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BREACHES OF FIDUCIARY DUTY AND EXCULPATORY CLAUSES IN ILLINOIS CONDOMINIUM DECLARATIONS

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As corporations became the pre-eminent means of doing business during the 19th century, Illinois courts needed to discern the responsibilities of those entrusted to manage the owners' investment in this new form of business organization. To do so, the courts looked to equity and, in particular, the law of agency and trusts. The early recognition of corporate fiduciary duties is briefly explored in Part I of this Article for the purpose of showing what would evolve into the relationship between corporate directors' fiduciary duties and the judiciary's rebuttable presumption of the business judgment rule.[1] This rule is designed to provide some level of protection for corporate directors against lawsuits by disgruntled investors.[2]

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1. Model Bus. Corp. Act, 5th ed. § 8.31, cmt. (AM. BAR ASS'N 2020).

> Courts have developed the broad common law concept of the business judgment rule. Although formulations vary, in basic principle, a board of directors generally enjoys a presumption of sound business judgment, and its decisions will not be disturbed by a court substituting its own notions of what is or is not sound business judgment if the board's decisions can be attributed to any rational business purpose. It is also presumed that, in making a business decision, directors act in good faith, on an informed basis, and in the honest belief that the action taken is in the best interests of the corporation.

Id.

2. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 93 (Harvard Univ. Press, 1991) (observing that "[b]ehind the business judgment rule lies recognition that investors' wealth

Part II of this Article looks to the role of condominium associations, a relatively recent form of property ownership, as not-for-profit corporations charged with managing the condominium property. As discussed in Part III below, with the acceptance of condominium property as a form of ownership was a recognition that condominium association directors owed fiduciary duties to unit owners.

This Article then examines, in Part IV, the impact of the Delaware Supreme Court's decision in *Smith v. Van Gorkom*,[3] which led to the legislative enactment and judicial recognition of exculpatory clauses in corporate organizational documents protecting directors from liability.[4] Within months of this Delaware decision, as discussed in Part V, the Illinois Supreme Court recognized in *Kelley v. Astor Investors, Inc.* that such exculpatory clauses in condominium declarations were enforceable.[5] The remainder of this Article explores the subsequent cases in Illinois which have either followed or ignored *Kelley*.

I. DEVELOPMENT OF CORPORATE FIDUCIARY DUTIES AND THE REBUTTABLE PRESUMPTION OF THE BUSINESS JUDGMENT RULE IN ILLINOIS

Since at least 1875, the Illinois Supreme Court has recognized that corporate directors owe fiduciary duties to their corporations.[6] One of the earliest reported decisions in Illinois recognizing directors' fiduciary duties was almost 150 years ago and involved a

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would be lower if managers' decisions were routinely subjected to strict judicial review").

3. 488 A.2d 858, 893 (Del. 1985) (holding that board of directors breached their fiduciary duty to the stockholders by failing to inform themselves of all information available and relevant about a corporate merger and failing to disclose all material information that reasonable stockholders would have wanted to know in approving the transaction).

4. *See generally* Platt v. Gateway Int'l Motorsports Corp., 351 Ill. App. 3d 326, 330 (5th Dist. 2004) (observing that "[a]n exculpatory agreement constitutes an express assumption of risk wherein one party consents to relieve another party of a particular obligation"). Sometimes legislatures will adopt legislation proscribing, prescribing, or permitting shifting liabilities through exculpatory clauses in agreements. *See* Zerjal v. Daech & Bauer Constr., Inc., 405 Ill. App. 3d 907, 912 (5th Dist. 2010) (recognizing that "[w]hen the legislature has intended to regulate the liability of parties, it has done so; the legislature has declared it to be against public policy for innkeepers, professional bailees, landlords, and building contractors to be exculpated from liability for their negligence").

5. Kelley v. Astor Investors, Inc., 106 Ill. 2d 505, 510 (1985).

6. *See generally* Gilman, Clinton & Springfield R.R. Co. v. Kelly, 77 Ill. 426, 436 (1875) (holding that a contract between a railroad and company which was to complete construction of the rail system was unlawful because the certain railroad directors later became stockholders and directors of the construction company).

railroad which, after selling stock and raising funds, subcontracted out the actual work of constructing the railroad's tracks in central Illinois.[7]

> The directors of a railroad company are, in an important sense, regarded as trustees for the stockholders, and it would be a breach of duty to transfer that trust, to assume obligations inconsistent with that relation; to place themselves in opposition to the interests of the stockholders, or in such position where their own individual interests would prevent them from acting for the best interests of those they represent. The rule is the same that applies to all persons acting in any fiduciary capacity that requires the utmost fidelity to the interests of the *cestui que trust*.[8]

The *Gilman* court had to determine whether three of the railroad corporation's directors could also be elected to serve on the board of the construction company that had a contract to complete construction of the railroad running from Gilman to Springfield, Illinois.[9] No evidence was presented that the construction contract was fraudulent, though, given the railroad's finances, the court acknowledged that it was doubtful that there would ever be any distributions to the shareholders bringing the action.[10] As part of the parties' several transactions, the remaining unpurchased shares of the railroad were transferred to the construction company without consideration, a transfer which vested control of the railroad in the construction company, even if the railroad's stock was essentially valueless and the railroad, which had lost money and issued over $600,000 in municipal bonds to local governments and $2,000,000 in bonds to mortgagees, was likely never to make a profit.[11]

At some time after the construction contract was signed and the stock was transferred, three directors of the railroad were invited to join the board of the construction company and at least two became stockholders in the construction company.[12] Each of these directors would likely profit from their role in the construction company but at the time of this litigation the profitability of the construction contract was not ascertainable. Looking to an equity principle that prohibited a trustee from speculating in the subject

7. *Id.*
8. *Id.* at 434.
9. *See id.* at 432 (concluding that

> Whether the contract was originally valid, is not now an important subject of inquiry; for if it was illegal for the directors to become members of the construction company, and participate in the profits, if any should be realized, that fact would establish a right in complainants to have an account taken, as clearly as though the contract, in the first instance, was unlawful).

10. *Id.* at 431.
11. *Id.* at 430-31, 433, 436.
12. *Id.* at 432.

of a trust, the court held that the directors could not serve on the construction company's board because the railroad had a contract to finish the construction of the railroad by which any profits would belong to the railroad.[13] The directors' duties to the railroad were "in antagonism" with their interests in the construction company.[14]

Noteworthy is the court's holding that the rule against directors entering into conflicting relationships is so strict that the court would not even consider a question as to whether the contract was objectively fair or whether any actual damages ensued from the breach.[15] The position taken by the *Gilman* court in its strict intolerance to any potential conflict of interest reflected the law throughout our country at the time.[16] Furthermore, the fact that the railroad's stockholders ratified the construction company's contract at a shareholders' meeting did not estop the stockholders' lawsuit because the stockholders were never informed that the three directors would be joining the construction company's board while continuing to serve on the railroad's board.[17] The Illinois Supreme Court affirmed the circuit court's decree finding the contract between the railroad and construction company illegal and void and the accompanying stock transfer void.[18]

The Illinois Supreme Courts' reliance on trust law[19] and a trustee's duties to infer the duties of corporate directors was not only typical of early corporate law cases, but also extended well into the early twentieth century as the law of business associations grew from its infancy into its own.[20] For decades law students have

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13. *Id.* at 432-33.

14. *Id.* at 433.

15. *Id.* at 435.

16. *Id.* at 434. Gilman cited and quoted from a United States Supreme Court opinion affirming, *inter alia*, that the administrators of a probate estate could not purchase property from the estate. Michoud v. Girod, 45 U.S. 503, 555, 560 (1846) (beginning its analysis with the premise that "[t]he general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity").

17. *Gilman*, 77 Ill. at 437. Here, we see an early example of the development of corporate common law in the United States where today it is recognized that shareholders may ratify a voidable, but not void, act of the directors. *See generally* Michelson v. Duncan, 407 A.2d 211, 219-20 (Del. 1979) (summarizing applicable law:

> If shareholders have approved an otherwise voidable act, their approval extinguishes any claim for losses based on prior lack of authority of the directors to undertake such action . . . Shareholder ratification is valid only where the stockholders so ratifying are adequately informed of the consequences of their acts and the reasons therefor).

18. *Gilman*, 77 Ill. at 437.

19. *See supra*, text accompanying note 12.

20. *See* Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAWYER 35 (1966). Professor Marsh's salient article from 1966 which examined the evolution of rules applied to corporate directors. *Id.* "In 1880 it could have been stated with confidence that in the United States

reflected upon the meaning of Justice Cardozo's (then Chief Judge) "punctilio of an honor the most sensitive[.]"[21]

The court applied an equitable principle from trust and agency law to declare the construction contract void.[22] By today's standards, the results in *Gilman* would be considered extreme because the court did not consider the objective fairness of the construction contract.[23] Although the court did not so say, presumably it did not consider whether any causation or injury resulted from the directors' breach because it was providing declaratory relief. Nevertheless, within the case's several holdings, one can see the foundation of the contemporary corporate fiduciary duty of loyalty.

The strict rule recognized and applied in *Gilman* evolved over

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the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction." *Id.* at 36.

> It could have been stated with reasonable confidence in 1910 that the general rule was that a contract between a director and his corporation was valid if it was approved by a disinterested majority of his fellow directors and was not found to be unfair or fraudulent by the court if challenged; but that a contract in which a majority of the board was interested was voidable at the instance of the corporation or its shareholders without regard to any question of fairness.

Id. at 40.

> By 1960, it could be said with some assurance that the general rule was that no transaction of a corporation with any or all of its directors was automatically voidable at the suit of a shareholder, whether there was a disinterested majority of the board or not; but that the courts would review such a contract and subject it to rigid and careful scrutiny, and would invalidate the contract if it was found to be unfair to the corporation.

Id. at 43. *See also* John Morley, *The Common Law Corporation: The Power of the Trust in Anglo-American Business History*, 116 COLUM. L. REV. 2145 (2016) (calling for a re-examination of the history of corporate law in England and the United States as an evolution of common law trusts).

21. *See* Meinhard v. Salmon, 164 N.E. 545, 546 (1928) (stating

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior).

22. *Gilman*, 77 Ill. at 434 (recognizing that "the rule stands on the obligation which a party owes to himself and his principal, that forbids him to assume a position which would ordinarily excite a conflict between his individual interest and a faithful discharge of his fiduciary duties").

23. *Id.* at 435 (admonishing "So strictly is this principle [*see supra*, note 21] adhered to, that no question is allowed to be raised as to fairness of the contract").

time with courts recognizing breach of fiduciary duty actions against directors who sat on both sides of transactions while also allowing for the consideration of objective fairness in the transaction. The evolution of corporate law in America has been impacted by a more than one-hundred year debate in corporate law as to the conflicts of shareholder, management, and stakeholder primacy.[24] This debate still thrives today.[25]

In *Dixmoor Golf Club, Inc. v. Evans*, the court continued to look to trust law for guidance, although it recognized the question presented as one of corporate law.[26] In that case, the court reasoned:

> The law is well settled that a trustee cannot without a breach of the trust deal with its subject matter in such a manner as to make a profit for his own benefit . . . The directors of a corporation are trustees of its business and property for the collective body of stockholders in respect to such business.[27]

However, the court acknowledged that in some circumstances, the fairness of the transaction to the corporation and candor of the directors in their disclosures would be considered.[28] By 1960, the Illinois Supreme Court clarified that it made no difference whether directors were individually on both sides of a transaction or were on the other side of the transaction through an entity which they controlled, such as by sitting on the counter-party's board.[29] The *Shlensky v. South Parkway Building Corp* court resolved a conflict in Illinois cases holding that the interested directors on both sides of the transaction had the burden of overcoming a presumption against the validity of the transaction by showing its fairness.[30] The court also held that where the interested directors fail to show the

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24. *C.f.* Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); A. A. Berle, *For Whom Corporate Managers Are Trustees,* 45 HARV. L. REV. 1365 (1932).

25. *Compare* Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAWYER 363 (2021) *with* Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy*, 76 BUS. LAWYER 397 (2021).

26. *See* Dixmoor Golf Club, Inc. v. Evans, 325 Ill. 612, 623-24 (1927) (holding that directors of a golf club were jointly and severally liable where they obtained options to purchase land for a golf club for themselves and then, without disclosure to the club members, sold the land to the golf club for 2.5 times what they paid, and they also took undisclosed commissions on membership shares sold to members).

27. *Id.* at 615-16.

28. *Id.* at 616-17.

29. *See* Shlensky v. South Parkway Bldg. Corp., 19 Ill. 2d 268, 281 (1960) (reversing the appellate court and affirming chancellor's decree finding directors of building management corporation breached their fiduciary duties where they controlled counter-parties on leases and directors failed to show the fairness of the lease transactions and chancellor charged directors' shares of stock in the corporation with the liability).

30. *Id.* at 280-81, 283.

fairness of the transaction, the court may either void the transaction or award damages against the directors for losses sustained by the corporation.[31]

A few years later, another person named Shlensky brought what would become a textbook case on suing corporate directors for the mismanagement of a corporation, *Shlensky v. Wrigley*.[32] Plaintiff brought a derivative action against the directors of the Delaware corporation which owned and operated Wrigley Field where the Chicago Cubs play professional baseball.[33] The complaint charged that the directors, especially Philip K. Wrigley, who was also president and 80% shareholder of the corporation at that time, were negligent and mismanaged the team by refusing to install lights and schedule night games.[34] As reflected in the court's opinion, the plaintiff made a compelling showing how the corporation was sustaining operating losses and financially deteriorating by not hosting night games in comparison to the heightened earnings of other teams, including the Chicago White Sox, whose weeknight games drew a larger attendance than the Cubs daytime games.[35]

Philip Wrigley opposed installing lights largely because of his belief that baseball was a daytime sport and that installing lights would deteriorate the neighborhood.[36] The court's analysis began by observing from both Illinois and Delaware cases that corporate law has long recognized that corporate directors serve the majority of shareholders and that absent fraud or some other legal violation, courts should not inject themselves into the affairs of managing the corporation.[37] Although it was likely that under the internal affairs

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31. *Id*. at 283.

32. Shlensky v. Wrigley, 95 Ill. App. 2d 173, 174 (1st Dist. 1968).

33. *Id*. at 175.

34. *Id.* at 174-75.

35. *Id.* at 175-76.

36. *Id.* at 176.

37. *Id.* at 177-78. Throughout the development of 20th Century corporate law, courts have repeatedly recognized that they should not be second-guessing management absent misconduct. *Id.*; *see generally* EASTERBROOK & FISCHEL, *supra* note 2, at 93-102 (Judge Easterbrook and Professor Fischel reject the common justifications that judges are not competent to review business decisions or that such review will dissuade risk or talented people from becoming managers; they conclude limits exist on the utility of liability rules to assure contractual performance). Shlensky v Wrigley, 95 Ill. App. 2d at 179-80 and Dodge v. Ford Motor Co., 204 Mich. 459, 499-500 (1919) both quote from a Michigan case cautioning judicial restraint:

> Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud or breach of that good faith which they are bound to

doctrine,[38] Delaware law should have controlled, the court never addressed the question of controlling law and the remainder of the decision relied upon Michigan and Illinois jurisprudence.[39] The court held for defendants, thereby refusing to substitute its business judgment for that of the directors.

For example, it appears to us that the effect on the surrounding neighborhood might well be considered by a director who is considering the patrons who would or would not attend the games if the park were in a poor neighborhood. Furthermore, the long run interest of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating. By these thoughts we do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability.[40] In effect, the appellate court adopted the defendants' argument that "the courts will not step in and interfere with the honest business judgment of the directors unless there is a showing of fraud, illegality or conflict of interest."[41]

In 1984, a bank shareholder brought a derivative action against the bank and its directors alleging that they mismanaged certain loans in the bank that were defaulted on and that the bank president and board chair who was in ill health with heart disease was overpaid (nearly $650,000 over a five-year period).[42] After a

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> exercise toward the stockholders.

Hunter v. Roberts, Throp & Co., 83 Mich. 63, 71 (1890).

38. Edgar v. Mite Corp., 457 U.S. 624, 645 (1982) (summarizing:

> The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands.

(citing Restatement (Second) of Conflicts of Laws § 302, cmt. b (1971)).

39. On the question presented, it did not appear that the results would have changed notwithstanding the application of Illinois, Delaware, or Michigan law in 1968. The Michigan cases discussed included the textbook case of *Dodge*, 204 Mich. at 507-08 and *Shlensky*, 95 Ill. App. 2d at 179. In *Dodge v. Ford Motor Co.,* the Dodge brothers, as ten percent minority shareholders, sought to compel Henry Ford to charge more for his cars to increase profits and to reverse his policy of putting money back into the corporation rather than make shareholder distributions. *Dodge*, 204 Mich. at 492-93. Ford argued that his ambition was to hire more employees and spread the benefits of industrialization to more people. *Id.* at 505-07. The Michigan Supreme Court recognized that "[a] business corporation is organized and carried on primarily for the profit of the stockholders." *Id.* at 507. However, the court was not persuaded that it should interfere with the discretion of the directors is determining the expansion of the corporate business. *Id.* at 507-08.

40. *Wrigley*, 95 Ill. App. 2d at 180-81.

41. *Id.* at 177.

42. Fields v. Sax, 123 Ill. App. 3d 460, 464-65 (1st Dist. 1984).

thirteen-day trial, the court entered defendants' motion for judgment at the close of the plaintiff's case in chief, and plaintiff appealed.[43] The appellate court affirmed, recognizing what could be described as the basis of the business judgment rule in Illinois.[44]

> Directors must exercise that degree of care and prudence that men prompted by self-interest exercise in the management of their own affairs . . . A corporate director will not be held liable for honest errors or mistakes of judgment as long as the decision does not involve fraud, illegality or conflict of interest . . . Further, where the acts complained of are corporate decisions which fall within the purview of the business judgment rule, this court is without authority to substitute its judgment for the lawful decisions of the directors.[45]

The court analyzed the president's health situation and the evidence presented at trial showing all he had accomplished and performed on a regular basis notwithstanding his heart disease.[46] The court also analyzed the three substantial defaulted loans and did not detect any wrongdoing in connection with accepting settlements of sixty-six percent, seventy-five percent, and eighty-six percent recovery on defaulted bank loans.[47] At the end of this opinion, language is found that Illinois courts would subsequently use in describing the standard of liability for breach of fiduciary duty actions in Illinois: "[a]bsent evidence of bad faith, fraud, illegality, or gross overreaching, courts are not at liberty to interfere with the exercise of business judgment by corporate directors."[48]

In 1993, the Illinois Director of Insurance filed an action against the outside directors of an insolvent insurance company alleging negligence and breaches of fiduciary duty.[49] The complaint alleged a long list of failures by the directors in managing the insurance company and pled that these breaches caused more than $100 million in damages.[50] Two defendant directors moved to

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43. *Id.* at 462.

44. *Id.* at 467 (in analyzing the plaintiff's allegation that the president was over-compensated and that the board should not have settled the defaulted loan claims as it did, the court began with the proposition that honest mistakes and errors of judgment are not in themselves a basis for director liability).

45. *Id.* at 463-64.

46. *Id.* at 464.

47. *Id.* at 464-67.

48. *Id.* at 467. This language would be quoted in articulating the business judgment rule in Goldberg v. Astor Plaza Condo. Ass'n, 2012 IL App. (1st) 110620 at ¶ 63.

49. Stamp v. Touche Ross & Co., 263 Ill. App. 3d 1010, 1011 (1st Dist. 1993).

50. *See id.* at 1012-13 (listing the range of breaches, including failing to develop and implement adequate procedures and controls with regard to underwriting, reserves, collections; underpricing insurance and reinsurance; failing to increase reserves or to set reserve liabilities; understating reserves; failing to plan for or control large premium growth; paying excessive commissions to managing agents; failing to oversee agent performance; failing to require agents to keep accurate books and records; failing to draw down timely on letters of credit; abdicating management responsibilities to other

dismiss the breach count, which the court granted, relying on *Shlensky v. Wrigley* because the complaint did not allege "any wrongdoing bordering on fraud, illegality, or conflict of interest" and therefore "the business judgment rule protected defendants from liability for honest errors or mistakes in judgment."[51] In affirming dismissal of the breach claims (but allowing plaintiff leave to amend the complaint for reasons not relevant here), the appellate court reiterated the *Shlensky* standard and then added from *Fields*:

The exercise of due care is a prerequisite to the applicability of the business judgment rule and consequently directors may still be held liable for damages caused by their lack of due care in carrying out their duties. If due care is exercised, however, then the business judgment rule is applicable to preclude director liability for erroneous judgments absent conduct involving fraud, illegality or conflict of interest.[52]

In *Ferris Elevator Co. v. Neffco, Inc.*, the appellate court clarified the role of the business judgment rule in Illinois as a rebuttable presumption that was a "bursting bubble."[53] The court rejected plaintiff's argument that the business judgment rule did not apply because plaintiff was challenging the process by which the directors made a decision, not the decision itself.[54]

> [T]he business judgment rule is a presumption that corporate decisions made by directors are made on an informed basis and with the honest belief that the course taken is in the best interests of the corporation . . . The burden is on the party challenging the decision to present facts rebutting the presumption . . . Illinois follows the bursting bubble theory, which provides that once evidence is established which contradicts the presumption, the presumption vanishes . . . Thereafter, because the presumption has ceased to operate, it is error to instruct the jury with regard to the presumption.[55]

Under the bursting bubble theory, the presumption of the business judgment rule need not be pled as an affirmative or special

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companies; failing to supervise the affairs of subsidiaries; failing to keep correct and adequate books and records; violating specific provisions of the Insurance Code; and failing to accurately disclose the company's true financial condition).

51. *Id.* at 1014.

52. *Id.* at 1016 (citing *Fields*, 123 Ill. App. 3d at 460).

53. Ferris Elevator Co. v. Neffco, Inc., 285 Ill. App. 3d 350, 355 (3rd Dist. 1996).

54. *Id.* at 354 (finding that

> the business judgment rule is a presumption which applies to all directors who allegedly fail to inform themselves before making corporate decisions . . . Therefore, we hold that until evidence is put forth which suggests that the directors failed to act on an informed basis, they enjoy the presumption of the rule.)

55. *Id.* at 355.

defense because it is not either.[56]

II. CONDOMINIUM ASSOCIATIONS TREATED AS CORPORATE ENTITIES

A condominium association manages the land and common elements owned by the unit owners.[57] The Illinois Condominium Property Act provides that an association may be incorporated as an Illinois not-for-profit corporation.[58] Even if the association does not incorporate as such, it still has the powers and responsibilities of an Illinois not-for-profit corporation.[59] Once an association is incorporated, its board of managers is usually referred to as a board of directors.[60] In practice, the terms "board of managers" and "board of directors" have become interchangeable and refer to the same deliberative body vested with administration and control of the condominium property outside the units and the conduct of the unit owners living in this collective housing environment.[61]

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56. *Id.* at 355.

57. *See* 765 ILL. COMP. STAT. ANN. 605/18.3 (2022) (stating that

> The unit owners' association is responsible for the overall administration of the property through its duly elected board of managers. Each unit owner shall be a member of the association . . . The association shall have and exercise all powers necessary or convenient to effect any or all of the purposes for which the association is organized, and to do every other act not inconsistent with law which may be appropriate to promote and attain the purposes set forth in this Act or in the condominium instruments.)

58. *See* 765 ILL. COMP. STAT. ANN. 605/18.1(a) (2022) (stating that "[t]he owner or owners of the property, or the board of managers, may cause to be incorporated a not-for-profit corporation under the General Not For Profit Corporation Act of the State of Illinois for the purpose of facilitating the administration and operation of the property").

59. *See* 765 ILL. COMP. STAT. ANN. 605/18.3 (2022) (stating "[t]he association, whether or not it is incorporated, shall have those powers and responsibilities specified in the 'General Not For Profit Corporation Act of 1986' that are not inconsistent with this Act or the condominium instruments, including but not limited to the power to acquire and hold title to land").

60. *See* 765 ILL. COMP. STAT. ANN. 605/18.3 (2022) (stating that

> The board of directors of such corporation shall constitute the board of managers provided for in this Act, and all of the rights, titles, powers, privileges and obligations vested in or imposed upon the board of managers in this Act and in the declaration may be held or performed by such corporation or by the duly elected members of the board of directors thereof and their successors in office).

See also Robinson v. LaCasa Grande Condo. Ass'n, 204 Ill. App. 3d 853, 857 (4th Dist. 1990) (stating that "The board of directors of a not-for-profit corporation constitutes the board of managers provided for in the Condominium Act" (citing ILL. REV. STAT. 1985, ch. 30, par. 318.1(d) (now codified at 765 ILL. COMP. STAT. ANN. 605/18.1(d) (2022))).

61. *See* 765 ILL. COMP. STAT. ANN. 605/18.4(a) (2022) (stating that "[t]he

III. CONDOMINIUM DIRECTORS OWE FIDUCIARY DUTIES

In 1983, the Illinois appellate court recognized that directors of condominium associations owed unit owners quasi-fiduciary or fiduciary duties.[62] The *Wolinsky* court did not rely on any controlling authority for this holding or even discuss what it identified as quasi-fiduciary[63] or fiduciary duties. Instead, the court referred to a prior Illinois case where a developer converting an apartment building to condominium property was found not to be in a relationship of special confidence with a tenant and therefore, did not owe the tenant any fiduciary duties.[64] The *Wolinsky* court also referenced, without discussion, a law review article by a Florida condominium lawyer and a condominium law treatise.[65] The court's analysis recognized that the directors owed fiduciary duties consisted solely of one paragraph.[66]

A fiduciary relationship exists where there is special confidence reposed in one who, in equity and good conscience, is bound to act in good faith with due regard to the interests of the other . . . We believe that all condominium association officers and board members become fiduciaries to some degree when they take office . . . Because the association officers and board members owe a fiduciary or quasi-fiduciary duty to the members of the association, they must act in a manner reasonably related to the exercise of that duty, and the failure to do so will result in liability not only for the association but also for the individuals themselves.[67]

That same year, the Illinois General Assembly amended the Illinois Condominium Property Act to recognize that directors owe unit owners a fiduciary duty of care.[68] "In the performance of their

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board of managers shall exercise for the association all powers, duties and authority vested in the association by law or the condominium instruments except for such powers, duties and authority reserved by law to the members of the association").

62. Wolinsky v. Kadison, 114 Ill. App. 3d 527, 533 (1st Dist. 1983).

63. *See generally Wolinsky*, 114 Ill. App. 3d at 533-34. The court did not elaborate on why it was characterizing the directors' duties as quasi-fiduciary or what it meant by this term. We can only speculate that the court recognized that it was venturing into new territory in recognizing that essentially volunteer directors of a condominium association owed fiduciary duties.

64. Jones v. Eagle II, 99 Ill. App. 3d 64, 72 (1st Dist. 1981).

65. *See Wolinsky*, 114 Ill. App. 3d at 533-34 (citing Wayne S. Hyatt & James B. Rhoads, *Concepts of Liability in the Development and Administration of Condominium and Home Owners Associations*, 12 WAKE FOREST L. REV. 915, 946 (1976)).

66. *See Wolinsky*, 114 Ill. App. 3d at 533-34 (citing Jones v. Eagle II, 99 Ill. App.3d 64, 72 (1st Dist. 1981) (quoting "[a] fiduciary relationship exists where there is special confidence reposed in one who, inequity and good conscience, is bound to act in good faith with due regard to the interests of the other")).

67. *Wolinsky*, 114 Ill. App. 3d at 533.

68. Pub. Act 83-833, §1, eff. July 1, 1984 (1983 Ill. Laws 5424).

duties, the officers and members of the board, whether appointed by the developer or elected by the unit owners, shall exercise the care required of a fiduciary of the unit owners."[69] This language was appended to the end of section 18.4 of the Act describing the powers and duties of the board.

One of the earliest opinions to address the fiduciary duties of condominium directors was Robinson v. LaCasa Grande Condominium Association.[70] Plaintiff's estate sued, inter alia, individual directors of the condominium association in a case of first impression for negligence in operating a swimming pool on the condominium property where the ten-year-old plaintiff girl drowned and died.[71] The court's analysis began with the premise that "an examination of condominium association law in Illinois, still a new area in this State."[72]

The first issue that the Robinson court rejected was defendants' argument that § 108.70 of the Illinois Not For Profit Corporation Act,[73] which exculpated directors from liability except for willful or wanton acts or omissions.[74] Section 108.70 provided such exculpation[75] to directors and officers of not-for-profit corporations (a) who served without compensation excluding reimbursement of expenses, and (b) if the corporation was tax exempt or qualified for tax exemption under section 501(c) of the Internal Revenue Code of 1954.[76] Defendants' argument failed because in the course of adopting a new § 528[77] to the Internal Revenue Code under the Tax Reform Act of 1976, Congressional legislative history affirmed that a homeowners' association is not

69. 765 ILL. COMP. STAT. ANN. 605/18.4 (2022) (originally codified at ILL. REV. STAT. 1985, ch. 30, par. 318.4). In *Robinson*, the court quoted the original language of the legislation as: "In the performance of their duties, the officers and members of the board are required to exercise, whether appointed by the developer or elected by the unit owners, the care required of a fiduciary of the unit owners." *Robinson,* 204 Ill. App. 3d at 857.

70. 204 Ill. App. 3d 853 (4th Dist. 1990).

71. *Id.* at 855.

72. *Id.* at 856.

73. Now codified as § 108.70(a) of the Illinois General Not For Profit Corporation Act of 1986, 805 ILL. COMP. STAT. ANN. 105/108.70(a) (2022).

74. *Robinson*, 204 Ill. App. 3d at 857-59.

75. *Id.* at 858 (summarizing certain requisites under § 108.70:

> To exempt the board of managers from liability under this statute, several prerequisites must be met. First, the directors must serve without compensation. Second, the corporation must be organized under the Not For Profit Corporation Act. Next, the corporation must be exempt from or qualify for exemption from taxation under Federal law . . . If these requisites are satisfied, then the analysis moves to the final requirement: the conduct of the directors or officers must not have been willful or wanton).

76. 26 U.S.C. § 501(c) (2022).

77. 26 U.S.C. § 528 (2022) (exempting qualifying homeowners', condominium, and timeshare associations from income tax).

qualified as a § 501(c) organization unless the common areas and facilities it maintains are for the use and enjoyment of the general public.[78] In Robinson, the condominium association's common areas were not open to the general public.[79]

The second issue addressed by Robinson was whether the association's corporate directors could be liable for negligent performance of their duties.[80] The court found that the directors could not be liable for negligence because they were fiduciaries of the unit owners, and therefore they could not be liable in tort for breaches of their fiduciary duties.[81]

> The members of the board of managers cannot be liable for negligent performance of their duties. The Condominium Act specifically makes the members of the board of managers fiduciaries of the unit owners . . . The law in Illinois is that breach of a fiduciary duty is not a tort. The Illinois Supreme Court has regarded the breach of fiduciary duty as controlled by the substantive laws of agency, contract and equity [as opposed to tort law].[82]

Where unit owners desire to sue an association for mismanagement, the means of doing so is through breach of fiduciary duty actions, which in Illinois, as recognized by Robinson, sound in contract, not tort.[83] *Carney v. Donley* is an example of a condominium case where board directors acted improperly but was not found to breach their fiduciary duties.[84] The board incorrectly granted three unit owners the right to extend their balconies which required breaking through concrete patios below and constructing supporting posts on the common elements.[85] A unit owner opposed to the extension filed an action for injunctive and other relief, although it is not clear from the opinion whether his action for breach of fiduciary duty against the directors was a derivative claim.[86]

In any event, the trial court granted summary judgment for

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78. *Robinson*, 204 Ill. App. 3d at 858-59 (relying upon H.R. Rep. No. 94-658, 94th Cong., 1st Sess. At 326-32; S. Rep. No. 94-938, 94th Cong., 2d Sess. at 393, U.S. Code Cong. & Admin. News 1976, pp. 2897, 3222-28, 3821).

79. *Robinson*, 204 Ill. App. 3d at 859.

80. *Id.*

81. *Id.*

82. *Id.* (*citing* Kinzer v. City of Chicago, 128 Ill.2d 437, 445 (1989)).

83. *Robinson*, 204 Ill. App. 3d at 859 (recognizing that "[t]he law in Illinois is that breach of a fiduciary duty is not a tort").

84. Carney v. Donley, 261 Ill. App. 3d 1002 (2d Dist. 1994).

85. *Id.* at 1003-04.

86. Davis v. Dyson, 387 Ill. App. 3d 676, 682 (1st Dist. 2008) ("[a] derivative action is an action that a corporate shareholder brings on behalf of a corporation to seek relief for injuries done to that corporation, where the corporation either cannot or will not assert its own rights") (citing Meyer v. Fleming, 327 U.S. 161, 167 (1946) (summarizing that derivative actions arise from equitable remedies where management, through fraud, nonfeasance, or other misfeasance, fails to assert a corporation's rights)).

defendant directors and the association.[87] The appellate court reversed, entering summary judgment for the plaintiff because the condominium declaration stated that any diminishment of the common elements of the property required unanimous approval of the ninety-one unit owners, which did not occur here.[88] The court also found that the board had not breached its fiduciary duty to the unit owners in misconstruing the declaration because it properly exercised its business judgment and therefore plaintiff's request for attorneys' fees and costs was denied.[89] In executing their duties, the directors sought legal advice before reaching its decision, a director interested in the decision recused himself from voting, and the board relied on the legal advice (which was apparently wrong) in making its decision.[90] "Under these circumstances, [the court could not] say that the Board acted unreasonably or failed to exercise properly its business judgment."[91]

In *Goldberg v. Astor Plaza Condo. Ass'n*,[92] plaintiff alleged that the association breached its fiduciary duty by failing to pay for and effect the repair of her unit's window frames and windows.[93] The appellate court began its analysis with a quote from *Fields* that "[u]nder the business judgment rule, 'absent evidence of bad faith, fraud, illegality, or gross overreaching, courts are not at liberty to interfere with the exercise of business judgment by corporate directors.'"[94] The court found that the board acted with due care in informing themselves of material facts necessary to make their business judgment because the board sought legal advice before reaching its decision and relied on the advice.[95] In what has become in practice a leading case on breaches of fiduciary duty by condominium directors, *Palm v. 2800 Lake Shore Drive Condominium Association,*[96] the court echoed the quadruple factor test for rebutting the presumption of the business judgment rule - bad faith, fraud, illegality, or gross overreaching.[97]

IV. LEGISLATORS ADOPT EXCULPATORY CLAUSES AFTER DELAWARE DECISION

In late January 1985, the Supreme Court of Delaware issued a corporate breach of fiduciary duty decision, *Smith v. Van Gorkom*,[98]

87. *Carney*, 261 Ill. App. 3d at 1005.
88. *Id.* at 1010.
89. *Id.* at 1011.
90. *Id.*
91. *Id.*
92. 2012 IL App (1st) 110620.
93. *Goldberg*, 2012 IL App. (1st) 110620, ¶ 14.
94. *Id.* at ¶63 (citing *Fields*, 123 Ill. App. 3d at 460).
95. *Goldberg*, at ¶¶ 64-65.
96. 2014 IL App (1st) 111290 [hereinafter *Palm II*].
97. *See id.* at ¶ 111 (reiterating the quadruple test).
98. 488 A.2d 858, 893 (Del. 1985).

that would send shock waves throughout corporate America.[99] The *Van Gorkom* decision caused an insurance crisis in the directors and officers insurance industry and led legislators to race to develop corporate protections for the corporate directors producing revenue to the states through franchise and other taxes paid for the privilege of being incorporated in each state.[100] The facts of *Van Gorkom* are long and involved meetings and negotiations over several months for members of the Pritzker family to buy-out Trans Union Corporation, a holding company primarily generating its earnings in the railway leasing business.[101]

The case arose as a class action in the Delaware Court of Chancery brought by shareholders of the defendant Trans Union Corporation whose stock was purchased for cash through a merger with a subsidiary of defendant Marmon Group, Inc.[102] Money damages were also sought from the ten individual directors of Trans Union, some officers, and two members of the Pritzker family who were owners of Marmon.[103] As Justice McNeilly's dissent in *Van Gorkom* illustrates, the Trans Union directors in this lawsuit were accused of breaching their fiduciary duties by failing to be sufficiently informed about the transaction the five "inside" (that is, employee) directors of Trans Union had been collectively employed by Trans Union for 116 years and had collectively served as directors for sixty-eight years.[104]

The five outside Trans Union directors were impressively credentialled: all but one were chief executive officers of Chicago corporations at least as large as Trans Union; collectively they had seventy-eight years' experience as chief executive officers; they had served collectively on Trans Union's board for fifty-three years; one was an economist, math statistician, professor at Yale, dean of the business graduate school at the University of Chicago, and

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99. *See generally Van Gorkom*, *infra* notes 112-15 and accompanying text (discussing the impact of Van Gorkom in creating an insurance crisis and leading to legislative action).

100. *See* Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001) (stating that

> [A]s a matter of the public policy of this State. Section 102(b)(7) was adopted by the Delaware General Assembly in 1986 following a directors and officers insurance liability crisis and the 1985 Delaware Supreme Court decision in *Smith v. Van Gorkom*. The purpose of this statute was to permit stockholders to adopt a provision in the certificate of incorporation to free directors of personal liability in damages for due care violations, but not duty of loyalty violations, bad faith claims and certain other conduct. Such a charter provision, when adopted, would not affect injunctive proceedings based on gross negligence.).

101. *Van Gorkom*, 488 A.2d at 864-70. Although this is a Delaware case, it is a Chicago story complete with contract negotiations during festivities before opening night at the Lyric Opera. *Id.*

102. *Id.* at 863.

103. *Id.*

104. *Id.* 488 A.2d at 894 (McNeilly, J., dissenting).

Chancellor of the University of Rochester, and served on several boards of well-recognized national and international corporations; another director was a University of Pennsylvania law graduate and had been president and director of several large corporations; another was a certified public accountant and served on several boards; another graduated attended Harvard and University of Chicago business schools and served on seven boards of large corporations; and another was a chemist who served as chief executive officer and chair of U.S. Gypsum and had been involved in thirty-one or thirty-two corporate takeovers.[105]

As Justice McNeilly summarized: "These men knew Trans Union like the back of their hands and were more than well qualified to make on the spot informed business judgments concerning the affairs of Trans Union including a one-hundred percent sale of the corporation."[106] The Delaware Supreme Court began its analysis recognizing the Delaware standard of care owed by corporate directors in a duty of care case, as distinguished from a duty of loyalty case,[107] and the standard of liability given the business judgment rule.[108]

> [A] director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty. Here, there were no allegations of fraud, bad faith, or self-dealing, or proof thereof. Hence, it is presumed that the directors reached their business judgment in good faith . . . and considerations of motive are irrelevant to the issue before us. The standard of care applicable to a director's duty of care has also been recently restated by this Court . . .

105. *Id.*

106. *Id.* at 895.

107. Fiduciary duties owed by corporate directors and officers may vary among jurisdictions in the United States but are generally described as being a duty of loyalty and a duty of care. One of the better descriptions of the demarcation of fiduciary responsibilities into these two camps is contained in § 8.30 of the Model Business Corporation Act, which defines the standards of conduct of directors. Subsection (a) describes the duty of loyalty owed: "Each member of the board of directors, when discharging the duties of a director, shall act: (i) in good faith; and (ii) in a manner the director reasonably believes to be in the best interests of the corporation." Model Bus. Corp. Act, 5th ed. § 8.30(a) (AM. BAR ASS'N 2020). Subsection (b) describes the duty of care owed: "The members of the board of directors or a board committee, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances." Model Bus. Corp. Act, 5th ed. § 8.30(a) (AM. BAR ASS'N 2020).

108. *Id.* at 872. One way of visualizing the relationship of these rules is to imagine the standard of care as the base upon which the presumption of the business judgment rule is laid to isolate these activities constituting a breach of the standard of care (suppose negligence) from liability. To obtain liability, the plaintiff needs to puncture the rebuttable presumption by proving the standard of liability, which is an elevated standard (suppose gross negligence).

> While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence. We again confirm that view. We think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one.[109]

The Delaware Supreme Court reversed the Court of Chancery and held that the board of directors' approval of the merger was not an informed business judgment; that their subsequent efforts to amend the merger agreement were ineffectual; and that the board did not deal in complete candor with the shareholders in obtaining their ratification of the merger.[110] The court entered judgment against the individual directors "for the fair value of the plaintiffs' stockholdings in Trans Union[.]"[111]

As noted above, the fallout from this decision holding directors of a publicly-traded corporation personally liable for gross negligence in exercising their duty of care in a merger was enormous.[112] As a direct result, the following year the Delaware legislature amended the Delaware General Corporation Law to add § 102(b)(7) which permits a Delaware corporation add an exculpatory clause to its certificate of incorporation "eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director" provided that the exculpation may not include (a) a breach of the duty of loyalty owed to the corporation and shareholders; (b) acts or omissions not in good faith, or which involve intentional misconduct or knowing violations of law; (c) certain unlawful payments of dividends; or (d) transactions from which the director derived an improper personal benefit.[113]

States throughout the country adopted similar legislation in their general corporation laws permitting corporations to add exculpatory clauses to their charters.[114] In Illinois, for example, section 2.10(b)3) of the Business Corporation Act of 1983 currently

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109. *Id.* at 872-73 (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

110. *Van Gorkom*, 488 A.2d at 864.

111. *Id.*

112. *See* EASTERBROOK & FISCHEL, *supra* note 2, at 107 (observing that "[i]t is not hard to see why the case produced such a swift and sweeping reaction. Judicial inquiry into the amount of information managers should acquire before deciding creates the precise difficulties that the business judgment rule is designed to avoid").

113. DEL. CODE. ANN. tit. 8, § 102(b)(7) (1983 and Supp. 1986).

114. James B. Behrens, *Delaware Section 102(b)(7): A Statutory Response to the Director and Officer Liability Insurance Crisis*, 65 WASH. U. L. Q. 481, 482 (1987) ("[s]ection 102(b)(7)-type statutes broaden the scope of director protection by permitting corporations to shield directors from liability for grossly negligent acts. This type of statute differs from the typical indemnification provision because it affects the shareholder's cause of action").

has such a provision that is similar to that adopted in Delaware.[115]

> Sec. 2.10. Articles of Incorporation. The articles of incorporation shall be executed and filed in duplicate in accordance with Section 1.10 of this Act . . .
>
> (b) The articles of incorporation may set forth:
>
> . . .
>
> (3) a provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, provided that the provision does not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its shareholders, (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, (iii) under Section 8.65 of this Act, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring before the date when the provision becomes effective.[116]

Neither the Illinois Condominium Property Act[117] nor the Illinois General Not For Profit Corporation Act of 1986[118] contains any provisions regarding exculpatory clauses in the organizational documents. However, just a few months after the *Van Gorkom* decision, the Illinois Supreme Court affirmed that exculpatory clauses in condominium declarations were enforceable with certain exceptions.[119]

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115. Section 102(b)(7) of the Delaware General Corporation Law relevantly provides:

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters: . . . (7) A provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its shareholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective.

116. 805 ILL. COMP. STAT. ANN. 5/2.10(b)(3) (2022).
117. 765 ILL. COMP. STAT. ANN. 605/1 *et seq.* (2022).
118. 805 ILL. COMP. STAT. ANN. 105/101.01 *et seq.* (2022).
119. *Kelley*, 106 Ill. 2d at 505.

V. ILLINOIS RECOGNIZES EXCULPATORY CLAUSES IN CONDOMINIUM DECLARATIONS.

A few months after *Van Gorkom* was decided, the Illinois Supreme Court recognized in *Kelley v. Astor Inv., Inc.*[120] that exculpatory provisions limiting or vitiating liability in condominium declarations or bylaws are valid.

> While it is true that the legislature has enacted an amendment to the Condominium Property Act which provides that the "members of the board are required to exercise, whether appointed by the developer or elected by the unit owners, the care required of a fiduciary of the unit owners". . . there is no controlling precedent for the plaintiffs' contention that the scope of such a fiduciary duty cannot be limited by the declaration of condominium. Therefore, in order for the plaintiffs to prevail against Astor under count II for breach of trust, they must prove wilful misconduct on the part of Astor in performing the duties required of it as the interim board of managers.[121]

In *Kelley*, plaintiff condominium purchasers in DuPage County sued a developer, Astor Investors, and its three officers, members of the Abraham family, who served as the interim directors of the condominium association for three days before the unit owners' board was elected.[122] The condominiums were the product of an apartment conversion project with very little rehabilitation work done.[123] After the closings of the units, the purchasers learned of leaking roofs and structural defects in the project.[124]

After dismissal with prejudice, the plaintiffs appealed Count II of their complaint relating to breach of trust against Astor and the three Abraham family members and Count III for breach of the implied warranty of habitability.[125] The appellate court affirmed the dismissals. As to the breach of trust action, the appellate court found that the individual directors had served for only three days and any wrongful conduct by the individuals took place before they were directors.[126] Additionally, as to Astor, the appellate court found that it served as the interim board of managers and under the condominium declaration, its liability was limited to willful misconduct, which did not occur here.[127] At the time of the litigation, the Condominium Property Act had a provision substantially similar to § 18.2(a)[128] today which granted and imposed upon the developer the same rights and duties as imposed on the board of

120. *Id.*
121. *Id.* at 510.
122. *Id.* at 507-08.
123. *Id.* at 508-09.
124. *Id.* at 507.
125. *Id.* at 508.
126. *Id.*
127. *Id.*
128. 765 ILL. COMP. STAT. ANN. 605/18.2(a) (1999).

directors elected by the unit owners.[129]

The Illinois Supreme Court affirmed both the appellate and trial courts below in dismissing both counts.[130] As to the implied warranty of habitability claim, the court accepted the appellate court's reasoning that such an implied warranty may apply where there have been extensive renovations, but not under these facts.[131] As to the breach of trust count, the Court upheld the exculpatory provision in the condominium declaration, which stated:

> *Liability of the Board of Managers*. Neither the members of the Board nor the officers shall be liable to the Owners for any mistake of judgment or for any other acts or omissions of any nature whatsoever as such Board members and officers, *except for any acts and omissions found by a court to constitute willful misconduct in the performance of duty*.[132]

The Illinois Supreme Court rejected plaintiffs' argument that the exculpatory provision would create a conflict between the declaration and the Condominium Property Act's duties imposed on developer serving as an interim board of managers.[133]

> We do not believe that the exculpatory clause violates public policy. The plaintiffs have not cited, and we have not found, any attempt by the legislature or judiciary to preclude a limitation on managerial liability. While it is true that the legislature has enacted an amendment to the Condominium Property Act which [imposes fiduciary duties on the board members], there is no controlling precedent for the plaintiffs' contention that the scope of such a fiduciary duty cannot be limited by the declaration of condominium. Therefore, in order for the plaintiffs to prevail against Astor under count II for breach of trust, they must prove wilful misconduct on the part of Astor in performing the duties required of it as the interim board of managers.[134]

On the question of enforceability of exculpatory provisions in condominium declarations, *Kelley* has been followed in several decisions. In *Adams v. Meyers*,[135] based upon standing and other grounds, the appellate court affirmed the dismissal of a unit owner's lawsuit challenging election procedures and budget issues. Among the several grounds for dismissal was plaintiffs' lack of standing because they did not plead either demand upon the board to file suit against the president or alternatively that making such a demand

129. *Kelley*, 106 Ill. 2d at 509 (quoting ILL. REV. STAT. ch. 30, par. 318.2 (1981) ("[u]ntil election of the initial board of managers, the same rights, titles, powers, privileges, trusts, duties and obligations vested in or imposed upon the board of managers by this Act and in the declaration and bylaws shall be held and performed by the developer")).

130. *Kelly*, 106 Ill. 2d at 512-13.

131. *Id.* at 512.

132. *Id.* at 509 (emphasis added).

133. *Id.* at 509-10.

134. *Id.* at 510.

135. 250 Ill. App. 3d 477, 486 (1st Dist. 1993).

would be futile which are required elements of pleading a derivative lawsuit.[136] The court also noted, in reviewing the Association's declaration and relying on *Kelley*, that the "Declaration expressly provides that members of the Board shall not be liable for any mistake of judgment or for any other acts or omissions of any nature except for acts or omissions found by a court to constitute gross negligence or fraud. Such exculpatory clauses do not violate public policy."[137]

In the context of condominium law, probably the most thorough examination of an exculpatory clause in the declaration arose in *LaSalle Nat'l Trust, N.A. v. Bd. of Dir. of the 1100 Lake Shore Drive Condo.*, where the appellate court affirmed, in part, the trial court's award of damages to a unit owner's efforts to renovate her unit.[138] Citing *Kelley*, the appellate court observed that the scope of board members' fiduciary duties may be limited by an exculpatory clause in the declaration.[139] In this case, the declaration provided:

> Neither the directors, Board, officers of the Association, Trustee, nor Developer shall be personally liable to the Unit Owners for any mistake of judgment or for any other acts or omissions of any nature whatsoever as such directors, Board, officers, Trustee or Developer, *except for any acts or omissions found by a court to constitute gross negligence or fraud.*[140]

This exculpatory clause is similar to that in *Kelley* except that this carved out liability for gross negligence or fraud instead of willful misconduct. The court noted that gross negligence was not at issue in the case.[141] What was at issue was whether the board's actions in interfering with and not cooperating with the renovation project constituted fraud.

The trial court had found that the board breached its fiduciary duties to the unit owner not because it intended to deceive the unit owner (actual fraud), but because "the Board's conduct surrounding all aspects of the construction project and their extreme lack of cooperation" constituted constructive fraud.[142] The appellate court rejected the board's argument that the word "fraud" in the exculpatory clause referred to "actual fraud" which is a tort, and not to constructive fraud. The court found that the word "fraud" referred to both actual and constructive fraud.[143] Without elaborating on its holdings, the appellate court used the term "constructive fraud" to refer to a breach of a legal or equitable

136. *Id.* at 485-86.
137. *Id.* at 486.
138. 287 Ill. App. 3d 449, 458 (1st Dist. 1997).
139. *LaSalle Nat'l Trust*, 287 Ill. App. 3d at 454.
140. *Id.* (emphasis added).
141. *Id.* at 454-55.
142. *Id.* at 456.
143. *Id.* at 455.

duty.[144] So by the trial court's finding that the board members breached their fiduciary duties, each of them engaged in constructive fraud, and therefore the exculpatory clause would not protect the directors from personal liability.[145] The appellate court did not address the fact that its reading of the exculpatory clause rendered the entire clause meaningless.

It may be observed here that although Illinois does not typically observe gross negligence as a standard of liability, instead preferring willful and wanton misconduct, the Illinois Supreme Court has recognized the two standards of liability are used in Illinois interchangeably.[146]

> Our jurisprudence has not been wholly consistent on the degree to which negligent acts are considered similar to willful and wanton behavior . . . For example, it has been remarked that willful and wanton acts bear greater resemblance to intentionally tortious misconduct . . . Other cases have observed that willful and wanton behavior is more similar to an act of ordinary negligence . . . Our case law has sometimes used interchangeably the terms "willful and wanton negligence," "gross negligence," and "willful and wanton conduct."[147]

In *Seven Bridges Courts Ass'n v. Seven Bridges Develop., Inc.*,[148] the appellate court held that the recognition of exculpatory clauses in *Kelley* and *LaSalle Nat'l Trust* in condominium declarations also extended to a townhome association.[149] In *Glickman v. Teglia*,[150] the appellate court reversed the dismissal of a slip and fall on stairs complaint, finding that although the developer of a condominium was protected equally as board members under a condominium declaration's exculpatory clause, such protection did not extend to the association itself.[151] The ramifications of the appellate court's holding in *Glickman* that the condominium association could be independently liable for plaintiff's slip and fall injury while also holding that the developer and association's directors could be exculpated from liability are outside the purview of this Article.

It may be noted here that no language in the opinion indicates that the condominium declaration even contained an exculpatory clause. Rather, the court's analysis was premised on practice notes published with the annotated statutes indicating that many associations have provisions in their declarations exonerating directors from liability and that practically these provisions make

144. *Id.*
145. *Id.* at 457.
146. Ziarko v. Soo Line R.R., 161 Ill.2d 267, 274-75 (1994).
147. *Id.*
148. 306 Ill. App. 3d 697 (2nd Dist. 1999).
149. *Seven Bridges*, 306 Ill. App. 3d at 705.
150. 388 Ill. App. 3d 141, 143 (1st Dist. 2009).
151. *Id.* at 151.

it difficult to impose liability on developers acting prior to the election of the initial board of directors.[152]

Additionally, the appellate court concluded that the association had a duty to maintain the common elements of the property prior to the election of the initial board of directors.[153] The conundrum with the appellate court's analysis is that it begs the question that a corporation, like all artificial and legally-recognized persons, is not a sentient or conscious actor. The not-for-profit corporation acts solely through its directors, officers, and agents. The Condominium Property Act does not empower and imposed duties on condominium associations, but rather the Act empowers and imposes duties on the board of directors.[154] If the board of directors is protected by the business judgment rule or exculpated from liability, is not imposing liability on the association itself simply disregarding and nullifying the business judgment rule or exculpatory clause? It appears that no published cases have addressed this question.

In *Palm II*,[155] the trial court, addressing a declaration with an exculpatory clause[156] similar to that in *LaSalle Nat'l Trust*, found that although the directors' conduct and many violations of the Condominium Property Act and condominium instruments did not constitute fraud, the directors' conscious disregard of their duties constituted gross negligence and therefore breaches of their fiduciary duties.[157] This was because "they intentionally failed to act in the face of a known duty, demonstrating a conscious disregard for their duties."[158] As Justice Gordon noted in his concurrence, the plaintiff did not seek damages from the individual directors, but a declaratory judgment that their conduct violated their fiduciary duty.[159] Given the trial court's finding that the directors were guilty of gross negligence in performing their fiduciary duties, they would not have been exculpated from liability had the plaintiff unit owner sought damages against them individually.

In *Boucher v. 111 E. Chestnut Condo. Ass'n*,[160] the appellate court reversed summary judgment for the association and its

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152. *Id.*
153. *Id.* at 150.
154. 765 ILL. COMP. STAT. ANN. 605/18.4 (2022).
155. *Palm II*, 2014 IL App (1st) at 111290.
156. See *id.* at ¶ 137 (Gordon, P.J., concurring) (quoting the declaration:

> Neither the members of the Board nor the officers of the Association shall be liable to the Unit Owners for any mistake of judgment or for any other acts or omissions of any nature whatsoever as such Board members and officers except for any acts or omissions found by a court to constitute gross negligence or fraud . . .).

157. *Id.* at ¶ 99.
158. *Id.* at ¶ 30.
159. *Id.* at ¶ 138.
160. 2018 IL App (1st) 162233.

directors where the appellate court found that a unit owner's vile conduct and attacks on management employees were afforded First Amendment protection and that the unit owner had a cause of action for breach of his First Amendment rights under § 18.4(h) of the Condominium Property Act.[161] Additionally, the appellate court found that genuine issues of material fact existed pertaining to whether all but three directors (who did not participate in a violation hearing) breached their fiduciary duty to the plaintiff in conducting the hearing against the plaintiff.[162] Additionally, the majority opinion rejected application of the declaration's exculpatory clause[163] to justify summary judgment for the defendants pursuant to following reasoning:

> If courts interpret the exculpatory clause in the declaration so broadly that it excuses decisions to withhold material information from unit owners, the clause conflicts with the Act's provision that board members owe fiduciary duties to unit owners. While the declaration may limit liability for business decisions made in good faith, it cannot limit liability for violations of the duties of honesty, candor, full disclosure, loyalty, and good faith.[164]

The appellate court cited *Sherman v. Ryan*[165] for the proposition that a declaration may not limit liability for violations of the duties of honesty, candor, full disclosure, loyalty, and good faith. However, *Sherman v. Ryan* is a case based solely on Delaware law and the exculpatory statute under Section 102(b)(7) of the Delaware General Corporation Law. In *Sherman*, the appellate court affirmed the dismissal of the third amended complaint because plaintiff failed to plead bad faith as an exception to Section 102(b)(7) with particularity.[166]

In *Kelley*, the Illinois Supreme Court approved an exculpatory clause which exculpated liability for all but "acts and omissions found by a court to constitute willful misconduct in the performance

161. *Id.* at ¶¶ 14-21. Section 18.4(h) of the Condominium Property Act, 765 ILL. COMP. STAT. ANN. 605/18.4(h), empowers the board to adopt rules and regulations pertaining to the operation and use of the property but prohibits rules which impair first amendment rights under the federal or state constitutions, including the free exercise of religion. The *Boucher* court found that this proscription in § 18.4(h) created a statutory right of action for the unit owner. *Boucher*, 2018 IL App (1st) 162233 at ¶ 21.

162. *Id.* at ¶ 64.

163. *See id.* at ¶ 51 (the clause provided that

> The Individual Directors, Board, [and] officers of the Association . . . shall not be liable to the Unit Owners for any mistake in judgment or for any other acts or omissions of any nature whatsoever as such individual Directors, Board or officers, except for any acts or omissions found by a court to constitute gross negligence, willful misconduct or fraud.).

164. *Id.* at ¶ 52 (internal citation omitted).

165. 392 Ill App. 3d 712 (1st Dist. 2009).

166. *Id.* at 732.

of duty."[167] There was no mention in *Kelley* of the duties of honesty, candor, full disclosure, loyalty, and good faith. Nor are duties of honesty, candor, or full disclosure discussed in *Sherman* and to the extent duties of loyalty and good faith are discussed, they are discussed in the context of Delaware law and specifically Section 102(b)(7) of the Delaware General Corporation Law.[168]

The *Boucher* court continued its exculpatory clause analysis:

> Insofar as the exculpatory clause in the declaration effectively reasserts the protections of the business judgment rule, like the business judgment rule, the clause does not justify the order granting summary judgment here. If the exculpatory clause negates the defendants' fundamental fiduciary duties of honesty and loyalty, where the duty of loyalty entails a duty of full disclosure, the exculpatory clause conflicts with the Act, and the Act establishes that the clause becomes ineffective. Thus, the exculpatory clause cannot justify the order granting the summary judgment motion here.[169]

Ultimately, the appellate court found that the exculpatory clause could not be utilized because it would conflict with the fiduciary duty imposed by the Condominium Property Act.[170] However, this analysis is in stark contrast to the Illinois Supreme Court's analysis in Kelley and the subsequent cases discussed herein. In addition to the fact the appellate court did not discuss any applicable precedent, the appellate court's analysis had other deficiencies.

The appellate court begins acknowledging that "the declaration may limit liability for business decisions made in good faith."[171] The appellate court, however, failed to identify any basis for this statement. It appears to flow from the business judgment rule, but the rule is a rebuttable judicial presumption, which is not something typically contained in a condominium declaration.

Similarly, *Boucher's* reliance on the Seventh Circuit's decision in *Burdett* for the proposition that a director must treat unit owners with the utmost "candor, rectitude, care, loyalty, and good faith" that he would treat himself[172] is misplaced. *Burdett* was a

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167. *Kelley*, 106 Ill.2d at 509.

168. *See generally Sherman*, 392 Ill. App. 3d at 730 (summarizing section 102(b)(7) of the Delaware General Business Law and quoting *Malpiede*, 780 A.2d at 1095: "The purpose of section 102(b)(7) is to permit stockholders to adopt a provision in the certificate of incorporation to free directors of personal liability in damages 'for due care violations, but not duty of loyalty violations, bad faith claims and certain other conduct.'").

169. *Boucher*, 2018 IL App (1st) 162233 at ¶ 52 (internal citations omitted).

170. *Id.* (stating that "[i]f the exculpatory clause negates the defendants' fundamental fiduciary duties of honesty and loyalty, where the duty of loyalty entails a duty of full disclosure, the exculpatory clause conflicts with the Act, and the Act establishes that the clause becomes ineffective." (internal citations omitted)).

171. *Id.*

172. *Boucher*, 2018 IL App (1st 162233) at ¶ 36.

Racketeering Influenced and Corrupt Organizations Act[173] case with a pendent claim for breach of fiduciary duty under Illinois law pertaining to a tax shelter investment, where a bench trial judgment was reversed on appeal.[174] The case had nothing to do with condominiums, declarations, or exculpatory clauses. It generally discusses fiduciary duties that are typically owed by an agent to his or her principal.[175]

Further, *Boucher's* reliance[176] on *Janowiak v. Tiesi*,[177] an action for fraud and breach of fiduciary duty by a family business shareholder against the trustee of the trust that held the stock of the corporation, provides no guidance or help. The case does not involve condominiums, declarations, or exculpatory clauses. In the end, it appears that *Boucher* either was unaware of the Illinois Supreme Court precedent and other Illinois cases on point or chose to ignore them.

VI. CONCLUSION

Illinois has recognized that condominiums and related homeowner associations may adopt exculpatory clauses in their declarations to protect directors and officers from liability for claims alleging breach of fiduciary duty brought by tenants. As this survey of the case law surrounding *Kelley*[178] demonstrates, the scope of these exculpatory clauses has been minimally examined in our courts in more than thirty-five years since they were recognized as enforceable by the Illinois Supreme Court. The appellate courts have generally followed *Kelley* in recognizing exculpatory clauses, although some have construed the exceptions to exculpation broadly – perhaps too broadly. As the Illinois legislature has given no guidance on the subject, condominium developers, associations, and attorneys need to further explore the breadth of exculpatory clauses in declarations.

173. 18 U.S.C. § 1962 (2022).

174. Burdett v. Miller, 957 F.2d 1375, 1384 (7th Cir. 1991) (reversing directing judgment for the defendant on the RICO count and remanding for further proceedings on damages plaintiff suffered by defendant's breach of fiduciary duty).

175. *Id.* at 1381.

176. *Boucher*, 2018 IL App (1st) 162233 at ¶ 35.

177. 402 Ill. App. 3d 997, 999 (1st Dist. 2010).

178. *See Kelley*, 106 Ill.2d at 505 (recognizing that exculpatory clauses limiting directors' liability as contained in condominium declarations are enforceable to defeat or limited breach of fiduciary duty claims by unit owners).