to [Empire’s] existing account base.’” (Mem. DSJ 6). However, knowledge by Empire that Barry and Leacy were Foodcomm’s employees; Leacy was in charge of the Empire account; and Leacy was involved in business negotiations between Foodcomm and Empire could lead a trier of fact to conclude that the actions of Empire and Outback were an implicit agreement to further Barry’s and Leacy’s breach of their alleged fiduciary duties. Additionally, a trier of fact could conclude that receiving the business plan from Barry and Leacy, seeking legal advice from Empire’s attorney about Leacy’s confidentiality agreement with Foodcomm, financing Outback, and distributing shareholder agreements to Barry and Leacy could constitute agreement to further the alleged breaches of fiduciary duties by Barry and Leacy.¹⁸⁴

Thus, there is no substantive reason why a third party cannot be liable for conspiring to divert its own deal away from the plaintiff-principal. The reason this odd-sounding formulation makes sense is that the third party’s liability arises from the illegal activities of others, in this case fiduciaries. Anyone who knows a fiduciary is misbehaving should be on his guard about joining in the fun. And it is safe to say that in almost every case reviewed here, the third parties were well aware (1) that they were dealing with someone else’s fiduciary and (2) that the

87 (Del. Ch. 2008) (offering extended discussion of the meaning of the phrase “knowing and intentional breach” in the contract context and holding that “mistake of law virtually never excuses a violation of law,” but then noting that the rule is different for third party liability: “[k]nowing participation in a board’s fiduciary breach requires the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach”).

183. *Id.* at 831 (quoting *Adcock*, 164 Ill. 2d at 64, 645 N.E.2d at 894).

184. *Id.*

fiduciary was bidding against or in lieu of his principal. Only in *Mile-O-Mo Fishing Club* did the fiduciary affirmatively tell the third party he was still acting on behalf of his principal in acquiring the property in his own name. In virtually all the rest, the third party knew or had reason to know something was amiss, but kept quiet to see who would offer the best deal. Indeed, in *Patient Care Services* and *LCOR*, the third parties actually had the temerity to try to take advantage of fiduciary disloyalty, openly pitting the principals in those cases against their own fiduciaries in bidding wars until courts intervened.

2. Remedies against Third Parties

Equitable relief against the fiduciary is the traditional and primary relief usually sought in Illinois corporate opportunity cases, and the same relief extends with full force to third parties who knowingly participate in or benefit from fiduciary misconduct. For example, unless the third party holds a position akin to a *bona fide* purchaser for value without notice, a court of equity always has the authority to impress a constructive trust on wrongfully obtained property a fiduciary transfers to complicit third parties.¹⁸⁵ This was the situation in the property usurpation decision in *Bakalis*. When Bressler obtained the property leased by the partnership, he gave it to his wife as a “gift.”¹⁸⁶ Despite this “gift,” the court ordered Bressler and his wife to convey half of the property ownership to Bakalis. The court did so, of course, because Bressler’s wife, having paid nothing for the property herself, could not qualify as a *bona fide* purchaser.

Unjust enrichment is another equitable theory commonly asserted against third parties in corporate opportunity cases. Williams’ liability for Savage’s wrongful gain in *Mullaney* furnishes one example of a third party’s liability for unjust enrichment in this context. Another, involving a slightly different fiduciary duty claim for bribery, can be found in *Chicago Park District v. Kenroy*.¹⁸⁷ That case arose at the dawn of “honest services” federal prosecutions of state and local officials for corruption,¹⁸⁸ with Chicago Alderman Paul Wigoda as one of the

185. *E.g.*, *Kenroy*, 78 Ill. 2d 555, 402 N.E.2d 181 (third party property owners who bribed public official to breach his fiduciary duties in connection with condemnation proceeding could be ordered to make restitution on the \$10 million condemnation award they received); *Winger*, 394 Ill. at 117, 67 N.E.2d at 279-80 (holding that third party Stice was not a *bona fide* purchaser in a breach of fiduciary duty case); *Village of Wheeling v. Stavros*, 89 Ill. App. 3d 450, 411 N.E.2d 1067 (1st Dist. 1980) (constructive trust may be imposed upon benefits obtained by a third person through his knowledge of or involvement in a public official’s breach of fiduciary duty).

186. *Bakalis*, 1 Ill. 2d 72, 75, 115 N.E.2d 323, 325 (1953).

187. *Kenroy*, 78 Ill. 2d 555, 402 N.E.2d 181.

188. WILLIAM E. BARNHART & EUGENE F. SCHLICKMAN, KERNER: THE CONFLICT OF INTANGIBLE RIGHTS 287-319 (1999) (examining the origin and

early prizes. Federal prosecutors pursued and convicted Wigoda for pocketing \$50,000 in bribes in return for rezoning property the Chicago Park District wanted to purchase for use as a golf course.¹⁸⁹ The net effect of Wigoda's bribe was to vastly increase the value of the property from \$5 million to \$10 million for condemnation purposes, leaving the bribe payers (the property owners) very happy on their investment returns. When the Chicago Park District discovered this fiduciary misconduct by Wigoda, it brought an action against the third party property owners to recover their unjust enrichment in the form of the excessive condemnation award. The Illinois Supreme Court found that this was a valid unjust enrichment cause of action against the property owners.¹⁹⁰

Just as the third-parties were subject to equitable relief in *Bakalis*, *Mullaney*, and *Kenroy*, a third party can also be liable for damages for another's breach of fiduciary duty. *Zokoych v. Spalding*¹⁹¹ offers an excellent example. In that case, greatly simplified, Zokoych and Spalding agreed to be equal owners of Ample Tool & Manufacturing, Inc. Spalding later transferred all of Ample Tool's assets to a new company, Spalding Manufacturing, leaving Zokoych with nothing but debts that he had guaranteed for Ample Tool. In order to accomplish this transfer, Spalding enlisted the help of Ample's bank, West Suburban Bank, which held a security interest in Ample Tool's assets. West Suburban Bank went along with Spalding's fraudulent transfer, later arguing that Ample Tool was in "default" under its loan agreement and that it was just protecting its security interest. The trial court found Spalding guilty of corporate opportunity usurpation and asset theft and rejected West Suburban Bank's argument that it was merely acting as a creditor, as the court determined no "default" had occurred on Ample Tool's part. Multiple trials and appeals then ensued, with each ending in an increased damages

history of the "honest services" / "intangible rights" doctrine in federal prosecutions of Illinois politicians, starting with former Governor Otto Kerner).

189. *United States v. Wigoda*, 521 F.2d 1221 (7th Cir. 1975) (affirming Wigoda's conviction).

190. The Illinois Supreme Court's imposition of fiduciary liability on public officials in *Kenroy* and *City of Chicago ex rel. Cohen v. Keane*, 64 Ill. 2d 559, 357 N.E.2d 452 (1976), anticipated by decades the current academic debate over the fiduciary foundations of public authority. See, e.g., D. Theodore Rave, *Politicians as Fiduciaries*, 126 HARV. L. REV. 671 (2013) (analogizing political incumbents' self-dealing in gerrymandering to corporate self-dealing problems); Heather K. Gerkin & Michael S. Karg, *Déjà Vu All Over Again: Courts, Corporate Law, and Election Law*, 126 HARV. L. REV. 86 (2013) (elaborating on Rave's agency cost parallel between corporate law and election law); Ethan J. Leib, David L. Ponet & Michael Serota, *Translating Fiduciary Principles Into Public Law*, 126 HARV. L. REV. 91 (2013) (questioning Rave's private law model for public actors).

191. 36 Ill. App. 3d 654, 344 N.E.2d 805 (1st Dist. 1976).

award in favor of Zokoych and against Spaulding and West Suburban Bank.¹⁹²

3. *No Contract Defenses for Third Parties*

Perhaps the most counterintuitive aspect of the third party “refusal to deal” problem is that remedies against the third party are derived from the claims against the fiduciary. In other words, even though the third party never entered into a contract with the plaintiff-principal and therefore cannot be directly liable to the principal, the third party can still be indirectly liable to the principal based upon the fiduciary’s actions. This means, in practice, that the third party will not be able to raise its contract defenses to the plaintiff’s opportunity diversion / vicarious liability claim against the third party.

No Illinois corporate opportunity case has directly addressed this “no contract defense” issue relating to third parties, but it was taken up by the Second Circuit Court of Appeals in *S & K Sales Co. v. Nike, Inc.*¹⁹³ Somewhat simplified, S & K Sales was a supplier looking to maintain its relationship with Nike. S & K’s key employee in charge of the Nike account, Johnson, approached Nike about jumping ship to Nike and cutting out the middle man – his employer S & K. Nike went along, Johnson switched sides, and then S & K sued both. After being found vicariously liable itself for Johnson’s \$1.1 million fiduciary duty liability, Nike appealed and argued that its contractual right to terminate its contract with S & K precluded the award against it. The Second Circuit disagreed:

Nike launches several attacks on the district court’s award of damages. It argues first that it could not be liable in damages for breaking the 1982 Agreement because that agreement was terminable on thirty days’ notice. As Judge Ward rightly noted, though, the fact that the agreement was terminable without cause is irrelevant when “the conduct alleged breaches a legal duty which exists independent of contractual relations between the parties.” *Hargrave v. Oki Nursery, Inc.*, 636 F.2d 897, 899 (2d Cir. 1980) (quoting *Channel Master Corp. v. Aluminum Limited Sales, Inc.*, 4 N.Y.2d 403, 408, 151 N.E.2d 833, 836, 176 N.Y.S.2d 259, 263 (1958)). Here, the duty breached by Johnson and participated in by Nike was clearly different from and independent of any duties under the 1982 Agreement. Thus, once it is established that the agreement was terminated as a result of Nike’s participation in Johnson’s breach, S & K was entitled to recover for its loss. *See Whitney*, 782 F.2d at 1115 (plaintiff is entitled to recover for “any damage” caused); *see also* Restatement (Second) of Torts § 874 & comment c.

This result is consistent with Illinois cases in other areas of

192. *See supra* note 158 (setting forth the subsequent history of the *Zokoych* case).

193. 816 F.2d 843 (2d Cir. 1987).

the law. For example, in *Kelsay v. Motorola, Inc.*,¹⁹⁴ plaintiff was an at will employee of Motorola. She claimed she was fired for asserting her workers' compensation rights following a workplace injury and brought a wrongful discharge action. Even though plaintiff was terminable at will as a contractual matter, the court held plaintiff could proceed with her retaliatory discharge "tort" claim. In other words, Motorola's contractual right to terminate Kelsay at will, meaning without cause and without notice – ordinarily a complete defense to a wrongful dismissal claim – was no defense to Kelsay's independent "tort" claim.

If a direct tort claim by one contract party against another is not subject to contract defenses, as in *Kelsay*, an indirect tort claim against a third party – whether cast as aiding and abetting or civil conspiracy – also should not be subject to contract defenses. The same is even truer when the plaintiff and the third party never had a contract with one another, and this is the typical scenario in corporate opportunity cases in which the fiduciary successfully seizes the opportunity before his principal and the third party have a chance to develop a relationship. Thus, the third party "defense" that it had an absolute right to terminate its contract with plaintiff, or that it had an absolute right not to renew its contract with plaintiff, or that it had an absolute right not to enter into a contract with plaintiff in the first place, is no defense at all to the third party's vicarious liability in tort arising from another's breach of fiduciary duty. The same should be at least as true when the third party's liability arises in equity, as in *Mullaney*.

III. POLICY AND PRECEDENT: BANNING THE THIRD PARTY REFUSAL TO DEAL DEFENSE

As this detailed review has shown, third parties always play some role in corporate opportunity cases. This has to be true in every case, since corporate opportunities by definition present three-cornered disputes: the plaintiff-principal and the defendant-fiduciary are vying for the third party's affections with respect to a deal. This configuration might seem to invite a balancing of the equities as among the three interested parties, but that is decidedly not the case in Illinois. As a matter of policy and precedent, the Illinois Supreme Court from *Kerrigan* forward has taken the view that the corporate opportunity doctrine is a "prophylactic" rule intended for the protection of trusting principals. If the defendant was in a fiduciary relationship with respect to the opportunity, and if the opportunity falls within the corporation's "line of business," fiduciary deterrence becomes the controlling policy consideration. Absent full disclosure, timely tender, and clear consent, the inquiry is at an end.

This is sound policy. It is not asking too much to require

194. 74 Ill. 2d 172, 384 N.E.2d 353 (1978).

fiduciaries to disclose and tender opportunities and to secure their principal's consent. This avoids all the uncertainty associated with after-the-fact inquiries to discern third party intent. It also avoids the time, effort, and cost expended in pursuing these third party intent inquiries. Avoiding unnecessary discovery and trial proceedings over irrelevant and fictional facts is all to the good. It also makes sense: nothing about the Illinois Supreme Court's categorical *Kerrigan* rule invites consideration of the interests of fiduciaries or third parties.¹⁹⁵

In the abstract, one could create a regime in which the motives of third parties could be examined *ad nauseum*, and in some instances – like the Franciscan Fathers in *Glasser v. Essaness Theatres Corp.*¹⁹⁶ – a court might even be able to declare with some confidence what the third party would or would not have done in the absence of the fiduciary's wrongdoing.¹⁹⁷ But as my review of Illinois cases in my second article shows, *Glasser* stands alone in this respect. In almost every other case, the third party happily took advantage of the situation, playing the fiduciary off against his principal to get what the third party undoubtedly believed was the best deal for the third party.¹⁹⁸ In the handful of cases in which the third party appeared adamantly opposed to the principal, the outcome can be explained on the grounds that the fiduciary either induced the third party's refusal, fueled it by angering the third party, or at least failed to quell it by making the best case for his principal – always as a prelude to the fiduciary's own proposal, of course.

Apart from wanting to get and keep the best deal, third parties have an entirely separate and arguably deeper motive to side with fiduciaries once they are caught in bed with them. In virtually every case, the third party faces potential liability for civil conspiracy, aiding and abetting, or collusion by virtue of its knowledge that the defendant-fiduciary was plaintiff's agent acting against the interests of his principal. In fact, of all the cases reviewed here, just one presented a factual scenario in which this was not true: only in *Mile-O-Mo* was a third party led to believe that the agent was acting *on behalf of* his principal in doing the

195. Cf. *Dowd & Dowd, Ltd.*, 181 Ill. 2d at 484, 693 N.E.2d at 371 (“The focus here is not on the conduct of the client in terminating the relationship, but on the conduct of the party inducing the breach or interfering with the expectancy”).

196. *Glasser v. Essaness Theatres Corp.*, 414 Ill. 180, 111 N.E.2d 124 (1953).

197. Cf. *United States v. Vrdolyak*, 593 F.3d 576 (7th Cir. 2010) (Posner, J.) (discussing possible actions prospective buyers might have taken in the absence of Vrdolyak's bribery / kickback scheme with fiduciary pretending to act on behalf of seller).

198. Cf. Epstein, *supra* note 4, at 959 (“Each partner may divert firm business to his own private account, all at a sporting discount, if only the customer remains quiet about the special arrangement”).

deal in his own name. Thus, unless a case presents the rare facts of *Mile-O-Mo*, or unless the third party had no reason to know the fiduciary was the agent for the principal in the first place, third parties should face secondary liability as a matter of course in Illinois corporate opportunity cases. One need only think of “receiving stolen goods” prosecutions to grasp this obvious point.¹⁹⁹

The third party refusal to deal defense clearly has no role in defining duty under *Kerrigan*, and it would be poor policy to invite the third party refusal to deal in through the back door of proximate cause. If this paper demonstrates nothing else, surely it shows that third parties are eager in every case to cut the best deal for themselves by pitting the principal against the agent. In most cases, this occurred without the principal’s knowledge, but in some – like *Patient Care Services* and *LCOR* – it took place openly. *Kerrigan*, however, is not an auction protection rule for the benefit of third parties; it is a loyalty enforcement rule for the benefit of principals.

In the end, the third party refusal to deal defense should be rejected for the most basic reason of all: it invites temptation. As Lord Chancellor King said nearly three-hundred years ago in *Keech v. Sandford*, “if a trustee, on refusal to renew, might have a lease to himself, few trust-estates would be renewed to the *cestui que use*.”²⁰⁰ That the third party landlord had refused to renew the lease in favor of the trust in *Keech* was no excuse for the trustee to seize it for himself. “It is sufficient that if he were permitted to keep the benefit, this would create the temptation to fiduciaries to act in that manner.”²⁰¹ Such conflicts of interest should be prohibited regardless of injury, as Justice Jackson elegantly explained in *Mosser v. Darrow*, “not because such interests are

199. *People v. Garmon*, 394 Ill. App. 3d 997, 916 N.E.2d 1191 (1st Dist. 2009) (evidence was sufficient to show that defendant knew the cell phones he purchased were stolen based on an explicit representation of a law enforcement officer).

200. Sel. Cas. T. King, 25 Eng. Rep. 223 (Ch. 1726), quoted in PALMER, *supra* note 1, §2.11, at 146 n. 18. Specifically, Lord Chancellor King in *Keech* held:

I must consider this as a trust for the infant; for I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to *cestui que use*; though I do not say there is a fraud in this case, yet he should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to *cestui que use*. So decreed, that the lease should be assigned to the infant, and that the trustee should be indemnified from any covenants comprised in the lease, and an account of the profits made since the renewal.

201. PALMER, *supra* note 1, §2.11, at 146.

always corrupt but because they are always corrupting.”²⁰²

IV. CONCLUSION

For both business and legal reasons, third party self-interest should be expected,²⁰³ which is why the categorical *Kerrigan* rule rightly ignores the third party’s interest. To say that the third-party’s position was etched in stone in any of these cases is to ignore both business reality and human nature. In all but the rarest case, there is no way to meaningfully test the “unalterability” of the third party’s refusal after-the-fact. Moreover, once caught, the third party has almost *no choice* but to side with the fiduciary, as the third party invariably faces potential collusion liability itself at that point and certainly faces business disruption through loss of its chosen partner, the fiduciary wrongdoer.²⁰⁴ These incentives call for a *per se* rule against such third party testimony.²⁰⁵

The best guide here is the oldest: trust law – the parent of fiduciary duty law. Trust law’s “no further inquiry” rule backed trust law’s foundational “sole interest” rule for precisely the reasons that concern us here.²⁰⁶ These trust rules originated in

202. *Mosser v. Darrow*, 341 U.S. 267, 271 (1950).

203. See JAMES B. STEWART, *TANGLED WEBS – HOW FALSE STATEMENTS ARE UNDERMINING AMERICA: FROM MARTHA STEWART TO BERNIE MADOFF* (2011) (exploring legal scandals featuring perjury and deception surrounding prominent figures Martha Stewart, Lewis “Scooter” Libby, Barry Bonds and Bernie Madoff); THOMAS O. MCGARITY & WENDY E. WAGNER, *BENDING SCIENCE: HOW SPECIAL INTERESTS CORRUPT PUBLIC HEALTH RESEARCH* (2008) (describing how self-interest has fueled wide-spread instances of scientific deception in and out of court); Charles W. Murdock, *Why Not Tell the Truth?: Deceptive Practices and the Economic Meltdown*, 41 *LOY. U. CHI. L. J.* 801, 801-29 (2010) (cataloging egregious instances of political, governmental, journalistic, scientific and business corruption over the past 15 years and how they have resulted in a crisis of truthfulness and a culture of deception).

204. Cf. Victoria Johnson, *Chilling Conspiracy Alleged in Suit: State Says Fix Was in on Price of Packaged Ice*, *CHICAGO SUN-TIMES*, March 13, 2011, at 25A (reporting lawsuit over alleged antitrust conspiracy among packaged ice companies, including clandestine meetings and almost daily emails to discuss prices and market allocations).

205. Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 *N.Y.U. L. REV.* 1045, 1074 (1991) (“[t]he duty of loyalty must be understood as the law’s attempt to create an incentive structure in which the fiduciary’s self-interest directs her to act in the best interest of the beneficiary”).

206. Judge Cardozo offered the rationale behind these rules in *Wendt v. Fischer*, 154 *N.E.* 303, 304 (N.Y. 1926) (quoting *Munson v. Syracuse, Geneva & Corning R.R.*, 8 *N.E.* 355, 358 (N.Y. 1886) (citations omitted):

[W]e are told that the [fiduciary] acted in good faith, that the terms procured were the best obtainable at the moment, and that the wrong, if any, was unaccompanied by damage. This is no sufficient answer by a trustee forgetful of his duty. The law “does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to

part out of concern over victimized beneficiaries' inability to prove fraud under the English Court of Chancery's "profoundly defective" investigative and fact-finding system in the late eighteenth and early nineteenth centuries made infamous in Dickens' *Bleak House*.²⁰⁷ Modern discovery and court procedures are vast improvements over the old English practice, to be sure. Yet *Mullaney* took 14 years to resolve,²⁰⁸ and *Vendo* was still going strong after 17 years.²⁰⁹ Indeed, the *Vendo* litigation literally outlived Vendo Company's fiduciary nemesis, Harry Stoner²¹⁰ – a circumstance calling to mind the 1839 lament quoted in Professor Langbein's duty of loyalty article: "No man, as things now stand, can enter into a Chancery suit with any reasonable hope of being alive at the termination if he has a determined adversary."²¹¹ Even after *Kerrigan* established its bright-line "disclose and tender" standard as glossed by *Vendo* and *Mullaney*, *Peterson Welding Supply* still required 21 witnesses to resolve a third party refusal to deal, and *Levy* still took 14 months to try this issue after years of discovery abuse and perjury.²¹² Clearly, the need for fiduciary deterrence is no less today than in Dickens' era,²¹³ but the ability to determine the truth in corporate opportunity cases remains as elusive as ever,²¹⁴ especially when the third party takes center stage, as these sad lessons from Illinois teach.

The *Kerrigan* "line of business" test is not a customer protection rule; it is a principal protection rule. The *Kerrigan*

enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case." Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.)

207. John H. Langbein, *Questioning the Trust Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L. J. 929, 945 (2005). Of course, criticism of the English Court of Chancery long pre-dated Dickens' lament. See J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 111 (Oxford U. Press 4th ed. 2007) ("For two centuries before Dickens wrote *Bleak House*, the word 'Chancery' had become synonymous with expense, delay and despair.").

208. Schaller, *supra* note 15, at 1035-36.

209. William Lynch Schaller, *Disloyalty and Distrust: The Eroding Fiduciary Duties of Illinois Employees*, 3 DEPAUL BUS. L. J. 1, 11-12 (1991) (recounting the *Vendo* litigation's epic history).

210. *Id.* at 12.

211. Langbein, *supra* note 207, at 946, n.78.

212. Schaller, *supra* note 15, at 1035.

213. *E.g.*, *Veritas Capital Management, LLC v. Campbell*, 918 N.Y.S.2d 448, 82 A.D.3d 529 (2011) (affirming dismissal of corporate opportunity action against Thomas Campbell, a Veritas hedge fund minority owner and employee, over \$100 million in "outside" investments Campbell made while still with Veritas).

214. Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor Langbein*, 47 WILLIAM & MARY L. REV. 541 (2005) (arguing that the concerns which gave rise to the "sole interest" and "no further inquiry" rules have not diminished appreciably over time).

requirements of tender and disclosure are simply not that onerous when compared with the risk of secret activity, the difficulty of verification after the fact, and the likelihood of induced unwillingness to deal. When it makes its inevitable appearance, the third party refusal to deal defense exponentially compounds the complexity of already-complicated Illinois corporate litigation, as reflected in the agonizing Illinois experience documented in my second article. For these reasons, the third party refusal to deal defense should be rejected as a matter of law and policy. To borrow the Illinois Supreme Court's penetrating observation in an early fiduciary duty case: "It requires no very keen moral perception to recognize the obvious justice of this universal rule of law, of justice and of morality."²¹⁵

215. *Dixmoor Golf Club, Inc. v. Evans*, 325 Ill. 612, 616, 156 N.E.2d 785, 787 (1927).

