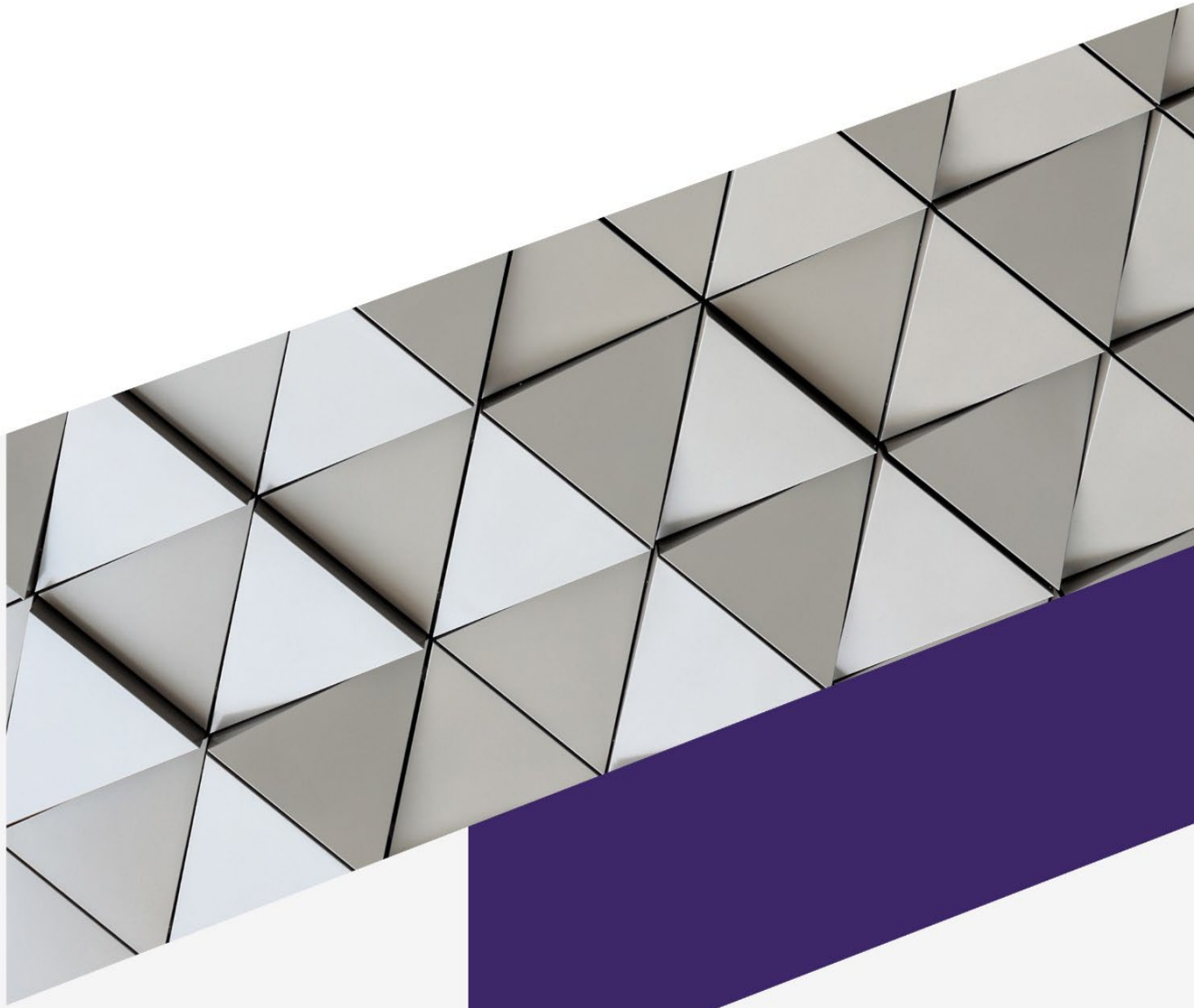


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# The Analysis and Comparison of Illinois and Delaware Corporate Governance Law



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This edition, *The Analysis and Comparison of Illinois and Delaware Corporate Governance Law*, was authored by Craig C. Martin, Chairman Americas, and Partner, Aaron Hersh.

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## **INTRODUCTION**

Though the corporation laws of the State of Delaware have long been regarded as the “most favorable” or “corporation-friendly” among the U.S. jurisdictions, Illinois corporate law presents quite the competition. When Illinois adopted the 1970 Constitution, it granted the legislature greater flexibility in dealing with corporations. Accordingly, Illinois adopted a comprehensive revision of its corporate laws: the Illinois Business Corporation Act of 1983 (the “Illinois Act,” “Illinois Corporations Act,” or the “Act”). The Illinois Act has an organization and numbering system that parallels the Model Business Corporation Act. As compared to Delaware law, Illinois has incorporated numerous provisions into its 1983 Business Corporation Act that enhance its flexibility, while the Delaware statute has a number of significant shortcomings in comparison.

The following treatise provides insight into the workings of the Illinois Act with respect to director and officer liability, as well as how its provisions specifically compare to Delaware law. Part One analyzes the similarities and differences between the liability of corporate officers and directors of companies incorporated in Illinois versus those incorporated in Delaware. Part Two evaluates and distinguishes shareholders’ rights of inspection in each state. Parts Three and Four discuss common shareholder claims within each jurisdiction as well as the remedies for those claims.

## Part One

### Liability of Officers and Directors

#### I. Standard of Care

Under Illinois law, a director or officer of an Illinois corporation owes fiduciary duties of care and loyalty to the corporation and its shareholders.<sup>1</sup> In the event the company becomes insolvent, directors and officers also owe fiduciary duties to the creditors of the corporation.

These duties require directors and officers to “administer the corporate affairs for the [] benefit of all the stockholders, and exercise their best care, skill, and judgment in the management of the corporate business solely in the interest of the corporation.”<sup>2</sup> They may not engage in decisions or dealings that would preclude them from acting in the best interest of the entity and its shareholders.<sup>3</sup>

Similarly, employees who receive substantial salaries and take part in top-level management meetings, negotiations and strategy discussions also owe fiduciary duties to the corporation and its shareholders, even if they are not officers or directors.<sup>4</sup>

Comparison to Delaware: Delaware law similarly requires corporate officers and directors to discharge the fiduciary duties of care and loyalty. These fiduciary duties must be at the forefront of officer and director decision-making, behavior, and dealing at all times.<sup>5</sup> Directors have “an unyielding fiduciary duty to protect the interests of the corporation and the stockholders alike.”<sup>6</sup> When a corporation becomes insolvent, however, “its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.”<sup>7</sup> Consequently, “the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.”<sup>8</sup>

<sup>1</sup> *Stamp v. Touche Ross & Co.*, 636 N.E.2d 616, 620 (Ill. App. Ct. 5th Dist. 1993) (“Directors owe a fiduciary duty to their corporations and to its [sic] shareholders.”).

<sup>2</sup> *Shlensky v. S. Parkway Bldg. Corp.*, 166 N.E.2d 793, 799 (Ill. 1960).

<sup>3</sup> *Dixmoor Golf Club v. Evans*, 156 N.E. 785, 787 (Ill. 1927) (“The stockholders are entitled to the utmost fidelity of the directors to the interest of the stockholders. It is a breach of duty for the directors to place themselves in a position where their personal interests would prevent them from acting for the best interests of those they represent.”); *Roberts v. Zimmerman*, 2021 IL App (2d) 191088-U, ¶ 118, *appeal denied*, 169 N.E.3d 324 (Ill. 2021) (“[C]orporate officers . . . are precluded from actively exploiting their positions within the corporation for their own personal benefits or hindering the ability of the corporation to conduct the business for which it was developed.”).

<sup>4</sup> *Advantage Mktg. Grp., Inc. v. Keane*, 143 N.E.3d 139, 149 (Ill. App. Ct. 1st Dist. 2019); *accord Lawlor v. N. Am. Corp. of Illinois*, 983 N.E.2d 414, 433 (Ill. 2012) (“[E]mployees, as well as officers and directors, owe a duty of loyalty to their employer.”).

<sup>5</sup> See *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006); *Crescent/Mach I Partners, L.P. v. Turner*, 846 A.2d 963, 979 (Del. Ch. 2000) (“Directors have an unyielding fiduciary duty to protect the interests of the corporation and the stockholders alike.”); See also *N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101–02 (Del. 2007) (“When a corporation is insolvent, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value. Consequently, the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.”).

<sup>6</sup> *Crescent/Mach I Partners, L.P.*, 846 A.2d at 979.

<sup>7</sup> *Gheewalla*, 930 A.2d at 101–02.

<sup>8</sup> *Id.*

## II. Fiduciary Duties

### A. *To Whom Duties Are Owed*

#### 1. Shareholders

Under Illinois law, corporate officers, directors, and controlling shareholders owe fiduciary duties to the corporation and its shareholders.<sup>9</sup>

Comparison to Delaware: Under Delaware law, directors' duties similarly run to the corporation, and its shareholders.<sup>10</sup>

#### 2. Creditors

Under Illinois law, when a corporation becomes insolvent, the fiduciary duties that directors, officers, and controlling shareholders owe to the corporation and its shareholders expand to the corporation's creditors as well.<sup>11</sup> The underlying theory of officer and director liability to creditors in the case of insolvency is based on the assumption that once the corporation is insolvent, the officers' and directors' duties shift from protecting the interests of the shareholders, who can no longer benefit from the corporation, to protecting the creditors of the corporation.<sup>12</sup>

To determine the point in time when the fiduciary duties of a corporation's directors and officers extend to its creditors, Illinois courts follow the statutory definition of insolvency: that is, when the "sum of the [corporation]'s debts is greater than all of the [corporation]'s assets at a fair valuation."<sup>13</sup>

Comparison to Delaware: In Delaware, directors and officers do not owe creditors fiduciary duties directly, even in insolvency.<sup>14</sup> Creditors of an insolvent corporation thus may not bring direct

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<sup>9</sup> *Anest v. Audino*, 773 N.E.2d 202, 209 (Ill. App. Ct. 3d Dist. 2002) ("Individuals who control corporations owe a fiduciary duty to their corporations and their shareholders."); *Truserv Corp. v. Chaska Bldg. Ctr., Inc.*, No. 02 C 1018, 2003 WL 924509, at \*19 (N.D. Ill. Mar. 6, 2003) ("Illinois law recognizes that officers and board members have a fiduciary duty to both the corporation and the shareholders.")

<sup>10</sup> *N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) ("It is well settled that directors owe fiduciary duties to the corporation . . . those duties may be enforced by its shareholders . . . because they are the ultimate beneficiaries of the corporation's growth and increased value.")

<sup>11</sup> *Schwendener, Inc. v. Jupiter Electric Co. Inc.*, 829 N.E.2d 818, 828 (Ill. App. Ct. 1st Dist. 2005) ("Generally, corporate officers owe a fiduciary duty only to the corporation and its shareholders. . . . However, once a corporation becomes insolvent, the fiduciary duty of an officer is extended to the creditors of the corporation.") (internal citations omitted).

<sup>12</sup> *Id.* at 828 (holding that "[t]he fiduciary duty arises because, from the moment a corporation becomes insolvent, its assets are deemed to be held in trust for the benefit of its creditors.")

<sup>13</sup> 740 ILCS 160/3(a). Further, "[a] debtor who is generally not paying his debts as they become due is presumed to be insolvent." 740 ILCS 160/3(b); See also *Technic Eng'g, Ltd. v. Basic Envirotech, Inc.*, 53 F. Supp. 2d 1007, 1012 (N.D. Ill. 1999) (applying Illinois law and holding that directors and officers owed fiduciary duties to the creditors because the company was "generally not paying debts as they came due" and the company's "debts exceeded its assets at fair market value.")

<sup>14</sup> *Gheewalla*, 930 A.2d at 101, n.28 ("[T]he need for providing directors with definitive guidance compels us to hold that no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency.")

claims for breaches of fiduciary duty against the corporation's directors or officers.<sup>15</sup> However, they may pursue derivative claims for breaches of fiduciary duty when the corporation is insolvent.<sup>16</sup> In Delaware, insolvency is not a bright line rule, and creditors may pursue derivative actions even before the corporation officially files for bankruptcy or enters receivership under Delaware law.<sup>17</sup>

### 3. Other Directors & Officers or Other Third Parties

Generally, under Illinois law, “corporate officers owe a fiduciary duty *only* to the corporation and its shareholders.”<sup>18</sup> Directors and officers of closely held corporations “owe mutual fiduciary duties and must deal with each other openly and honestly.”<sup>19</sup> Otherwise, Illinois courts have not addressed whether directors and officers owe fiduciary duties to other directors and officers or other third parties.

Comparison to Delaware: Similarly, Delaware courts have held that directors and officers have fiduciary duties only to the corporation and its shareholders.<sup>20</sup>

### 4. Do Directors Owe Different Duties From Officers?

Directors and officers owe the same fiduciary duties under Illinois law.<sup>21</sup>

Comparison to Delaware: Under Delaware law, directors and officers owe the same fiduciary duties.<sup>22</sup>

## **B. The Duty of Care**

The duty of care requires officers and directors to exercise “in the management of corporate affairs the degree of care which prudent [individuals], prompted by self-interest, would exercise in the management of their own affairs.”<sup>23</sup> Directors and officers therefore “have the duty to inform themselves of the material facts necessary to exercise their judgment. If directors and officers exercise such care, they will not be held liable for honest errors in judgment.”<sup>24</sup> Illinois courts may

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<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> See *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 791 (Del. Ch. 1992) (plaintiffs adequately pled that the corporation was insolvent in fact based on allegations that the corporation's “substantial assets were so liquidated that its liabilities probably were greater than the value of its assets,” as supported by examples of substantial asset losses by the company).

<sup>18</sup> *Paul H. Schwendener, Inc. v. Jupiter Elec. Co.*, 829 N.E.2d 818, 828 (Ill. App. Ct. 1st Dist. 2005) (emphasis added).

<sup>19</sup> *Fleming v. Louvers Int'l, Inc.*, 2019 IL App (2d) 180364-U, ¶ 156.

<sup>20</sup> *Gheewalla*, 930 A.2d at 99 (“It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders. . . . Delaware courts have traditionally been reluctant to expand existing fiduciary duties.”).

<sup>21</sup> See *Anest v. Audino*, 773 N.E.2d 202, 210 (Ill. App. Ct. 3d Dist. 2002) (“Officers and directors in a corporation owe fiduciary duties to shareholders and to the corporation.”).

<sup>22</sup> *Gantler v. Stephens*, 965 A.2d 695, 708 (Del. 2009) (“[C]orporate officers owe fiduciary duties that are identical to those owed by corporate directors.”).

<sup>23</sup> *Fleming*, 2019 IL App (2d) 180364-U, ¶ 156.

<sup>24</sup> *Id.* (citations omitted).

also allow exculpation of director liability for grossly negligent conduct.<sup>25</sup> However, bad-faith conduct cannot be exculpated.<sup>26</sup>

Even absent exculpation, it is difficult to plead a valid claim under Illinois law for breach of the duty of care. Illinois courts generally accord great deference to the business judgment of directors and officers, a presumption known as the business judgment rule. Under the business judgment rule, absent a showing of fraud, illegality, or a conflict of interest, Illinois courts do not question the business judgment of corporate directors.<sup>27</sup> For a more detailed discussion on the business judgment rule, please see *infra* Part One, Section II.E.

See also:

- *Stamp v. Touche Ross & Co.*<sup>28</sup>: Absent allegations of bad faith, fraud, illegality or gross overreaching, courts will defer to the business judgment of corporate directors. In *Stamp*, the Director of Insurance for the State of Illinois brought suit against directors of insolvent defendant company. Plaintiff alleged that the directors failed to discharge their duty of care in part by “fail[ing] to develop and implement adequate” procedures and controls, “consistently underpric[ing] reinsurance and insurance business,” and “fail[ing] to keep correct and accurate books and records.” The Illinois Appellate Court affirmed and remanded on dismissal, holding that such allegations were insufficient to state a claim for breach of the duty of care. The court reasoned that all the allegations of wrongdoing “pertain to actual decisions or determinations of judgment made by defendants” rather than to any “inexcusable unawareness or inattention or lack of good faith on part of the directors.”
- *Fleming v. Louvers International, Inc.*<sup>29</sup>: The Illinois Appellate Court affirmed in part and reversed in part the trial court’s judgment that a majority shareholder in a closely held corporation breached its common law fiduciary duty and statutory duties to the minority shareholder by (1) failing to comply with the requirement of pro rata distributions, (2) incorrectly reporting the amount of distributions to the IRS and (3) classifying education payments made to the minority shareholder’s children as distributions.
- *Romanik v. Lurie Home Supply Ctr., Inc.*<sup>30</sup>: Shareholders brought suit alleging that the defendant directors violated their duty of care by issuing three loans to the corporation’s deceased president’s trust for the purpose of paying the president’s estate taxes. Although these loans were transactions that the court found involved a conflict of interest, the Illinois Appellate Court affirmed the trial court’s judgment that the directors breached the duty of care in issuing two of the loans because at the time that these loans were issued, a prior loan was already overdue. The appellate court further reasoned that the directors’ issuance

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<sup>25</sup> See *In re Abbott Lab’ys Derivative S’holders Litig.*, 325 F.3d 795, 811 (7th Cir. 2003).

<sup>26</sup> *Id.*

<sup>27</sup> See *Romanik v. Lurie Home Supply Ctr., Inc.*, 435 N.E.2d 712 (Ill. App. Ct. 5th Dist. 1982).

<sup>28</sup> 636 N.E.2d 616 (Ill. App. Ct. 5th Dist. 1993).

<sup>29</sup> 2019 IL App (2d) 180364-U.

<sup>30</sup> 435 N.E.2d 712 (Ill. App. Ct. 5th Dist. 1982).

of these loans was a breach of their fiduciary duty of care because the loans were issued at a lower interest rate than the prevailing rate at the time.

*Comparison to Delaware:* Under Delaware law, the duty of care similarly requires directors and officers to exercise the “amount of care which ordinarily careful and prudent men would use in similar circumstances.”<sup>31</sup> An officer or director may be held liable for breach of the duty of care based on action or nonaction flowing from an ill-advised or negligent board decision, or from “an unconsidered failure of the board to act in circumstances in which due attention would . . . have prevented the loss.”<sup>32</sup> This would include failure to exercise oversight and monitor information and systems of the entity.<sup>33</sup> To determine whether an officer or director has breached his or her duty of care, Delaware courts consider factors such as the amount of time relevant information was available to the fiduciary for review, whether the officer or director actually reviewed the available information, and whether he or she sought the advice of experts.<sup>34</sup>

To prevail on a claim for breach of fiduciary duty under Delaware law, a plaintiff must plead and prove that the defendant owed a fiduciary duty, and that he or she breached that duty.<sup>35</sup> Delaware courts also apply the business judgment rule, which presumes that “directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>36</sup> For a more detailed discussion of the business judgment rule, please see *infra* Part One, Section II.E.

Delaware law also allows for the exculpation of directors and officers from duty of care liability. For a more detailed discussion of exculpation, please see *infra* Part One, Section VI.

See also:

- *In re Abbott Lab’ys Derivative S’holders Litig.*<sup>37</sup>: The Seventh Circuit reversed the district court’s dismissal of the amended complaint for failure to plead demand futility. The Seventh Circuit found that the director defendants’ failure to act after six years of noncompliance, inspections and warning letters from the federal government, press articles, and the largest civil fine imposed by the FDA up to that point in time as sufficient to allege that the directors’ inaction was not a valid exercise of business judgment, thus adequately pleading demand futility. This was not a final determination on the merits that the directors acted in bad faith.

### **C. The Duty of Loyalty**

Illinois law requires corporate officers and directors to act for the benefit of the entity in all matters related to the entity. The duty of loyalty prohibits directors and officers from “actively exploit their positions within the corporation for their own personal benefit” or “hinder[ing] the ability of a

<sup>31</sup> *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 749 (Del. Ch. 2005).

<sup>32</sup> *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

<sup>33</sup> *Id.* A more detailed discussion of failure to monitor claims can be found below. See *infra* Part Three, Section IV.

<sup>34</sup> See *Brehm v. Eisner*, 746 A.2d 244, 258 (Del. 2000).

<sup>35</sup> *Beard Rsch., Inc. v. Kates*, 8 A.3d 573, 601 (Del. Ch. 2010), *aff’d sub nom. ASDI, Inc. v. Beard Rsch., Inc.*, 11 A.3d 749 (Del. 2010).

<sup>36</sup> *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 36 (Del. Ch. 2010).

<sup>37</sup> 325 F.3d 795 (7th Cir. 2003) (interpreting Delaware law).

corporation to continue the business for which it was developed.”<sup>38</sup> Illinois courts have found a breach of duty of loyalty when an officer or director (1) fails to inform the company that employees are forming a rival company or engaging in other fiduciary breaches; (2) solicits the business of a single customer before leaving the company; (3) uses the company’s facilities or equipment to assist him or her in developing his or her new business; or (4) solicits fellow employees to join a rival business.<sup>39</sup>

See also:

- *Patient Care Servs., S. C. v. Segal*<sup>40</sup>: The Illinois Appellate Court reversed the trial court’s judgment in favor of the defendant, holding that the defendant officer breached his duty of loyalty to the corporation because “he helped set up and subsequently took over control of a different corporation organized to per[form] the very similar, if not identical, services [plaintiff corporation] was organized to perform.”
- *Cooper Linse Hallman Capital Mgmt., Inc. v. Hallman*<sup>41</sup>: The plaintiff alleged that the defendant officers “failed to inform plaintiff of their plans to form a rival corporation, conspired with one another to form a rival corporation and used plaintiff’s computer to type a business plan and advertisements.” The First District Appellate Court affirmed the judgment entered in favor of the defendants after a trial on the merits, holding that these actions “[fell] short of a breach of their fiduciary duties to plaintiff . . . [because the defendants] neither exploited their positions with plaintiff for their own benefit nor hindered the ability of plaintiff to continue business.”
- *Covinsky v. Hannah Marine Corp.*<sup>42</sup>: The First District Appellate Court affirmed the trial court’s dismissal of the defendant’s counterclaim under § 2-615 for failure to state a cause of action, explaining that the defendant did not breach its duty of loyalty by subleasing a piece of property leased by the corporation for little compensation. The court reasoned that while the defendant “may not have made a good bargain . . . when he executed the sublease,” and “may have known that a sublease can be a valuable asset,” there was no basis to conclude that he breached his duty of loyalty by “enter[ing] into the lease with[out] the good-faith belief that he was furthering the interests of [the corporation], that he purposely entered into a bad bargain or that he personally benefitted from the sublease.”

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<sup>38</sup> *Veco Corp. v. Babcock*, 611 N.E.2d 1054, 1059 (Ill. App. Ct. 1st Dist. 1993).

<sup>39</sup> See *Unichem Corp. v. Gurtler*, 498 N.E.2d 724, 728 (Ill. App. Ct. 1st Dist. 1986) (finding that while employed at plaintiff corporation, the defendant officer failed to inform the corporation that his son had formed a rival company and encouraged employees to leave for the rival company); *Smith–Shrader Co., Inc. v. Smith*, 483 N.E.2d 283, 290 (Ill. App. Ct. 1st Dist. 1985) (the defendant director solicited key clients and former employees from the company after forming his own rival company); *ABC Trans Nat. Transport, Inc. v. Aeronautics Forwarders, Inc.*, 379 N.E.2d 1228, 1238 (Ill. App. Ct. 5th Dist. 1978) (the defendant director employed a vendor that was under exclusive contract with the plaintiff to make deliveries for a rival company and also used plaintiff’s facilities and personal property to furnish supplies to the rival company).

<sup>40</sup> 337 N.E.2d 471 (Ill. App. Ct. 1st Dist. 1975).

<sup>41</sup> 856 N.E.2d 585 (Ill. App. Ct. 1st Dist. 2006).

<sup>42</sup> 903 N.E.2d 422 (Ill. App. Ct. 1st Dist. 2009).

- *Lawlor v. North American Corporation of Illinois*<sup>43</sup>: Plaintiff corporation alleged that the defendant, the corporation’s former salesperson, breached her duty of loyalty by attempting to divert business to a competitor while still employed by the corporation. The Illinois Supreme Court held that evidence that the defendant was actively interviewing with the competitor was “too speculative and wholly insufficient to conclude that [the defendant], while employed by North American, tried to divert business to [the competitor].”
- *Advantage Marketing Group, Inc. v. Keane*<sup>44</sup>: Plaintiff corporation alleged that a former principal employee failed to disclose a corporate opportunity to purchase a competing business and exploited a client referral to his advantage, thereby breaching his duty of loyalty. The court held that the corporation’s allegations that the employee failed to disclose that a competing corporation was looking to sell, and intended to purchase the competitor for himself, were sufficient to state a claim for breach of the duty of loyalty.

Comparison to Delaware: Delaware imposes a similar duty of loyalty on directors and officers. Officers and directors may be held liable for breach of the duty of loyalty when they have a material interest in a transaction with the corporation, or undertake an action in bad faith. The benefit received by the director or officer must be “of a sufficiently material importance, in the context of the director’s economic circumstances, as to have made it improbable that the director could perform her fiduciary duties . . . without being influenced by her overriding personal interest[.]”<sup>45</sup> Generally, Illinois courts apply the duty of loyalty more strictly against officers and directors than Delaware courts.<sup>46</sup> Illinois courts more closely scrutinize the disinterestedness of directors or shareholders in connection with the authorization of transactions involving a conflict of interest. For a more detailed discussion, *see infra* Part Three, Section I.

For a detailed discussion of the common types of breach of duty of loyalty claims, *see infra* Part Three.

#### ***D. Statute of Limitations for Breach of Fiduciary Duties Claims***

The statute of limitations for a breach of fiduciary duty claim in Illinois is five years from the accrual of the cause of action.<sup>47</sup> A cause of action accrues when the plaintiff suffers injury.<sup>48</sup> For breach of fiduciary duty claims, a plaintiff suffers an injury when the action or conduct complained about occurs.<sup>49</sup>

However, Illinois applies a “discovery rule” to toll the statute of limitations for breach of fiduciary duty claims to the time the plaintiff knew or reasonably should have known that he had been

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<sup>43</sup> 983 N.E.2d 414 (Ill. 2012).

<sup>44</sup> 143 N.E.3d 139 (Ill. App. Ct. 1st Dist. 2019).

<sup>45</sup> *In re Trados Inc. S’holder Litig.*, 73 A.3d 17 (Del. Ch. 2013).

<sup>46</sup> *See* The Illinois Supreme Court and the duty of loyalty, 8 Ill. Prac., Business Organizations § 14:2 (2d ed.).

<sup>47</sup> 735 ILCS 5/13–205; *Richter v. Prairie Farms Dairy, Inc.*, 53 N.E.3d 1, 14 (Ill. 2016); *Clark v. Robert W. Baird Co.*, 142 F. Supp. 2d 1065, 1075 (N.D. Ill. 2001) (applying Illinois law).

<sup>48</sup> *Id.* (citing *Hermitage Corp. v. Contractors Adjustment Co.*, 651 N.E.2d 1132, 1135 (Ill. 1995)).

<sup>49</sup> *See, e.g., Richter*, 53 N.E.3d at 14 (cause of action accrued when the defendant-cooperative terminated plaintiff’s membership and agreement).

injured and that his injury was wrongfully caused.<sup>50</sup> That is, if a reasonable person would have conducted further inquiry to determine whether a legal wrong had been committed, then the statute of limitations will not be tolled.<sup>51</sup> Whether a plaintiff should have known of the need for inquiry is an objective determination to be made by the factfinder.<sup>52</sup> If the facts are undisputed and only one conclusion may be drawn, then the question “becomes one for the court.”<sup>53</sup> Illinois courts have viewed the discovery rule as both tolling the statute of limitations and as modifying when a cause of action accrues.<sup>54</sup>

The statute of limitations for breach of fiduciary duty claims also will be tolled if the defendant’s “affirmative acts or representations [are] calculated to lull or induce a plaintiff into delaying the filing of [their] claim or preventing [them] from discovering the claim.”<sup>55</sup> Additionally, the statute of limitations can also be tolled if the defendant fraudulently concealed the right of action.<sup>56</sup>

See also:

- *Henderson Square Condo. Association v. LAB Townhomes, LLC*<sup>57</sup>: After the appellate court reversed the circuit court’s dismissal, the Supreme Court of Illinois affirmed the appellate court’s decision and held that the plaintiffs adequately pled a claim for breach of fiduciary duties against the original members of a condominium board. Plaintiffs alleged that the board members had failed to adequately pay their share of common expenses and to fund sufficient reserves when they knew, or should have known, that the project contained extensive defects. Rejecting the defendants’ argument that nearly 15 years had passed since the directors had resigned from the board, the Court found that the plaintiffs adequately alleged that they could not have discovered the defect until approximately two years before the suit was brought. Plaintiffs specifically alleged that the former directors acted fraudulently and in bad faith because they knew of the shoddy construction yet failed to account for those repairs when they set the condominium association’s reserves.
- *Abrams v. Clarke*<sup>58</sup>: The Illinois Appellate Court affirmed the trial court’s order dismissing the plaintiffs’ claims as time barred. The complaint was filed in late 2015 for alleged acts occurring between 2007 and 2009. The court explained that the filing was not timely because a draft complaint was circulated to certain plaintiffs, but never filed, on May 2, 2010. The appellate court held that the circulation of the draft complaint was sufficient to put a reasonable person on notice of his or her injury and its wrongful causation and, from that point, the plaintiffs bore the burden to inquire further as to the existence of a cause of

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<sup>50</sup> *Henderson Square Condo. Ass’n v. LAB Townhomes, LLC*, 46 N.E.3d 706, 720–21 (Ill. 2015), *opinion modified on denial of reh’g* (Jan. 28, 2016); *Clark*, 142 F. Supp. 2d at 1075.

<sup>51</sup> *Young v. McKiegue*, 708 N.E.2d 493, 501 (Ill. App. Ct. 1st Dist. 1999).

<sup>52</sup> *Clark*, 142 F. Supp. 2d at 1075.

<sup>53</sup> *Pruitt v. Schultz*, 601 N.E.2d 1372, 1379 (Ill. App. Ct. 1st Dist. 1992).

<sup>54</sup> *Compare Henderson Square*, 46 N.E.3d at 720–21 (the discovery rule postpones the start of the limitations period) *with id.* at 716 (the discovery rule provides that a cause of action accrues when a party knows or reasonably should know). Functionally, there is no difference.

<sup>55</sup> *Cahnman v. Timber Ct. LLC*, 196 N.E.3d 151, 167 (Ill. App. Ct. 1st Dist. 2021) (quoting *Henderson Square*, 46 N.E.3d at 717).

<sup>56</sup> *Henderson Square*, 46 N.E.3d at 718.

<sup>57</sup> 46 N.E.3d 706 (Ill. 2015).

<sup>58</sup> 2020 IL App (1st) 191996-U, *appeal denied*, 167 N.E.3d 622 (Ill. 2021).

action. Under these circumstances, the court assumed *arguendo* that fraudulent concealment occurred but held the claims were still time-barred because the plaintiffs discovered, or should have discovered, the facts underlying their claim by 2012 at the latest, and had reasonable time thereafter to file suit but failed to do so.

*Comparison to Delaware:* The statute of limitations under Delaware law for a breach of fiduciary duty claim is three years from the time when the contested conduct occurred.<sup>59</sup> Similar to Illinois courts, Delaware courts recognize three doctrines that toll the statute of limitations: inherently unknowable injuries, fraudulent concealment, and equitable tolling following a breach of fiduciary duty.<sup>60</sup>

- *Inherently Unknowable Injury:* “Under the doctrine of inherently unknowable injury, the statute of limitations will be tolled until the point when an injury becomes empirically discoverable. At that time, the plaintiff would be on inquiry notice of a claim and the statute would begin to run.”<sup>61</sup>
- *Fraudulent Concealment:* “Under the doctrine of fraudulent concealment, the statute of limitations will be tolled if there was an affirmative act of concealment or some misrepresentation that was intended to put a plaintiff off the trail of inquiry until such time as the plaintiff is put on inquiry notice.”<sup>62</sup>
- *Equitable Tolling:* The third tolling doctrine, equitable tolling, applies when a plaintiff reasonably relies on the competence and good faith of a fiduciary.<sup>63</sup> Unlike fraudulent concealment, equitable tolling does not require intentional concealment, but the statute of limitations is tolled only until the investor knew or had reason to know of the facts constituting the breach.<sup>64</sup>

See also:

- *Largo Legacy Grp., LLC v. Charles*<sup>65</sup>: The Delaware Chancery Court held that the plaintiff company’s breach of fiduciary duties claim was timely because the action did not accrue until the defendant refused to reimburse plaintiff for certain expenditures. The court rejected the defendant’s argument that plaintiff’s claim accrued at the time the defendant made the contested expenditures. Moreover, the court also held that even if the action accrued earlier, equitable tolling would preserve the plaintiff’s claims. The court explained that plaintiff had reasonably relied on the defendant’s representations that it would be reimbursed for the expenditures.

<sup>59</sup> 10 Del. C. § 8106; *Largo Legacy Grp., LLC v. Charles*, No. CV 2020-0105-MTZ, 2021 WL 2692426, at \*9 (Del. Ch. June 30, 2021).

<sup>60</sup> *Vichi v. Koninklijke Philips Elecs. N.V.*, No. CIV.A. 2578-VCP, 2009 WL 4345724, at \*17 (Del. Ch. Dec. 1, 2009); see *Largo Legacy Grp.*, 2021 WL 2692426, at \*9.

<sup>61</sup> *Winner Acceptance Corp. v. Return on Cap. Corp.*, No. CIV.A. 3088-VP, 2008 WL 5352063, at \*15 (Del. Ch. Dec. 23, 2008).

<sup>62</sup> *Id.* (internal quotations omitted).

<sup>63</sup> *Id.*

<sup>64</sup> *Largo Legacy Grp.*, 2021 WL 2692426, at \*11–12.

<sup>65</sup> No. CV 2020-0105-MTZ, 2021 WL 2692426 (Del. Ch. June 30, 2021).

### ***E. Standard of Review for Fiduciary Duty Actions***

Illinois and Delaware generally apply two standards when evaluating fiduciary duties: the business judgment rule and the entire fairness doctrine.<sup>66</sup>

#### 1. Business Judgment Rule

The business judgment rule is a “presumption that officers and directors of a corporation make decisions on an informed basis, in good faith, and with the best interests of the corporation at heart.”<sup>67</sup> It provides that, “[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.”<sup>68</sup>

This deference is illustrated in *Shlensky v. Wrigley*.<sup>69</sup> In *Shlensky v. Wrigley*, plaintiff shareholders sued directors of the Chicago National League Ball Club, which operated the Chicago Cubs and Wrigley Field. Plaintiffs alleged that the Cubs sustained operating losses because of the failure to install lights for night games despite the fact that all other baseball teams had done so.<sup>70</sup> However, the court held that the decision not to install lights was properly within the business judgment of the directors, holding that in “absence of a clear showing of dereliction of duty on the part of the specific directors” the court would not interfere with the business judgment of directors and that “mere failure to follow the crowd is not such a dereliction.”<sup>71</sup>

Corporate decision-makers are afforded the presumption of the business judgment rule so long as they “exercise due care in carrying out their corporate duties.”<sup>72</sup> “If directors fail to exercise due care, then they may not use the business judgment rule as a shield for their conduct.”<sup>73</sup> “Due care” requires that officers and directors “inform themselves of material facts necessary for them to properly exercise their business judgment.”<sup>74</sup> Thus, a party may defeat the presumption of the business judgment rule by demonstrating that directors or officers failed to inform themselves of material facts necessary for them to become “sufficiently informed to make an independent business decision.”<sup>75</sup> For this reason, the business judgment rule most often comes into play “where mismanagement is the gravamen of the cause of action.”<sup>76</sup>

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<sup>66</sup> See *supra* Part One, Section II.B. A more detailed discussion of how courts review common types of breach of fiduciary duties claims is provided below. See *infra* Part Three & Part Four.

<sup>67</sup> *Willmschen v. Trinity Lakes Improvement Ass’n*, 840 N.E.2d 1275, 1279 (Ill. App. Ct. 2d Dist. 2005).

<sup>68</sup> *Goldberg v. Astor Plaza Condo. Ass’n*, 971 N.E.2d 1, 17, *as modified on denial of reh’g*, (May 4, 2012).

<sup>69</sup> 237 N.E.2d 776 (Ill. App. Ct. 1st Dist. 1968).

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 781 (internal quotation omitted).

<sup>72</sup> *Goldberg*, 971 N.E.2d at 17.

<sup>73</sup> *Davis v. Dyson*, 900 N.E.2d 698, 704 (Ill. App. Ct. 1st Dist. 2008).

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Willmschen*, 840 N.E.2d at 1279.

See also:

- *Miller v. Thomas*<sup>77</sup>: The First District Appellate Court affirmed the circuit court’s dismissal of breach of fiduciary duty action against the board of directors for refusing shareholder’s demand to bring a lawsuit against certain present and former directors of the corporation. The Court reasoned that the “propriety of the board’s refusal of the demands is immaterial” because “[t]he plaintiffs *failed to assert* that this decision was made in bad faith, that the decision was based on inadequate information, or that the decision was made without due care.”
- *Stamp v. Touche Ross & Co.*<sup>78</sup>: The Fifth District affirmed dismissal of an action brought by a liquidator of insolvent insurance company against certain directors of the company for breach of fiduciary duty. The liquidator alleged that the defendant directors made discretionary decisions which were allegedly harmful to the company, such as developing inadequate underwriting procedures and controls. In rejecting these allegations, the Court reasoned that “absent allegations of bad faith, fraud, illegality or gross overreaching, courts are not at liberty to interfere with the exercise of business judgment by corporate directors.”

*Comparison to Delaware*: Delaware courts also apply the business judgment rule, which presumes that “directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>79</sup>

## 2. Entire Fairness Doctrine

“If the business judgment rule is rebutted, the burden shifts to the director defendants to demonstrate that the challenged transaction was ‘entirely fair’ to the corporation and the plaintiff shareholders.”<sup>80</sup> This is known as the entire fairness doctrine. Under the entire fairness standard of judicial review, the defendant directors bear the burden of proving that the transaction was the product of fair dealing and fair price.<sup>81</sup> As discussed in more detail below, any interested transaction receives entire fairness review. “The classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders.”<sup>82</sup>

In evaluating the fairness of a transaction, courts consider the following nonexclusive factors<sup>83</sup>:

- (1) whether the corporation received in the transaction full value in all the commodities purchased;
- (2) the corporation’s need for the property at issue;

<sup>77</sup> 656 N.E.2d 89 (Ill. App. Ct. 1st Dist. 1995).

<sup>78</sup> 636 N.E.2d 616 (Ill. App. Ct. 5th Dist. 1993).

<sup>79</sup> *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 36 (Del. Ch. 2010).

<sup>80</sup> *Shaper v. Bryan*, 864 N.E.2d 876, 884 (Ill. App. Ct. 1st Dist. 2007) (internal citations omitted).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at 885.

<sup>83</sup> *Shlensky v. S. Parkway Bldg. Corp.*, 166 N.E.2d 793, 801–02 (Ill. 1960).

- (3) the corporation’s ability to finance the purchase;
- (4) whether the transaction was at the market price, or below, or constituted a better bargain than the corporation could have otherwise obtained in dealings with others;
- (5) whether there was a detriment to the corporation as a result of the transaction;
- (6) whether there was a possibility of corporate gain siphoned off by the directors directly or through corporations they controlled; and
- (7) whether there was full disclosure.

See also:

- *Romanik v. Lurie Home Supply Ctr., Inc.*<sup>84</sup>: Shareholders brought suit challenging a lease transaction that the corporation entered into to lease property owned by a director of the corporation. After trial, the trial court found for the defendant. The Illinois Appellate Court reversed, reasoning that the lease transaction was an interested director transaction and it was the defendant director’s burden to establish that the transaction was fair to the corporation at the time it was executed. The Illinois Appellate Court found that the defendant failed to demonstrate that the lease was fair, reasoning that the excessive rent could not be justified by the corporation’s desire to remain at the same property.

Comparison to Delaware: Rather than applying a facts and circumstances inquiry, Delaware courts have articulated an “exacting” entire fairness standard that requires “judicial scrutiny regarding both ‘fair dealing’ and ‘fair price.’”<sup>85</sup> “Fair dealing focuses upon the conduct of the corporate fiduciaries in effectuating the transaction, ‘such as its initiation, structure, and negotiation.’”<sup>86</sup> “Fair price ‘relates to the economic and financial considerations of the [contract], including all relevant factors [such as] assets, market value, earnings, [or] future prospects[.]’”<sup>87</sup>

See also:

- *Toedtman v. TurnPoint Medical Devices, Inc.*<sup>88</sup>: In a case involving cross-motions for summary judgment, the court held, *inter alia*, that an employment agreement was a product of both fair dealing and fair price. The plaintiff asserted that he had a valid employment agreement with the defendant company, which the defendant breached when it failed to pay severance and other benefits after the plaintiff’s termination without cause. The defendant company argued that the employment agreement was voidable under Del. C. § 144(a) because it was executed by the plaintiff-director without any board approval.

The court held that this was an interested transaction and that the plaintiff director had the burden of proving entire fairness of the employment contract. When considering whether

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<sup>84</sup> 435 N.E.2d 712 (Ill. App. Ct. 5th Dist. 1982).

<sup>85</sup> *Toedtman v. TurnPoint Med. Devices, Inc.*, No. CV N17C-08-210 RRC, 2019 WL 328559, at \*10 (Del. Super. Ct. Jan. 23, 2019).

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> No. CV N17C-08-210 RRC, 2019 WL 328559 (Del. Super. Ct. Jan. 23, 2019).

there was fair dealing, the court reasoned that testimony indicated that employment agreements are normal, in good corporate practice, and a natural occurrence within corporate governance under Delaware law. The court further noted that the Board's delegation of the authority to negotiate employment contracts to the CFO was also fair and reasonable. The negotiation and structure of the agreement appeared to be fair to the court as well because the employment contract was based on a template contract. Evidence also demonstrated that there was no indication that the plaintiff hid the existence of the employment agreement or otherwise acted in bad faith. Accordingly, the court held that the contested employment agreement was entirely fair.

- *Mills Acquisition Co. v. Macmillan, Inc.*<sup>89</sup>: The court held that an auction that was biased towards one of the buyers was not a fair transaction. The court found that management's financial advisor, in the presence of complicit officers who were on the buy-side of the transaction, misled the board about the bidding process. The court noted that both parties had not received identical information during the action and that conflicted officers had "remained silent" despite knowing that another officer had wrongfully tipped one party's bid to another.

Delaware also has articulated an intermediate standard known as "enhanced scrutiny."<sup>90</sup> The "enhanced scrutiny" standard governs "specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decisionmaking context can subtly undermine the decisions of even independent and disinterested directors."<sup>91</sup> Delaware courts deploy enhanced scrutiny in "specific, recurring situations marked by two features. First, [when] there is an identifiable decision-making context where the realities of the situation can subtly undermine the decisions of even an independent and disinterested fiduciary . . . [and] second, the decision under review involves the fiduciary intruding into a space where stockholders possess rights of their own."<sup>92</sup>

See also:

- *Unocal Corp. v. Mesa Petroleum Co.*<sup>93</sup>: Finding that when a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders and that "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."<sup>94</sup>

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<sup>89</sup> 559 A.2d 1261 (Del. 1989).

<sup>90</sup> *In re Trados Inc. S'holder Litig. (Trados II)*, 73 A.3d 17, 44 (Del. Ch. 2013).

<sup>91</sup> *Id.*

<sup>92</sup> *Firefighters' Pension Sys. of City of Kansas City v. Found. Bldg. Materials, Inc.*, 318 A.3d 1105, 1140 (Del. Ch. 2024).

<sup>93</sup> 493 A.2d 946 (Del. 1985), *holding modified by Coster v. UIP Companies, Inc.*, 300 A.3d 656 (Del. 2023).

<sup>94</sup> *Id.* at 954.

### III. Direct vs. Derivative Actions

Under Illinois law, shareholders may bring direct suits, derivative suits, or both.<sup>95</sup> “To bring an *individual* claim, the shareholder must allege a harm that is separate and distinct from that suffered by other shareholders, and the shareholder must allege something more than a wrong to the corporate body.”<sup>96</sup> On the other hand, a derivative claim is appropriate if the direct injury is to the corporation, and the individual shareholder suffers injury only because the value of her shares has been diminished as a result of the injury to the corporation.<sup>97</sup> “[W]hether an action is derivative or direct turns on whether the [corporation] or the individual [shareholder] has been injured.”<sup>98</sup> The facts underlying each claim are not determinative, as “[d]irect and derivative claims can arise from the same nucleus of facts.”<sup>99</sup> In fact, a plaintiff may bring both “a direct claim for their individual damages and a derivative claim on behalf of the [corporation]” with respect to the same conduct.<sup>100</sup>

See also:

- *Caparos v. Morton*<sup>101</sup>: Certain limited partners brought both direct and derivative claims against the partnership’s general partners. Observing that direct and derivative claims can be brought together if each theory is supported sufficiently by the alleged facts, the court nevertheless reclassified the plaintiffs’ claims as derivative rather than direct, and affirmed the trial court’s judgment in favor of the plaintiffs on the derivative claim, modifying the judgment to direct recovery to the partnership. It was the defendants, not the plaintiffs, who had appealed.

Comparison to Delaware: The analysis under Delaware law is similar. In determining whether a shareholder’s claim is direct or derivative, the Delaware Supreme Court considers two questions: “(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?”<sup>102</sup> The identity of the purported wrongdoer is immaterial to determining whether the claim is direct or derivative.<sup>103</sup> In *Brookfield*, the Delaware Supreme Court overruled the holding in *Gentile* and reaffirmed the “classic” *Tooley* test for distinguishing stockholder derivative claims from direct claims. The Delaware Supreme Court found that plaintiffs’ purportedly direct claims were actually derivative claims and that “corporation

<sup>95</sup> *Caparos v. Morton*, 845 N.E.2d 773, 781–83 (Ill. App. Ct. 1st Dist. 2003) (limited partners in a nightclub brought action against general partners, alleging breach of fiduciary duty both as an individual and as a derivative suit).

<sup>96</sup> *Roberts*, 2021 IL App (2d) 191088-U, ¶ 117 (citations omitted) (emphasis in original).

<sup>97</sup> *Id.*

<sup>98</sup> *Caparos*, 845 N.E.2d at 783.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> 845 N.E.2d 773 (Ill. App. Ct. 1st Dist. 2003).

<sup>102</sup> *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). In *Tooley*, the Delaware Supreme Court rejected the “amorphous” “special injury” test for distinguishing direct claims from derivative claims as needlessly complicating the inquiry by injecting analysis of the nature of the injury itself, rather than simply the parties affected by the injury.

<sup>103</sup> *Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251, 1274 (Del. 2021) (overruling *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006)). In *Gentile*, the Delaware Supreme Court had previously created an exception to the *Tooley* test by allowing direct standing for minority shareholders for claims of corporate overpayments because they caused harms of different magnitudes to minority and controlling shareholders. The *Brookfield* court overruled the *Gentile* carve-out because of its tension with *Tooley* and reliance on “special injury” precedent.

overpayment/dilution *Gentile* claims, like those present here, are exclusively derivative under *Tooley*.”<sup>104</sup> Delaware courts continue to apply the *Tooley* test while citing *Brookfield* to find that plaintiffs have impermissibly brought derivative, not direct, suits and grant defendants’ motions to dismiss these types of suits.<sup>105</sup>

See also:

- *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*<sup>106</sup>: Minority shareholders sued for lost time-value of money caused by a controlling shareholder’s delay in closing a tender offer. The trial court held that the minority shareholders had failed to allege standing to assert a direct claim because the delay harmed every shareholder equally. The court affirmed on the distinct ground that neither a direct *nor* a derivative claim had been stated, because there was no individual shareholder contract right at stake, and the corporation had not been harmed by the delay.

#### **A. Direct Suits**

A shareholder who has a direct and personal interest in a claim may bring suit in an individual capacity even if the corporation’s rights are also implicated.<sup>107</sup> The shareholder asserting a direct claim must allege something more than wrong to the corporate body, such as an injury that is “separate and distinct from that suffered by other shareholders,” or that involves a contractual right that exists independently of any corporate right.<sup>108</sup> This is known as the “shareholder standing rule,” which bars direct claims by corporate shareholders where there is no showing that the plaintiff was injured in any capacity that is distinct from fellow shareholders.<sup>109</sup> If the injury is incurred by the corporation only, then the shareholders are limited to bringing a derivative claim only, and may not assert a direct claim.<sup>110</sup> That the foundational allegations giving rise to an individual direct claim are the same as the allegations giving rise to a derivative claim is not automatically fatal to the direct claim, so long as the plaintiff alleges an injury that is unique to that plaintiff, as distinct from the corporation.<sup>111</sup>

See also:

- *Sterling Radio Stations, Inc. v. Weinstine*<sup>112</sup>: The plaintiff shareholder was able to bring a legal malpractice claim against corporation’s former attorneys because he had personally

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<sup>104</sup> *Id.*

<sup>105</sup> *See In re FairPoint Ins. Coverage Appeals*, 311 A.3d 760, 767–68 (Del. 2023), as revised (Dec. 19, 2023); *In re Tesla Motors, Inc. S’holder Litig.*, 298 A.3d 667, 694 n.80 (Del. 2023); *Tornetta v. Musk*, 310 A.3d 430, 495 (Del. Ch. 2024).

<sup>106</sup> 845 A.2d 1031 (Del. 2004).

<sup>107</sup> *Alpha School Bus Co., Inc. v. Wagner*, 910 N.E.2d 1134 (Ill. App. Ct. 1st Dist. 2009); *Davis*, 900 N.E.2d at 705–06.

<sup>108</sup> *Davis*, 900 N.E.2d at 710; See also *Caparos*, 845 N.E.2d at 781.

<sup>109</sup> *Larochelle v. Allamian*, 836 N.E.2d 176, 186–87 (Ill. App. Ct. 2d Dist. 2005).

<sup>110</sup> *Id.*

<sup>111</sup> *Davis*, 900 N.E.2d at 711. *But see Flynn v. Maschmeyer*, 156 N.E.3d 540, 565 (Ill. App. Ct. 1st Dist. 2020) (no direct claims were stated where “those claims [we]re merely the same claims [brought derivatively] . . . wearing a slightly different hat.”).

<sup>112</sup> 765 N.E.2d 56 (Ill. App. Ct. 1st Dist. 2002).

guaranteed a promissory note. The court found that the plaintiff shareholder, as the guarantor of the promissory note and the one who had hired the law firm to represent both him and the corporation, was personally liable in the prior lawsuit and so he was seeking to recover for a harm done directly to him by the defendant attorneys.

- *Alpha School Bus Co., Inc. v. Wagner*<sup>113</sup>: The corporation brought suit against corporate officer, managing employee, and competing company owned by officer. The court held that a controlling shareholder lacked individual standing for injuries directly to the company it had a controlling stake in because a shareholder of a corporation seeking relief for an injury to the corporation, rather than a direct injury to the shareholder himself, must bring the suit derivatively on behalf of the corporation.<sup>114</sup>

Comparison to Delaware: Similar to Illinois law, the distinction between a derivative versus individual action under Delaware law rests upon whether the plaintiff alleges a direct or independent injury flowing from the alleged wrongdoing.<sup>115</sup> To have standing to sue individually, a plaintiff must allege more than an injury resulting from a wrong to the corporation.<sup>116</sup> Delaware courts hold that strictly derivative claims that are mistakenly brought as direct claims must be dismissed.<sup>117</sup>

- *Gatz v. Ponsoldt*<sup>118</sup>: Plaintiffs brought an action challenging certain “recapitalization” transactions. The court held that this challenge was appropriately brought as a direct action because the transactions caused “an expropriation of economic value and voting power from the public shareholders.”

#### 1. Common Direct Claims Against Directors and Officers

Claims commonly brought as direct claims under Illinois law include those regarding

- a shareholder’s right to vote;<sup>119</sup>
- a shareholder employee’s termination;<sup>120</sup> and
- the nonpayment of promised dividends.<sup>121</sup>

A corporation’s appropriation of a shareholder’s property also would give rise to a direct suit.<sup>122</sup>

<sup>113</sup> 910 N.E.2d 1134 (Ill. App. Ct. 1st Dist. 2009).

<sup>114</sup> *Id.* at 1157.

<sup>115</sup> *Kramer v. Western Pacific Indus., Inc.*, 546 A.2d 348, 351 (Del. 1988).

<sup>116</sup> *Id.* (citing *Moran v. Household International, Inc.*, 490 A.2d 1059, 1070 (Del. Ch. 1985) (“[T]o set out an individual action, the plaintiff must allege either ‘an injury which is separate and distinct from that suffered by other shareholders,’ or a wrong involving a contractual right of a shareholder . . . which exists independently of any right of the corporation.”)).

<sup>117</sup> *Caspian Select Credit Master Fund Ltd. v. Gohl*, 2015 WL 5718592, at \*18 (Del. Ch. Sept. 28, 2015).

<sup>118</sup> 925 A.2d 1265 (Del. 2007).

<sup>119</sup> See *Caparos*, 845 N.E.2d at 781.

<sup>120</sup> See *Kovac v. Barron*, 2014 IL App (2d) 121100, ¶¶ 63, 65.

<sup>121</sup> See *Romanik*, 435 N.E.2d at 723.

<sup>122</sup> See *Zokoych v. Spalding*, 344 N.E.2d 805, 813 (Ill. App. Ct. 1st Dist. 1976).

See also:

- *Alpha School Bus Co., Inc. v. Wagner*<sup>123</sup>: Plaintiff corporation was permitted to bring a direct suit against a former officer of a wholly owned subsidiary of plaintiff corporation where the former officer allegedly converted seven boxes of records and files belonging to plaintiff corporation.
- *Davis v. Dyson*<sup>124</sup>: Condominium unit owners were not permitted to bring a direct suit against former members of the condominium association’s board of directors for breach of fiduciary duty because the condominium unit owners could not allege “something more than wrong to the corporate body.”
- *Larochelle v. Allamian*<sup>125</sup>: Shareholders sufficiently alleged facts to establish their standing to bring a direct suit when they alleged that (1) they had received monthly statements showing a consistently rising share value; (2) they were later informed that their shares had actually decreased in value by 4.36% and that all of their shares were to be redeemed; (3) they were subsequently informed that this decrease in value was actually 15.78% and had been occurring for almost seven months without disclosure; (4) plaintiffs’ shares were not liquid; (5) plaintiffs had not received any redemption payouts; and (6) certain insider investors had received a full payout of their share values just prior to the 4.36% announcement. The court found that under these facts, the plaintiffs had been subject to acts and suffered injuries that were distinct.
- *Andrews v. Gerace*<sup>126</sup>: The plaintiff shareholder alleged that her defendant co-shareholder stole earnings and other property from two corporations. The court held that the shareholder failed to allege a direct claim because, even though the shareholder’s profit payouts were reduced, the alleged theft directly injured the corporation only.
- *Cashman v. Coopers & Lybrand*<sup>127</sup>: The court affirmed dismissal of the plaintiff shareholders’ direct claims against the corporation’s accountants for breach of contract, negligence, and fraud because the accountants’ contractual duties ran to the corporation and the alleged misrepresentations were made to both the shareholders and the corporation. The court rejected the shareholders’ claim that the accountants’ actions injured them directly by misleading them to not sell their shares before the shares became worthless, as this was not practically different from the claim that the accountants’ actions caused the shares to become worthless—a derivative claim.

Comparison to Delaware: Direct claims under Delaware law frequently concern

- a shareholder’s right to vote (including dilution and inadequate disclosure before a vote);<sup>128</sup>

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<sup>123</sup> 910 N.E.2d 1134 (Ill. App. Ct. 1st Dist. 2009).

<sup>124</sup> 900 N.E.2d 698 (Ill. App. Ct. 1st Dist. 2008).

<sup>125</sup> 836 N.E.2d 176 (Ill. App. Ct. 2d Dist. 2005).

<sup>126</sup> 2014 WL 4627383 (N.D. Ill. Sept. 15, 2014) (applying Illinois law).

<sup>127</sup> 623 N.E.2d 907 (Ill. App. Ct. 2d Dist. 1993).

<sup>128</sup> See *In re J.P. Morgan Chase & Co. S’holders Litig.*, 906 A.2d 766, 771 (Del. 2006).

- a shareholder’s right to alienate shares;<sup>129</sup> or
- the enforcement of constraints on a board’s authority under the corporation’s charter, bylaws, or the Delaware General Corporate Law.<sup>130</sup>

Contract parties may sue directly on their contracts, regardless of whether a corporation—even one in which the contract party owns stock—is a third-party beneficiary. This is because parties may always enforce their own rights under a contract independent of third-party rights.<sup>131</sup> Shareholders may also sue directly to vindicate their statutory rights, such as the right to bring an action to validate a defective corporate act;<sup>132</sup> the right to bring an action challenging ballot, proxies, or votes;<sup>133</sup> and the right to bring an appraisal proceeding.<sup>134</sup>

See also:

- *In re J.P. Morgan Chase & Co. S’holder Litig.*<sup>135</sup>: The Court held it was undisputed that a claim that shareholder approval of an acquisition was induced by a misleading proxy statement, which failed to disclose an offer by the target company that would not have required a premium from the acquiring company, stated a direct claim because the nondisclosure had allegedly “impaired the stockholders’ right to cast an informed vote.” Despite finding the disclosure claim was direct, the court ultimately affirmed dismissal because the shareholders failed to plead compensatory damages logically related to the disclosure violation.
- *In re Gaylord Container Corp. S’holder Litig.*<sup>136</sup>: The Court ruled that a claimed injury from a board’s adoption of a poison pill stated a direct claim because the alleged interference in the shareholder’s ability to sell its shares to a new owner caused no injury to the corporation itself.
- *Grayson v. Imagination Station, Inc.*<sup>137</sup>: The Court held that a claim that a corporation acted without approval of its duly authorized board—because the defendants had blocked the appointment of a director to which the plaintiffs were entitled—stated a direct claim because the defendant, who was both a shareholder and a director, had “violated th[e] structural relationship [established by the DGCL] by disregarding the specific restraints placed on him [] by the shareholders.”

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<sup>129</sup> See *In re Gaylord Container Corp. S’holders Litig.*, 747 A.2d 71, 78–79 (Del. Ch. 1999).

<sup>130</sup> See *Grayson v. Imagination Station, Inc.*, No. CIV.A. 5051-CC, 2010 WL 3221951, at \*5 (Del. Ch. Aug. 16, 2010).

<sup>131</sup> *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 176 (Del. 2015).

<sup>132</sup> 8 Del. C. § 205.

<sup>133</sup> *Id.* § 231(c).

<sup>134</sup> *Id.* § 262(a).

<sup>135</sup> 906 A.2d 766 (Del. 2006).

<sup>136</sup> 747 A.2d 71 (Del. Ch. 1999).

<sup>137</sup> No. CIV.A. 5051-CC, 2010 WL 3221951 (Del. Ch. Aug. 16, 2010).

## B. *Derivative Suits*

A shareholder derivative suit permits an individual shareholder to bring suit “to enforce a corporate cause of action against officers, directors, and third parties.”<sup>138</sup> It was intended as a vehicle to allow shareholders to protect a corporation’s interests from “faithless directors and managers.”<sup>139</sup> In derivative suits, “the suit is brought on behalf of the corporation for harm done to it for which the corporation either cannot assert or refuses to assert its own right.”<sup>140</sup> Where corporate management, “through fraud, neglect of duty or other cause[,] declines to take the proper and necessary steps to assert the [corporation’s] rights,” shareholders are entitled to fulfill management’s duty to bring a lawsuit.<sup>141</sup> Illinois courts view derivative suits as “technically” involving two causes of action: “one against the board of directors for failing to sue, and the other based upon the corporate right that was allegedly violated.”<sup>142</sup> “Because of this, a corporation is a necessary party to a derivative suit on its behalf . . . nominally [as] a defendant.”<sup>143</sup>

See also:

- *Davis v. Dyson*<sup>144</sup>: Condominium unit owners were allowed to bring a derivative suit on behalf of a condominium association against former members of its board of directors for breach of fiduciary duty, even though the former directors were no longer on the board, because “[o]nce unit owners are permitted to step into an association’s shoes [via a derivative suit], it follows that they ought to be able to sue any party that the association itself might sue,” and there was no dispute that the association could sue its former directors.

Comparison to Delaware: As in Illinois, Delaware derivative suits have dual purposes: They seek to compel the corporation to act, as well as to recover on behalf of the corporation for injuries done to it.<sup>145</sup> Common derivative claims include those that “involve corporate mismanagement or breach of fiduciary duty” and breach of a contract to which the corporation itself is a party.<sup>146</sup> Any recovery from derivative suits must inure to the corporation.<sup>147</sup> For example, “[a] stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation, and may pursue such a claim even after the merger at issue has been consummated”; however, a challenge based on “alleged wrongs associated with the merger, such as the award of golden parachute employment contracts” seeks relief for the company, and thus would be a derivative suit.<sup>148</sup>

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<sup>138</sup> *Kamen v. Kemper Financial Servs., Inc.*, 500 U.S. 90, 95 (1991) (quoting *Ross v. Bernhard*, 396 U.S. 531, 534 (1970)).

<sup>139</sup> *Kamen*, 500 U.S. at 95 (quoting *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 548 (1949)).

<sup>140</sup> *Caparos*, 845 N.E.2d at 781.

<sup>141</sup> *Davis*, 900 N.E.2d at 705.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> 900 N.E.2d 698 (Ill. App. Ct. 1st Dist. 2008).

<sup>145</sup> *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

<sup>146</sup> *In re Activision Blizzard, Inc. S’holder Litig.*, 124 A.3d 1025, 1046 & n.4 (Del. Ch. 2015).

<sup>147</sup> *Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251, 1263 (Del. 2021).

<sup>148</sup> *Parnes v. Bally Ent. Corp.*, 722 A.2d 1243, 1245 (Del. 1999).

See also:

- *Kramer v. Western Pacific Indus, Inc.*<sup>149</sup>: The shareholders challenged the decision by the board of directors to grant stock options and golden parachutes to management six months before a buyout merger. The shareholders argued that the claim was direct because their share of the proceeds from the buyout sale was reduced by the resources used to pay for the options and golden parachutes. The court held that this was actually a derivative claim because the injury, and accordingly any recovery, would be to the corporation.

1. Standing

Derivative suits require plaintiffs to satisfy unique standing requirements:

- The derivative plaintiff “must have been a shareholder at the time of the transaction of which he complains *and must maintain his status as a shareholder throughout the entire pendency of the action.*”<sup>150</sup>
- There must not be a conflict between the interests of the derivative plaintiff “and the interests of the parties he represents.”<sup>151</sup>
- The derivative plaintiff “must allege with particularity the demand made, if any, to obtain action by the directors and either why the complainant could not obtain the action or why he or she did not make the demand.”<sup>152</sup>

While insolvency does not divest a corporation’s shareholders of their standing to bring derivative suits, it does extend standing for derivative claims to the corporation’s creditors.<sup>153</sup>

See also:

- *Stevens v. McGuireWoods LLP*<sup>154</sup>: Former shareholders in a corporation “divested themselves of their right to assert claims on [the corporation’s] behalf” when they “divested themselves of their ownership interest in [the corporation].”
- *Caulfield*<sup>155</sup>: Plaintiffs had a significant conflict of interest that barred them from bringing a derivative suit because they had previously obtained and were pursuing collection of substantial individual judgments against the same defendants in separate litigation. Specifically, the plaintiffs’ ongoing attempts to satisfy their individual judgments served to deplete the assets available to the corporations’ shareholders, for whom they would be fiduciaries as derivative plaintiffs.

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<sup>149</sup> 546 A.2d 348 (Del. 1988).

<sup>150</sup> *Stevens v. McGuireWoods LLP*, 43 N.E.3d 923, 931 (Ill. 2015) (emphasis in original).

<sup>151</sup> *Caulfield v. Packer Grp., Inc.*, 56 N.E.3d 509 (Ill. App. Ct. 1st Dist. 2016).

<sup>152</sup> *Silver v. Allard*, 16 F. Supp. 2d 966, 969 (N.D. Ill. 1998) (applying Illinois law and citing 805 ILCS 5/7.80(b)).

<sup>153</sup> *Caulfield*, 56 N.E.3d at 519.

<sup>154</sup> 43 N.E.3d 923 (Ill. 2015).

<sup>155</sup> 56 N.E.3d 509 (Ill. App. Ct. 1st Dist. 2016).

*Comparison to Delaware:* Like Illinois, Delaware requires special standing requirements to maintain a derivative suit. Specifically, derivative plaintiffs must<sup>156</sup>:

- (1) (a) retain ownership of their shares throughout the litigation;
- (2) (b) make a pre-suit demand on the board; and
- (3) (c) obtain court approval of any settlement.

Like Illinois law, Delaware law allows for the disqualification of a representative shareholder plaintiff if “a serious conflict exists [and] the plaintiff cannot be expected to act in the interests of the others because doing so would harm his other interests.”<sup>157</sup> Delaware law also holds that a corporation’s insolvency expands the class of those eligible to bring a derivative claim to include creditors in addition to shareholders.<sup>158</sup>

See also:

- *Youngman v. Tahmoush*<sup>159</sup>: While acknowledging that the plaintiff may have had, in part, a “selfish motive” in bringing the derivative action, the court declined to disqualify the plaintiff where the primary conflict of interest alleged was that the plaintiff owned a “substantial,” but “hardly . . . majority or controlling interest” in a company that had made a tender offer to acquire the defendant corporation, and the director defendants’ defensive measures against that tender offer were the subject of the derivative suit. The only other allegation—that the plaintiff would use insider information against the defendant corporation—was entirely speculative and unsupported by the record. Disqualification was thus unwarranted because it takes more than “mere hypothesis to disqualify a plaintiff,” and the record did not support the defendants’ allegations of disqualifying antagonism.

## 2. Demand

To bring a derivative suit, a shareholder must first make a demand to the board of directors to bring the suit on behalf of the company. “The demand requirement is a substantive requirement that [e]nsure[s] that a stockholder exhausts his intracorporate remedies, provide[s] a safeguard against strike suits, and assure[s] that the stockholder affords the corporation the opportunity to address an alleged wrong without litigation and to control any litigation which does occur.”<sup>160</sup> To avoid dismissal, a derivative plaintiff “must allege with particularity the demand made, if any, to obtain action by the directors and either why the complainant could not obtain the action or why he or she did not make the demand,” i.e., why demand would have been futile.<sup>161</sup>

Where demand on the board of directors is futile, a plaintiff need not make the demand prior to initiating a derivative suit. To determine whether demand is futile, Illinois courts employ the two-

<sup>156</sup> *Tooley*, 845 A.2d at 1036 (citing Del. Ch. Ct. R. 23.1).

<sup>157</sup> *Emerald Partners v. Berlin*, 564 A.2d 670, 674 (Del. Ch. 1989).

<sup>158</sup> *Caulfield*, 56 N.E.3d at 519; See also *Schoon v. Smith*, 953 A.2d 196, 208 n.46 (Del. 2008).

<sup>159</sup> 457 A.2d 376 (Del. Ch. 1983).

<sup>160</sup> *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, No. 404, 2020, 2021 WL 4344361 (Del. Sept. 23, 2021) (internal quotations omitted).

<sup>161</sup> 805 ILCS 5/7.80(b).

pronged standard from *Aronson v. Lewis*<sup>162</sup>. To establish futility, the plaintiff must “raise[] a reasonable doubt that (1) the directors are disinterested and independent or (2) that the challenged transaction was the product of a valid exercise of the directors’ business judgment.”<sup>163</sup>

“[T]o show lack of disinterest and independence, [p]laintiffs must allege with particularity ‘self-dealing, personal benefit or bias.’”<sup>164</sup> However, “the mere fact that the directors are asked to sue themselves and risk personal liability is not enough to show lack of disinterest and independence.”<sup>165</sup>

The fact that a claim may be brought derivatively does not necessarily preclude a plaintiff from bringing the claim directly on their own behalf.

See also:

- *Conant, Jr. v. Delman*<sup>166</sup>: the plaintiff established demand futility when a distribution caused by the corporation’s two managing members resulted in the plaintiff, a member who owned 50% of the LLC, receiving only 7% of the distributed funds while the managing members, who comprised the remaining 50% ownership of the LLC, received 93%. After a bench trial, the court found that the managing members caused the imbalanced distribution, failed to disclose it to the plaintiff, and persisted in defending it when confronted. The court held that the managing members were neither disinterested nor independent and, thus, the adversely impacted member did not need to demand that the managing members bring suit on behalf of the LLC.
- *In re Boricich*<sup>167</sup>: Demand futility was established when the defendant was one of the corporation’s only two directors, and owned 50% of the corporation’s stock, because the defendant clearly would not have approved any action against himself brought by the corporation.

Comparison to Delaware: Delaware and Illinois courts both use the two-pronged *Aronson* standard in determining whether demand is excused as futile. The Delaware Supreme Court recently refined this test, combining it with the alternative *Rales* test<sup>168</sup> into a three-prong “universal test for

<sup>162</sup> 473 A.2d 805 (Del. 1984), *rev’d on other grounds*, *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

<sup>163</sup> *In re Boricich*, 2011 WL 2600692, at \*6 (Bankr. N.D. Ill. June 29, 2011), *amended*, 464 B.R. 335 (Bankr. N.D. Ill. 2011) (applying Illinois law).

<sup>164</sup> *Silver*, 16 F. Supp. 2d at 970; *Conant, Jr. v. Delman*, No. 13CH15361, 2016 WL 675755, at \*9 (Ill. Cir. Ct. Cook Cnty. Jan. 29, 2016) (“Courts have found demand unlikely to succeed, or futile, when the controlling members personally participated in the alleged wrongful conduct.”).

<sup>165</sup> *Silver*, 16 F. Supp. 2d at 970–71. *See Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 179 (Del. Ch. 2005), *aff’d*, 906 A.2d 114 (Del. 2006) (“Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence.”); *Desimone v. Barrows*, 924 A.2d 908, 946 (Del. Ch. 2007) (holding that demand was excused because the directors were not disinterested in the challenged transaction, which granted the directors a personal financial stake by giving them market-price options).

<sup>166</sup> No. 13CH15361, 2016 WL 675755 (Ill. Cir. Ct. Cook Cnty. Jan. 29, 2016).

<sup>167</sup> 2011 WL 2600692, at \*6 (Bankr. N.D. Ill. June 29, 2011), *amended*, 464 B.R. 335 (Bankr. N.D. Ill. 2011) (applying Illinois law).

<sup>168</sup> Prior to the 2021 *Zuckerberg* decision, the test from *Rales v. Blasband* was applied “where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit.” 634

assessing whether demand should be excused as futile.”<sup>169</sup> Delaware courts now determine whether demand is excused as futile by considering, on a director-by-director basis, a complaint’s allegations of particularized fact in light of the following questions<sup>170</sup>:

- whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;
- whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and
- whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

“If the answer to any of the questions is ‘yes’ for at least half of the members of the demand board, then demand is excused as futile.”<sup>171</sup>

See also:

- *Aronson v. Lewis*<sup>172</sup>: Demand futility was not established when one of the director defendants owned 47% of the corporation’s stock and was alleged to have personally selected the other directors on the board, because the plaintiffs failed to allege facts showing domination and control of the other directors.

#### IV. Jurisdiction and Venue

In Illinois, venue is statutory. Section 2-101 of the Illinois Code of Civil Procedure provides that every action must be commenced either: (1) in the county where any defendant lives, or (2) in the county where the cause of action arose.<sup>173</sup> Subsection 2-102(a) defines residency for corporate defendants. It provides that a private corporation “is a resident of any county in which it has its registered office or other office or is doing business.”<sup>174</sup> This provision “reflect[s] the legislature’s view that a [corporate defendant] should not be put to the burden of defending an action in a county

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A.2d 927, 933–34 (Del. 1993). The test broadened *Aronson*’s application by asking only “whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.” *Id.* at 934. Because “the *Aronson* test is best understood as a special application of the *Rales* test,” the *Zuckerberg* court formulated a single, universal test to replace both. *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1048 (Del. 2021).

<sup>169</sup> *Zuckerberg*, 262 A.3d at 1058.

<sup>170</sup> *Id.* at 1058–59.

<sup>171</sup> *Id.* at 1059.

<sup>172</sup> 473 A.2d 805 (Del. 1984), *rev’d on other grounds*, *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

<sup>173</sup> 735 ILCS 5/2-101.

<sup>174</sup> 735 ILCS 5/2-102(a).

where the party does not maintain an office or do business and where no part of the transaction complained of occurred.”<sup>175</sup>

The phrase “other office” as used in the statute means a fixed place of business at which the affairs of the corporation are conducted in furtherance of a corporate activity. The phrase “other office” includes any fixed location purposely selected to carry on an activity in furtherance of the corporation’s business activities, and the facility may be open to the public or may be a strictly private corporate operation.<sup>176</sup> It need not be a traditional office in which clerical activities are conducted.<sup>177</sup>

The “doing business” provision of the venue statute is not synonymous with the test for establishing jurisdiction, as the venue provision is narrower and is intended to uphold the principle of convenience.<sup>178</sup> Thus, establishing “doing business” for venue purposes requires quantitatively more business activity than for purposes of jurisdiction.<sup>179</sup>

See also:

- *Gardner v. Int’l Harvester Co.*<sup>180</sup>: The court found venue to be improper where a manufacturer’s sales representative did not make sales of the company’s products during visits to the county, but instead solicited orders and completed sales elsewhere.
- *Reynolds v. GMAC Fin. Services*<sup>181</sup>: The court found venue proper in the county where a company had purchased finance contracts from 21,797 county residents since 1991, contracted with dealers in the county for financing purposes, exchanged money generated from income derived from these financing contracts each month, and had been involved in wholesale security agreements with dealers in the county to finance dealer inventory and certain loans.
- *Weaver v. Midwest Towing, Inc.*<sup>182</sup>: The court found venue proper where some business was done in the county and where the company failed to justify why its arguments to the contrary were proper.

Comparison to Delaware: Directors and senior officers of a Delaware corporation are subject to personal jurisdiction in Delaware for civil suits brought in the State of Delaware. This applies for actions involving corporations in which its director or officer is a necessary or proper party, or in any action or proceeding against such director or officer for violation of a duty in such capacity. It does not matter if such person continues to serve as such director or officer at the time suit is commenced.<sup>183</sup> An action to interpret, apply, enforce or determine any provision of the certificate of incorporation or the bylaws may be brought in the Court of Chancery, except to the extent that

<sup>175</sup> *Bucklew v. G.D. Searle & Co.*, 562 N.E.2d 186, 189 (Ill. App. Ct. 1st Dist. 1990).

<sup>176</sup> *Melliere v. Luhr Bros., Inc.*, 706 N.E.2d 40, 44 (Ill. App. Ct. 5th Dist. 1999).

<sup>177</sup> *Id.*

<sup>178</sup> *Id.* at 43.

<sup>179</sup> *Baltimore & O. R. Co. v. Mosele*, 368 N.E.2d 88, 92 (Ill. 1977).

<sup>180</sup> 499 N.E.2d 430 (Ill. 1986).

<sup>181</sup> 801 N.E.2d 11 (Ill. App. Ct. 5th Dist. 2003).

<sup>182</sup> 487 N.E.2d 1259 (Ill. App. Ct. 5th Dist. 1986), *judgment aff’d and remanded*, 507 N.E.2d 838 (Ill. 1987).

<sup>183</sup> 10 Del. C. § 3114.

a statute confers exclusive jurisdiction on a court, agency or tribunal other than the Court of Chancery.<sup>184</sup>

### A. *Forum Selection*

Many Illinois corporations have charter or bylaw forum selection provisions for intra-entity disputes. This forum selection practice was established in dicta by *In re Revlon Inc.*<sup>185</sup> and is frequently adopted by corporations formed in other states. Illinois courts have generally recognized that public policy favors enforcement of forum selection clauses and will enforce parties' choice of law unless it is "dangerous, inconvenient, immoral, or contrary to Illinois public policy."<sup>186</sup>

See also:

- *Schnall v. Chessick*<sup>187</sup>: The plaintiff shareholder brought suit against a defendant officer who was a resident of Illinois, alleging that the defendant officer breached its duty of care and loyalty to the corporation. The defendant argued that the suit should have been brought in Delaware courts in line with the forum selection clause in the corporation's bylaws. The plaintiff shareholder argued that the forum selection clause was unenforceable because litigating in Delaware would impose hardship on the plaintiff and that adoption of the forum selection clause itself was a breach of the defendant officer's fiduciary duties. The court rejected the plaintiff shareholder's argument, reasoning that forum selection clauses are "presumptively valid" and that the plaintiff had failed to submit any evidence establishing that the forum selection clause was invalid "due to fraud, undue influence or overweening bargaining power," or that it was unreasonable. Accordingly, the court granted the defendant's motion to dismiss.

Comparison to Delaware: In Delaware, incorporating documents and bylaws may contain a provision mandating adjudication of intra-corporate disputes in Delaware courts.<sup>188</sup> A forum selection bylaw also may select a state other than the state of incorporation for resolution of intra-corporate disputes.<sup>189</sup> 8 Del. C. § 115 further provides that neither the certificate of incorporation nor the bylaws may prohibit bringing such claims in Delaware.<sup>190</sup> The statute defines "internal corporate claims" as claims, including claims brought on behalf of the corporation, that are based

<sup>184</sup> 8 Del. C. § 111.

<sup>185</sup> 990 A.2d 940 (Del. Ch., 2010).

<sup>186</sup> *DeValk Lincoln Mercury, Inc. v. Ford Motor Co.*, 811 F.2d 326, 330 (7th Cir. 1987) (applying Michigan law since such law was not dangerous, inconvenient, or immoral nor contrary to the public policy of Illinois law); *Fabian v. BCG Holdings, LP*, 24 N.E.3d 307, 313 (Ill. App. Ct. 1st Dist. 2014) (affirming the circuit court's decision to allow for the forum selection clause because it did not contravene Illinois public policy, and because all parties freely entered into the agreement); *Schnall v. Chessick*, 17 CH 14264, 2018 Ill. Cir. LEXIS 1771 (Ill. Cir. Ct. Cook Cnty. Sept. 21, 2018) (holding that forum selection clauses may address the rights of shareholders as to where they may exercise their right to bring certain internal affairs claims against the corporation, directors, and officers) (citing *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 951 (Del. Ch. 2013)).

<sup>187</sup> 17 CH 14264, 2018 Ill. Cir. LEXIS 1771 (Ill. Cir. Ct. Cook Cnty. Sept. 21, 2018).

<sup>188</sup> 8 Del. C. § 115; *see Boilermakers*, 73 A.3d at 963 (holding that the bylaw providing that litigation relating to the internal affairs of the corporation should be conducted in the forum state was valid and enforceable).

<sup>189</sup> *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229, 242 (Del. Ch. 2014) (holding that the bylaw selecting state law for intra-corporate disputes involving a corporation organized under state law was valid), *superseded on other grounds by statute*, 8 Del. C. § 115.

<sup>190</sup> 8 Del. C. § 115; *See also Salzberg v. Sciabacucchi*, 227 A.3d 102, 119 (Del. 2020).

upon a violation of a duty by a current or former director or officer or shareholder in such capacity.<sup>191</sup> For example, this would include any claim subject to the internal affairs doctrine, such as claims for breach of fiduciary duty.

## V. Indemnification

In certain situations, a corporation may indemnify a director (permissive indemnification), or must indemnify a director (mandatory indemnification).

The indemnification provided by Illinois statute is not exclusive, but provides a perspective on the scope of indemnification.<sup>192</sup> The statute governs not just indemnification for “a director, officer, employee or agent of the corporation,”<sup>193</sup> but also encompasses the people who serve in the foregoing capacities at the request of the corporation but with respect to “another corporation, partnership, joint venture, trust or other enterprise” (such as employees of a parent corporation who serve as directors or officers of a subsidiary).<sup>194</sup> The indemnification also extends to someone who has ceased to be a director, officer, employee or agent and such person’s legal representatives, unless negated by the initial authorization of the indemnification.<sup>195</sup> Since indemnification of officers and directors is a significant activity from the standpoint of corporate governance, whenever a corporation pays indemnity or advances expenses to an officer or a director, the corporation is required to report such activity in writing to the shareholders “with or before the notice of the next shareholders meeting.”<sup>196</sup>

*Comparison to Delaware:* 8 Del. C. § 145 sets out the statutory authority for Delaware corporations to indemnify their directors, officers, employees, and agents. In Delaware, indemnification is mandatory for a present or former director or officer who is successful on the merits or otherwise in any suit covered by Section 145.<sup>197</sup> It is permissive for any other person who is not a present or former director or officer and who is successful on the merits or otherwise in any such suit or matter.<sup>198</sup> Section 145(e) also provides that advancements may be provided for expenses (including attorneys’ fees) incurred by an officer or director of the corporation in defending any lawsuit as long as the officer or director agrees to pay that advancement back if the officer and director later loses the lawsuit. Section 145(g) also grants the corporation the power to purchase and maintain insurance on behalf of officers and directors.

### A. Permissive Indemnification

#### 1. Scope

In Illinois, the scope of permissible indemnification is very broad, and includes “expenses, (including attorneys’ fees), judgments, fines and amounts paid in settlement” for “threatened, pending or completed” litigation that is “civil, criminal, administrative or investigative” in

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<sup>191</sup> 8 Del. C. § 115.

<sup>192</sup> 805 ILCS 5/8.75(f).

<sup>193</sup> 805 ILCS 5/8.75(a), (b), (d), (e), (g), (i), (j), (k).

<sup>194</sup> 805 ILCS 5/8.75(a), (b), (g), (i).

<sup>195</sup> 805 ILCS 5/8.75(k).

<sup>196</sup> 805 ILCS 5/8.75(h).

<sup>197</sup> 8 Del. C. § 145(c)(1).

<sup>198</sup> *Id.* § 145(c)(2).

nature.<sup>199</sup> Indemnification is allowed for “any person who was or is a party, or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding.”<sup>200</sup> Other indemnifications are also permitted under any “by-law, agreement, vote of shareholders or disinterested directors” of the corporation.<sup>201</sup>

*Comparison to Delaware:* 8 Del. C. § 145(a) and 145(b) authorize, but do not require, a Delaware corporation to indemnify its current or former directors, officers, employees, or agents in both third-party actions and corporate and derivative actions. Sections 145(a) and 145(b) also apply to employees, agents, and persons serving at the corporation’s request as a director, officer, employee, or agent of another entity. While they are not required to do so, many corporations agree in advance to provide an eligible person with the maximum scope of indemnification that the corporation may provide to that person under Sections 145(a) and 145(b).

## 2. Third-Party Claims

There are two main types of claims that can be brought against an officer and director—claims brought directly by a third party, and claims brought against the director or officer by the corporation itself (such as derivative claims). These two types of claims are treated separately in the indemnification context. For third-party claims, a director or officer may be indemnified for “expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred.”<sup>202</sup> However, directors and officers must show that: (1) they acted in good faith; and (2) they acted in a manner that they “reasonably believed to be in, or not opposed to[,] the best interests of the corporation.”<sup>203</sup> In addition, with respect to a criminal proceeding, the person seeking indemnification must have had “no reasonable cause to believe his or her conduct was unlawful.”<sup>204</sup> Any judgment or settlement in an associated litigation does not “create a presumption” that the person did not meet the required standard of conduct for indemnification.<sup>205</sup>

For a corporation to approve any indemnification, it must determine that the person seeking indemnification has acted with the required standard of conduct discussed above. Generally, this determination can be made (1) by the majority vote of the directors who are not parties to such action, suit or proceeding, (2) by a committee of such directors designated by a majority vote of such directors, (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the shareholders.<sup>206</sup>

*Comparison to Delaware:* Delaware’s requirements for indemnification of third-party claims against directors and officers are materially the same as those of Illinois.<sup>207</sup>

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<sup>199</sup> 805 ILCS 5/8.75(a).

<sup>200</sup> *Id.*

<sup>201</sup> *Id.* 5/8.75(f).

<sup>202</sup> 805 ILCS 5/8.75(a).

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> 805 ILCS 5/8.75(d).

<sup>207</sup> “A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding” and “[a]ny indemnification . . . shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the

### 3. Corporate and Derivative Actions:

For suits brought against the director or officer by the corporation (including derivative suits), the director and officer may only be indemnified for reasonably incurred expenses of litigation, including attorney's fees.<sup>208</sup> Persons seeking indemnification must also show that they "acted in good faith and in a manner [they] reasonably believed to be in, or not opposed to, the best interests of the corporation."<sup>209</sup> As with direct claims, whether the person seeking indemnification acted in good faith and with the best interests of the corporation may be determined (1) by the majority vote of the directors who are not parties to such action, suit or proceeding, (2) by a committee of such directors designated by a majority vote of such directors, (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the shareholders.<sup>210</sup> However, when an officer or director has been held liable to the corporation, only the court can determine that the director or officer acted with the required standard of conduct and authorize any indemnification.<sup>211</sup>

*Comparison to Delaware:* Delaware's requirements for indemnification of claims brought by the corporation against directors and officers are materially the same as those of Illinois.<sup>212</sup> Like Illinois, Delaware does not allow indemnification of judgments, fines, or settlement amounts for claims brought by the corporation because indemnifying for these payments is "circular since the corporation would simply be paying itself."<sup>213</sup>

Also similar to Illinois, if the director or officer is found to be liable to the corporation (such as in a derivative suit), the director or officer is only entitled to indemnification if the court determines that, even though the person has been found liable, they are fairly and reasonably entitled to indemnification.<sup>214</sup>

#### ***B. Mandatory Indemnification***

In Illinois, indemnification for "expenses (including attorneys' fees) actually and reasonably incurred" is mandatory for any "present or former director, officer or employee of a corporation" who "has been successful, on the merits or otherwise, in the defense of any action, suit or proceeding . . . [or] claim, issue or matter therein."<sup>215</sup> Persons seeking indemnification need to have "acted in good faith and in a manner [they] reasonably believed to be in, or not opposed to,

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present or former director, officer, employee or agent is proper in the circumstances because the person has met the applicable standard of conduct." 8 Del. C. § 145(a), (d).

<sup>208</sup> 805 ILCS 5/8.75(b).

<sup>209</sup> *Id.*

<sup>210</sup> 805 ILCS 5/8.75(d); See also *Behrstock v. Ace Hose & Rubber Co.*, 496 N.E.2d 1024, 1029 (Ill. App. Ct. 1st Dist. 1986) (holding that indemnification is inappropriate because the defendant did not act in good faith or in the best interest of the corporation when he signed an unauthorized employment agreement).

<sup>211</sup> 805 ILCS 5/8.75(b).

<sup>212</sup> See 8 Del. C. § 145(b). Delaware courts have clarified that actions brought by a wholly owned subsidiary, absent veil-piercing, are not governed under this section of the statute, but rather count as a direct actions against the director or officer, which are covered under 8 Del. C. § 145(a), discussed above. See *Cochran v. Stifel Fin. Corp.*, 2000 WL 286722, at \*11–14 (Del. Ch. March 8, 2000), *rev'd in part on other grounds*, 809 A.2d 555 (Del. 2002).

<sup>213</sup> *Arnold v. Soc'y for Sav. Bancorp.*, 678 A.2d 533, 540 n.18 (Del. 1996).

<sup>214</sup> 8 Del. C. § 145(b); *Stephanis v. Yiannatsis*, No. CIV. A. 1508, 1994 WL 198711, at \*3 (Del. Ch. May 9, 1994), *aff'd sub nom. Yiannatsis v. Stephanis by Sterianou*, 653 A.2d 275 (Del. 1995).

<sup>215</sup> 805 ILCS 5/8.75(c).

the best interests of the corporation.”<sup>216</sup> As with permissive indemnification, a corporation may determine whether the person acted in good faith and in the best interest of the corporation for mandatory indemnification (1) by the majority vote of the directors who are not parties to such action, suit or proceeding, (2) by a committee of such directors designated by a majority vote of such directors, (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the shareholders.<sup>217</sup>

*Comparison to Delaware:* Similar to Illinois, Delaware requires mandatory indemnification of “expenses (including attorneys’ fees) actually and reasonably incurred” for “present or former director[s] or officer[s]” that have “been successful on the merits or otherwise in defense of any action, suit or proceeding . . . or in defense of any claim, issue or matter therein.”<sup>218</sup>

For acts and omissions occurring after December 31, 2020, Delaware law requires indemnification of an officer who: (1) is or was the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer, or chief accounting officer of the corporation; (2) is or was identified as one of the most highly compensated executive officers in the corporation’s public filings with the Securities and Exchange Commission (“SEC”); or (3) has, by written agreement, consented to service of process on the corporation’s registered agent for any action against the corporation for which the officer is a necessary party.<sup>219</sup> Prior to the December 31, 2020 amendments, the provisions did not define the officers that are entitled to mandatory indemnification under Section 145(c). One Third Circuit panel has interpreted Delaware law not to automatically limit the term “officer” to individuals appointed by a board resolution.<sup>220</sup>

Unlike in Illinois, mandatory indemnification in Delaware does not require a showing that the officer or director acted in good faith or in the best interests of the corporation. Thus, if a director or officer is successful, the corporation must indemnify them, even if the director or officer did not act in good faith or in the best interests of the corporation.<sup>221</sup> A director or officer also does not need to be completely successful to be eligible for mandatory indemnification under Section 145(c)(1). Partial indemnification is available to individuals who succeed on one claim, even if they do not succeed on all related claims.<sup>222</sup>

Another difference between Delaware and Illinois law is that while Illinois law requires indemnification of employees, Delaware law only requires indemnification of directors and officers. Delaware separately allows for permissive indemnification of “any other person” who is “successful on the merits or otherwise” if the expenses are reasonably incurred.<sup>223</sup>

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<sup>216</sup> *Id.* Mandatory indemnification is thus generally limited to the expenses of litigation, since a successful defendant would not have a judgment or penalty to indemnify.

<sup>217</sup> *Id.* 5/8.75(d).

<sup>218</sup> 8 Del. C. § 145(c)(1).

<sup>219</sup> 10 Del. C. § 3114(b); 8 Del. C. § 145(c)(1).

<sup>220</sup> See *Aleynikov v. The Goldman Sachs Grp., Inc.*, 765 F.3d 350, 361 (3d Cir. 2014).

<sup>221</sup> *Perconti v. Thornton Oil Corp.*, No. CIV.A. 18630-NC, 2002 WL 982419, at \*2, \*8 (Del. Ch. May 3, 2002) (holding that indemnification was appropriate because of the dismissal of the charges against the defendant even though the defendant abused his corporate position).

<sup>222</sup> *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. Ct. 1974).

<sup>223</sup> 8 Del. C. § 145(c)(2).

## VI. Exculpation from Fiduciary Liability

Effective January 1, 1994, Illinois amended the Business Corporation Act to permit a corporation to exculpate duty of care claims in its articles of incorporation.<sup>224</sup> The Act provides that a corporation may eliminate or limit “the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director,” other than liability:

- (1) for any breach of the director’s duty of loyalty to the corporation or its shareholders;
- (2) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
- (3) under Section 8.65 of the Act;<sup>225</sup> or
- (4) 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.<sup>226</sup>

The Illinois statute, which is patterned after the Delaware statute discussed below, “permits shareholders to exculpate directors from breaches of the common-law duty of care.”<sup>227</sup> This statute likely allows for exculpation for liability for gross negligence.<sup>228</sup> However, directors and officers are still liable if the conduct of the director is so grossly negligent or reckless that it evidences a lack of good faith.<sup>229</sup>

What constitutes good faith is heavily fact-dependent. At minimum, good faith requires directors to inform themselves as to all information that was reasonably available to them.<sup>230</sup>

Generally, exculpatory clauses “are not favored and are strictly construed and must have clear, explicit and unequivocal language showing that it was the intent of the parties.”<sup>231</sup> For example, in one Illinois case, the court interpreted an exculpation clause narrowly, and held that the clause did not exculpate the members of a condominium board from their breach of their fiduciary duty of care.<sup>232</sup> In that case, a condominium owner who sought to renovate an apartment brought an action against the condominium board for constructive fraud based on allegations that the board impeded her attempts to rebuild the apartment by refusing to grant permission for her construction projects. The exculpatory clause stated that “[n]either 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,

<sup>224</sup> 805 ILCS 5/2.10(b)(3).

<sup>225</sup> 805 ILCS 5/8.65 holds directors of a corporation liable for making certain prohibited distributions, for failing to provide notice to creditors in the case of the dissolution of a corporation, and for continuing to operate a corporation after filing for dissolution.

<sup>226</sup> 805 ILCS 5/2.10(b)(3).

<sup>227</sup> 8 Ill. Prac., Business Organizations § 13:13 (2d ed.).

<sup>228</sup> See *In re Abbott Lab’s Derivative S’holders Litig.*, 325 F.3d 795, 811 (7th Cir. 2003).

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* See also *Spillyards v. Abboud*, 662 N.E.2d 1358, 1370 (Ill. App. Ct. 1st Dist. 1996).

<sup>231</sup> *Zimmerman v. Northfield Real Estate, Inc.*, 510 N.E.2d 409, 415 (Ill. App. Ct. 1st Dist. 1986).

<sup>232</sup> *LaSalle Nat. Tr., N.A. v. Bd. of Dirs. of the 1100 Lake Shore Drive Condo.*, 677 N.E.2d 1378, 1383 (Ill. App. Ct. 1st Dist. 1997).

officers, Trustee or Developer, except for any acts or omissions found by a court to constitute gross negligence or fraud.”<sup>233</sup> The defendants argued that “fraud” in the exculpatory clause encompassed only “actual” fraud and, thus, they were exculpated from the plaintiff’s allegations of “constructive fraud.” The court held that the word “fraud” in the exculpatory clause included both actual and constructive fraud. The court further reasoned that “[a] holding to the contrary would virtually wipe out the Condominium Property Act’s creation of a fiduciary duty between the Board and unit owners,” because “[i]f the Board were able to limit itself to actual fraud, there would be no liability for violation of its fiduciary duty.”<sup>234</sup> Accordingly, the Illinois Appellate Court affirmed the trial court’s judgment for the owner, holding that the board had breached its fiduciary duty to the owner.

*Comparison to Delaware:* As in Illinois, Delaware law also allows for the exculpation of directors and some senior officers. 8 Del. C. § 102(b)(7) contains a nearly identical statute to the Illinois exculpation statute, allowing the articles of incorporation to eliminate director liability for all claims except (i) disloyalty, (ii) failing to act in good faith, (iii) engaging in intentional misconduct, (iv) knowingly violating a law, (v) approving an unlawful dividend, redemption or stock repurchase under Section 174 or (vi) obtaining an improper personal benefit.<sup>235</sup> Delaware courts have held that corporate charters may exculpate directors and officers for liability for gross negligence where bad faith is not alleged.<sup>236</sup>

In addition, on August 1, 2022, Delaware amended Section 102(b)(7) to expand this exculpation right to executive officers (including the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer), as well as directors.<sup>237</sup> However, this statute limits that exculpation for officers to suits that are not brought by the corporation or derivatively.<sup>238</sup>

Exculpation under Section 102 (b)(7) is an affirmative defense that can be raised against a duty of care claim on a motion to dismiss.<sup>239</sup>

**Practice Tip:** 8 Del. C. § 102 (b)(7) was recently amended on August 1, 2022 to allow exculpation of certain senior officers, including the president, CEO, COO, CFO, and CLO of a corporation. Previously, only directors could be exculpated under this provision. Corporations should consider amending their certificates of incorporation to add exculpation for their senior officers as well.<sup>240</sup>

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<sup>233</sup> *Id.* at 1382.

<sup>234</sup> *Id.* at 1383.

<sup>235</sup> 8 Del. C. § 102(b)(7).

<sup>236</sup> See *ABRY Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032, 1063 (Del. Ch. 2006) (holding that a corporate charter exculpated directors from liability for gross negligence).

<sup>237</sup> 8 Del. C. § 102(b)(7).

<sup>238</sup> See 8 Del. C. § 102(b)(7)(v); *Salama v. Simon*, 328 A.3d 356, 374 (Del. Ch. 2024).

<sup>239</sup> See *Malpiede v. Townson*, 780 A.2d 1075, 1093–95 (Del. 2001) (holding that “the exculpation afforded by the statute must affirmatively be raised by the defendant directors” and affirming the Chancery Court’s dismissal of a breach of duty of care claim based on a charter provision exculpating directors from liability for gross negligence).

<sup>240</sup> 8 Del. C. § 102(b)(7).

## VII. Delegation and Vicarious Liability

### A. Delegation

Section 8.05 of the Illinois Business Corporation Act provides that “the business and affairs of the corporation shall be managed by or under the direction of the board of directors.”<sup>241</sup> However, it is common knowledge that directors and officers of a corporation delegate many of their responsibilities to other employees of the corporation or experts. This generally means the officers and other senior employees are in charge of day-to-day management while directors are responsible for matters that rise to the level of a policy decision. An officer may have express authority from statutory provisions, from the bylaws, or from resolution of the board of directors.<sup>242</sup> For example, the Act provides that the secretary of the corporation has the authority “to certify the by-laws, resolutions of the shareholders and board of directors and committees thereof, and other documents of the corporation as true and correct copies thereof.”<sup>243</sup> The following cases exemplify the importance of adherence to corporate bylaws, articles of incorporation, and the Act for purposes of delegation of powers.

See also:

- *International Union of Operating Eng’rs, Local 150 v. Triad Construction Services*<sup>244</sup>: The court granted the defendant corporation’s summary judgment motion in the plaintiff’s suit to recover unpaid arbitration awards from the defendant pursuant to a collective bargaining agreement. There, a collective bargaining agreement was entered into with the plaintiff by the defendant’s secretary. However, under the defendant’s Articles of Incorporation, only the President and Vice-President had the authority to contract for the corporation in the absence of an express delegation of authority from the Board of Directors. Since the plaintiff could not present any evidence of an express authorization from the Board of Directors, the court determined that the secretary did not have express authority to contract on behalf of the defendant.
- *Fritzsche v. LaPlante*<sup>245</sup>: The Illinois Appellate Court held that the secretary/treasurer of a closely held corporation lacked authority to enter into a lease and promissory note on behalf of the corporation, under either common law or the Illinois Business Corporations Act. The court analyzed two corporate transactions, the lease of substantially all the corporation’s property and the issuance of a promissory note from the perspective of whether a corporate officer had the authority to enter into such transactions. The Illinois Appellate Court stated that whether the lease was covered by statutory procedures (such as Section 11.60 of the Act) “supersedes any question concerning which corporate tasks may be delegated from president to secretary/treasurer, as well as any question concerning the general authority of a secretary/treasurer or the authority of a POA to act in corporate matters. This is so because, if Board approval and/or shareholder notice were required, then no corporate officer, including [the]president of FIP, could have entered into the Lease without

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<sup>241</sup> 805 ILCS 5/8.05.

<sup>242</sup> 805 ILCS 5/8.50.

<sup>243</sup> *Id.*

<sup>244</sup> No. 97-CV-6218, 1999 WL 571053 (N.D. Ill. July 29, 1999) (applying Illinois law).

<sup>245</sup> 927 N.E.2d 218 (Ill. App. Ct. 2d Dist. 2010).

following the appropriate corporate procedures.”<sup>246</sup> Thereafter, the court concluded that the lease was an extraordinary and unusual contract, such that it required board approval and other corporate formalities. Further, the court determined that, because the plaintiffs alleged that the lease covered substantially all the assets of the company, “the burden then falls upon defendants to name any corporate property and/or assets that are not covered by the Lease, so that the court may decide if a question of fact exists as to whether the Lease includes ‘substantially all’ of [the company]’s assets.”<sup>247</sup> Because the defendants did not do so, the court accepted that the lease covered all or substantially all of the corporation’s assets, and, accordingly, the statutory procedures of Section 11.60, namely director approval and shareholder notice and vote, were applicable.

### 1. Delegation of Certain Powers to Committees

Section 8.40 of the Illinois Business Corporation Act authorizes the creation of one or more committees or subgroups of the board of directors if either the articles of incorporation or the bylaws so provide.<sup>248</sup> The members of the committee do not serve for a specified term but rather serve at the pleasure of the board.<sup>249</sup> A committee can act informally by unanimous consent.<sup>250</sup> Unless the board of directors or the bylaws provide otherwise, the committee determines the time and place of its meetings and the notice that is required for a valid meeting.<sup>251</sup>

Subject to the articles of incorporation or the bylaws, once a committee is appointed, it possesses the authority of the board of directors itself.<sup>252</sup> The statute also imposes specific limits on the extent to which authority can be delegated to a committee. For example, a committee does not have the authority to do the following<sup>253</sup>:

- (1) authorize distributions, except for dividends to be paid with respect to shares of any preferred or special classes or any series thereof;
- (2) approve or recommend to shareholders any act the Illinois Business Corporation Act requires to be approved by shareholders;
- (3) fill vacancies on the board or on any of its committees;
- (4) elect or remove officers or fix the compensation of any member of the committee;
- (5) adopt, amend, or repeal the bylaws;
- (6) approve a plan of merger not requiring shareholder approval;

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<sup>246</sup> *Id.* at 227.

<sup>247</sup> *Id.* at 230.

<sup>248</sup> 805 ILCS 5/8.40.

<sup>249</sup> 805 ILCS 5/8.40(a).

<sup>250</sup> 805 ILCS 5/8.40(b).

<sup>251</sup> *Id.*

<sup>252</sup> 805 ILCS 5/8.40(c).

<sup>253</sup> *Id.*

- (7) authorize or approve a reacquisition of shares, except according to a general formula or method prescribed by the board;
- (8) authorize or approve the issuance or sale, or contract for sale, of shares, except that the board may direct a committee (i) to fix the specific terms of the issuance or sale or contract for sale, including without limitation the pricing terms or the designation and relative rights, preferences, and limitations of a series of shares if the board of directors has approved the maximum number of shares to be issued pursuant to such delegated authority or (ii) to fix the price and the number of shares to be allocated to particular employees under an employee benefit plan; and
- (9) amend, alter, repeal, or take action inconsistent with any resolution or action of the board of directors when the resolution or action of the board of directors provides by its terms that it shall not be amended, altered or repealed by action of a committee.

## 2. Delegation and Reliance on Advice of Counsel

*IOS Capital, Inc., v. Phoenix Printing, Inc.*<sup>254</sup> instructs that advice of counsel may shield a director from liability under Illinois law. There, the court did not hold the director liable for an improper withholding of assets from a third party in a breach of contract action where he acted solely on advice of legal counsel.<sup>255</sup> The Lessor of copiers sued the lessee corporation, its president, and its majority owner for conversion after the corporation stopped making monthly payments on the lease. The director delegated authority to enter into the lease agreement for the lease of printers to the company’s corporate officer and president, who was later terminated prior to the company’s default on payments for the printers.<sup>256</sup> After the default, the director, on advice of counsel, refused to return the printers, jeopardizing the company’s financial status. The Illinois Appellate Court held that the director was not liable for conversion and explained, “[t]he reasonableness of acting on advice of legal counsel applies in the corporate context as in other areas of the law” and while an officer or director may not blindly accept counsel’s advice to avoid liability, he may rely on such advice when there is no reason to believe that such reliance is unreasonable.<sup>257</sup>

Comparison to Delaware: Under 8 Del. C. § 141(e), directors are “fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation’s officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person’s professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.” For example, Delaware courts have ruled that a company’s compensation committee was entitled to rely on an executive compensation consultant, as the committee reasonably believed that the analysis of the terms of the company’s president’s employment agreement was within the consultant’s professional competence, the consultant’s analysis was not so deficient that the committee would have reason to question it, and the consultant was selected with reasonable care. *In re Walt Disney Co.*

<sup>254</sup> 808 N.E.2d 606 (Ill. App. Ct. 4th Dist. 2004).

<sup>255</sup> *Id.* at 609.

<sup>256</sup> *Id.* at 606–11.

<sup>257</sup> *Id.* at 614.

*Derivative Litig.*, 907 A.2d 693, 758 (Del. Ch. 2005). There is no analogue under Illinois law to the broad authority to delegate fiduciary discretion that Delaware law provides.

## **B. Vicarious Liability**

### 1. Active Participation

In Illinois, a corporate officer cannot be found personally liable for the corporation's wrongful conduct unless he actively participated in that conduct or had sufficient knowledge of it.<sup>258</sup> The same is true with respect to directors and their coequals.<sup>259</sup> A director's mere negligence is insufficient to impose personal liability.<sup>260</sup> In some cases, corporate defendants can be held liable under theories of vicarious liability and have, in some cases, recovered indemnification from the officers and directors whose unlawful conduct "saddled" the corporation with that liability.<sup>261</sup>

In *Cooke v. Maxum Sports Bar & Grill, Ltd.*,<sup>262</sup> the Illinois Appellate Court affirmed judgment in the defendant's favor, finding that bar owners were not vicariously liable for their subordinates.<sup>263</sup> There the court found that the bar's owners did not actively participate in the bar's breach of duty to protect patrons by negligently failing to provide them with a safe means of egress or by negligently failing to properly train and supervise security guards, and thus were not personally liable for the bar's negligence in failing to protect patrons from being attacked in the parking lot.<sup>264</sup> At the time of the attack, one owner was no longer involved in the bar's management and the second owner, while slightly more involved, had delegated the bar's management to an operations manager.<sup>265</sup> Neither owner knew that the manager or the bouncers the manager hired were incompetent or that the manager was not properly hiring or training security personnel.<sup>266</sup>

Comparison to Delaware: Delaware courts have recognized that "[m]ost of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention."<sup>267</sup> Consequently, a claim that directors are subject to personal liability for employee failures is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."<sup>268</sup> Importantly, "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."<sup>269</sup>

For example, in *Stone ex rel. AmSouth Bancorporation v. Ritter*, the court concluded that there was no basis for an oversight claim seeking to hold directors personally liable for failures of a

<sup>258</sup> See *Cooke v. Maxum Sports Bar & Grill, Ltd.*, 109 N.E.3d 811, 829 (Ill. App. Ct. 2d Dist. 2018).

<sup>259</sup> *Zahl v. Krupa*, 927 N.E.2d 262, 275 (Ill. App. Ct. 2d Dist. 2010), *abrogated on other grounds by Doe v. Coe*, 135 N.E.3d 1 (Ill. 2019).

<sup>260</sup> *Id.*

<sup>261</sup> See, e.g., *In re Olympia Brewing Co. Secs. Litig.*, 674 F. Supp. 597 (N.D. Ill. 1987) (applying Illinois law).

<sup>262</sup> 109 N.E.3d 811 (Ill. App. Ct. 2d Dist. 2018).

<sup>263</sup> *Cooke*, 109 N.E.3d at 830.

<sup>264</sup> *Id.* at 829.

<sup>265</sup> *Id.* at 829.

<sup>266</sup> *Id.*

<sup>267</sup> *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996).

<sup>268</sup> *Id.* at 967.

<sup>269</sup> *Id.* at 971.

corporation's employees to file required suspicious activity reports (SARs) because the report issued by an independent consultant refuted the assertion that the directors never took the necessary steps to ensure that a reasonable regulatory compliance and reporting system existed<sup>270</sup>.

## 2. The Responsible Corporate Officer Doctrine

In both Illinois and Delaware, the law imposes responsibility upon corporate agents who do not proactively work to prevent violations of statutes that affect the public's health and safety from occurring. In some jurisdictions this is known as the "responsible corporate officer doctrine" ("RCO Doctrine"). The Supreme Court has held that the responsible corporate officer doctrine requires specific allegations of corporate responsibility with regard to the wrongful acts, rather than just general allegations of corporate responsibility.<sup>271</sup> When defending against an RCO Doctrine charge, an executive may raise the defense that it was objectively impossible for the executive to prevent or correct the violation.<sup>272</sup>

In *People v. Lincoln, Ltd.*, the Illinois Appellate Court held that an individual officer was not personally liable for a corporation's environmental regulation violations under the responsible corporate officer doctrine.<sup>273</sup> There, a corporation was found to have operated a landfill for five years without a waste disposal permit from the Illinois Environmental Protection Agency.<sup>274</sup> The state contended that liability should be extended to the owners of the property and to an individual officer of the owner corporation.<sup>275</sup> The state's argument for holding the officer personally liable is that he was either a "responsible corporate officer" of the corporation, an active participant in the statutory violations, or the "alter ego" of the corporation.<sup>276</sup> The court explained that while personal liability can be based on an individual corporate officer's personal involvement or active participation in violations of regulatory statutes, the allegations and argument regarding the officer's conduct did not meet the standard.<sup>277</sup>

## VIII. Ratification of Otherwise Defective Corporate Acts

"Ratification occurs when the principal learns of an unauthorized transaction, then retains the benefits of the transaction, or takes a position inconsistent with nonaffirmation."<sup>278</sup> Illinois statutes do not provide any guidance on ratification of defective or prohibited corporate acts. However, under Illinois common law, a principal may ratify unauthorized acts of an agent under general agency principles. Ratification requires: (1) timely knowledge on the part of the alleged principal

<sup>270</sup> 911 A.2d 362, 372 (Del. 2006).

<sup>271</sup> See *United States v. Park*, 421 U.S. 658, 675 (1975) ("[T]he main issue for determination was not respondent's position in the corporate hierarchy, but rather his accountability, because of the responsibility and authority of his position, for the conditions which gave rise to the charges against him."); *United States v. Dotterweich*, 320 U.S. 277, 284 (1943) ("The offense is committed . . . by all who do have such a responsible share in the furtherance of the transaction which the statute outlaws.").

<sup>272</sup> See, e.g., *United States v. Park*, 421 U.S. 658, 673 (1975); *United States v. Wiesenfeld Warehouse Co.*, 376 U.S. 86, 91 (1964).

<sup>273</sup> 70 N.E.3d 661, 682 (Ill. App. Ct. 1st Dist. 2016).

<sup>274</sup> *Id.* at 662.

<sup>275</sup> *Id.*

<sup>276</sup> *Id.* at 663.

<sup>277</sup> *Id.* at 682.

<sup>278</sup> *Stathis v. Geldermann, Inc.*, 692 N.E.2d 798, 808 (Ill. App. Ct. 1st Dist. 1998).

that the alleged agent is purporting to act for the alleged principal and; (2) some act or statement, either expressed or implied, which indicates that the principal accepts the actions of the alleged agent.<sup>279</sup> Whether a principal has ratified a defective corporate act depends on all the surrounding circumstances of the particular case.

See also:

- *Terminal Freezers, Inc. v. Roberts Frozen Foods, Inc.*<sup>280</sup>: the plaintiff sought to avoid a contract on the basis that the plaintiff's officer, who negotiated the contract, had arranged to go to work for the defendant prior to the signing of the contract. However, after the officer departed, a major shareholder and secretary-treasurer of the plaintiff, who was aware of the contract, continued the day-to-day operations between the two companies without repudiating or disaffirming the agreement. The trial court entered judgment for the plaintiff, but the Illinois Appellate Court reversed, holding that the plaintiff had ratified the contract. The appellate court explained, "[R]atification may be found when a corporation, with knowledge of the material facts of the improper transaction, retains and enjoys the benefits of the transaction." Moreover, ratification may be implied "from the conduct of the parties." The appellate court reasoned that by not rejecting the contract and "[b]y retaining the benefits of that contract," the plaintiff had ratified the contract, even though the officer who negotiated the contract "possessed an adverse interest."
- *Stathis v. Geldermann, Inc.*<sup>281</sup>: In *Stathis*, the plaintiff's son negotiated a transaction to sell a controlling interest of the plaintiff's business on behalf of the plaintiff. The plaintiff sued the purchaser alleging conversion of business property and fraud. The Illinois Appellate Court affirmed the jury verdict for the defendant, holding that the plaintiff had ratified the sale agreement after its execution. The court noted that the plaintiff had reviewed the transaction agreement shortly after its execution and that, while he expressed dissatisfaction with its terms, the plaintiff did not reject the agreement. The plaintiff had also accepted payments as part of the transaction agreement. While observing "[a]cceptance of these payments alone did not constitute ratification of the agreement," the court held that the plaintiff's "earlier knowledge of the terms of the agreement, combined with undisputed evidence that he did not indicate to anyone that [his son] was not authorized to execute it, supports the conclusion that ratification took place."

Comparison to Delaware: Unlike Illinois law, Delaware statutes lay out a specific process and various requirements for ratification of otherwise defective corporate acts. Specifically, 8 Del. C. § 204 grants the Court of Chancery jurisdiction to determine the validity of a defective corporate action, and permits entities to ratify defective corporate acts retroactively. Under Section 204(a), defective corporate acts or putative stocks cannot be deemed void solely as a result of a failure of

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<sup>279</sup> See *Arthur Rubloff & Co. v. Drovers Nat. Bank of Chi.*, 400 N.E.2d 614, 618–19 (Ill. App. Ct. 1st Dist. 1980) (holding that the principal did not ratify the broker's acts and did not owe the broker a commission because the principal did not have full knowledge that the broker would conduct negotiations on the principal's behalf).

<sup>280</sup> 354 N.E.2d 904 (Ill. App. Ct. 3d Dist. 1976).

<sup>281</sup> 692 N.E.2d 798, 807 (Ill. App. Ct. 1st Dist. 1998).

authorization if they were ratified as provided in Section 204.<sup>282</sup> Defective corporate acts may also be ratified by a court order from the Court of Chancery per Section 205.

To ratify a defective corporate act, the board of directors must adopt resolutions that define<sup>283</sup>:

- (1) the defective corporate act to be ratified;
- (2) the date of each defective corporate act;
- (3) the number and type of shares of putative stock issued and the date upon which these shares were purported to have been issued;
- (4) the nature of the failure of authorization for each defective act; and
- (5) the approval of the ratification of the defective corporate act by the board of directors.

These ratification resolutions may be approved by the entity's board of directors and shareholders in accordance with the required quorum and voting standards that would have been needed to initially approve of the defective corporate act.<sup>284</sup> If at the time of ratification the entity's certificate of incorporation or bylaws, or an agreement to which the entity was a party, now requires a larger quorum or number of approval votes, the larger number will control.<sup>285</sup>

Delaware law also sets out prompt notice requirements for ratification. Section 204(g) requires prompt notice of the ratification to be given to all holders of valid and putative stock (whether non-voting or voting) within 60 days of the adoption.<sup>286</sup> Holders of record of valid and putative stock must also be given notice.<sup>287</sup> Notices to shareholders must include (1) copies of the adopted resolution and (2) a statement that any claim that the ratified defective corporate act or putative stock is void or voidable due to the failure of authorization (or that the Court of Chancery should deem the ratification ineffective) must be brought within 120 days from the validation effective time.<sup>288</sup> The validation effective time means: (a) the time when the shareholders approve the ratification, or, if shareholder approval is not required, the time when the board adopts the resolutions, (b) where no certificate of validation is required, the time specified by the board in the adopted resolutions, or (c) the time at which any certificate of validation shall become effective.<sup>289</sup> Notice is not required if the ratification of the defective corporate act is presented to shareholders for approval at the time originally taken.<sup>290</sup> Notice also is satisfied if the corporation's class of

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<sup>282</sup> 8 Del. C. § 204(a).

<sup>283</sup> 8 Del. C. § 204(b)(1)(A-E).

<sup>284</sup> 8 Del. C. § 204(b)(1).

<sup>285</sup> *Id.*; Nate Emeritz, *The Development of Statutes for Ratification and Validation of Defective Corporate Acts*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Jul. 28, 2019), <https://corpgov.law.harvard.edu/2019/07/28/the-development-of-statutes-for-ratification-and-validation-of-defective-corporate-acts/>.

<sup>286</sup> 8 Del. C. § 204(g).

<sup>287</sup> *Id.*

<sup>288</sup> *Id.*

<sup>289</sup> 8 Del. C. § 204(h)(6).

<sup>290</sup> 8 Del. C. § 204(g).

stock is listed on a national securities exchange and notice is disclosed in a publicly filed document with the Securities and Exchange Commission.<sup>291</sup>

For certificates of amendment, certificates of designation, certificates of merger, or other corporate instruments, Delaware law requires that the corporation file a certificate of validation with the secretary of state for ratifications of corporate acts that would have initially required such a filing.<sup>292</sup>

## IX. Interpretation or Enforcement of Bylaws

Illinois law on the interpretation or enforcement of bylaws is limited. As a general matter, because “[a] corporation’s bylaws constitute a contract between the corporation and its shareholders” under Illinois law, courts analyze alleged violations of a corporation’s bylaws under the familiar rubric of breach of contract.<sup>293</sup> In Illinois, that rubric requires “(1) the existence of a valid and enforceable contract; (2) substantial performance by the plaintiff; (3) a breach by the defendant; and (4) resultant damages.”<sup>294</sup> In *Vanco*, plaintiff alleged a breach of contract action because the defendant company did not hold required meetings, and did not send notice of such meetings, as required by the bylaws. The court reasoned that the plaintiff adequately alleged that a breach had occurred because enough facts existed to show that the company plausibly breached the bylaws. The court also reasoned that the defendant could have waived compliance with the bylaws as an affirmative defense, as is done in ordinary contract claims, but it failed to do so.<sup>295</sup> Depending on their context, claims for violations of a corporation’s bylaws may be brought as derivative or direct claims.<sup>296</sup>

Corporate bylaws have salience in other causes of action as well. For example, noncompliance with bylaws may bear on questions of an agent’s authority, alter ego liability, and wrongful termination.

### See also:

- *Eskew v. Int’l Ass’n of Machinists & Aerospace Workers*<sup>297</sup>: Former employee filed suit against employer, claiming wrongful termination in breach of bylaws. The court granted the defendant employer’s motion to dismiss, reasoning that the plaintiff employee had failed to follow the bylaws’ exhaustion requirement prior to bringing suit.
- *United States v. Cohen*<sup>298</sup>: Government filed suit against defendant corporation seeking determination that the defendant corporation was an alter ego of Irving Cohen, an individual, who was delinquent on his taxes. Evidence showed that while the bylaws of the defendant corporation required the corporation’s president to sign off on all agreements and contracts, this bylaw was often ignored and Irving Cohen had final say in the

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<sup>291</sup> *Id.*

<sup>292</sup> 8 Del. C. § 204(e).

<sup>293</sup> *Vanco v. Mancini*, 495 F. Supp. 3d 712, 726 (N.D. Ill. 2020) (applying Illinois law).

<sup>294</sup> *Id.*

<sup>295</sup> *Id.* at 727.

<sup>296</sup> *See, e.g., id.* at 726–28 (acknowledging that the same series of events can give rise to both direct and derivative causes of action).

<sup>297</sup> 74 F. Supp. 3d 867 (N.D. Ill. 2014) (applying Illinois law).

<sup>298</sup> 930 F. Supp. 2d 962 (C.D. Ill. 2013) (applying Illinois law).

corporation's decisions. The court held that this failure of the corporation to follow bylaws evidenced the corporation being Irving Cohen's alter ego.

- *In re Grabill Corp.*<sup>299</sup>: Plaintiff bank brought suit seeking repayment of loans that president of a corporation had taken out with the bank on the corporation's behalf. Defendant corporation raised the affirmative defense that the president did not have the authority to take out those loans on behalf of the company because the corporation's bylaws required that the president obtain a resolution of the board of directors to authorize any loan for the corporation. The court noted that while the bylaws showed that the president may not have been given explicit authority for the loans, a trier of fact could determine that the president, by virtue of his position, had implied authority for the loans. Thus, the court denied the defendant's motion for summary judgment.
- *Vanco v. Mancini*<sup>300</sup>: The court held that the plaintiff properly stated a claim for breach of a corporation's bylaws where the bylaws required written notice for an annual shareholder meeting and plaintiff alleged that these meetings either did not occur or, if they did, the plaintiff was not provided notice.

*Comparison to Delaware*: Delaware law similarly regards corporate bylaws as “constitut[ing] part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework” of the Delaware General Corporate Law.<sup>301</sup> Delaware courts “endeavor to enforce [bylaws] to the extent that it is possible to do so without violating anyone's legal or equitable rights.”<sup>302</sup> Nevertheless, “charter and bylaw provisions that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.”<sup>303</sup>

Directors of Delaware corporations may unilaterally adopt and amend bylaws if permitted by their articles of incorporation.<sup>304</sup> Through their investment, shareholders impliedly assent to be bound by any future changes to the bylaws.<sup>305</sup> Settled Delaware law presumes the validity of bylaws; shareholders can evade them only by showing that they “cannot operate validly in any conceivable circumstance.”<sup>306</sup>

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<sup>299</sup> 121 B.R. 983 (Bankr. N.D. Ill. 1990) (applying Illinois law).

<sup>300</sup> 495 F. Supp. 3d 712 (N.D. Ill. 2020) (applying Illinois law).

<sup>301</sup> *Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013). Accordingly, “bylaws are interpreted using contractual principles.” *Id.* at 957. See also *BlackRock Credit Allocation Income Tr. v. Saba Cap. Master Fund, Ltd.*, 224 A.3d 964, 977 (Del. 2020), *reh'g denied* (Jan. 29, 2020); *Strategic Inv. Opportunities LLC v. Lee Enters., Inc.*, 2022 WL 453607, at \*10 (Del. Ch. Feb. 14, 2022).

<sup>302</sup> *Boilermakers*, 73 A.3d at 949.

<sup>303</sup> *Salzberg v. Sciabacucchi*, 227 A.3d 102, 135 (Del. 2020).

<sup>304</sup> *Boilermakers*, 73 A.3d at 939.

<sup>305</sup> *Id.* at 940.

<sup>306</sup> *Id.* (citing *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985)).

Delaware law recognizes that shareholders may sue to enforce a corporation's bylaws.<sup>307</sup> Because a corporation acts only through its directors, a derivative breach of contract suit on the bylaws may not be possible; derivative breach of fiduciary duty claims may instead be more appropriate.<sup>308</sup>

See also:

- *Strategic Inv. Opportunities LLC v. Lee Enters., Inc.*<sup>309</sup>: The court held that the plaintiff improperly claimed that Defendant breached the bylaws when a Nomination Notice was rejected by the Company. The court held that the rejection did not violate the bylaws because the Notice itself was deficient.
- *Villare v. Beebe Med. Ctr., Inc.*<sup>310</sup>: The court held that the plaintiff's breach of bylaw/contract claim failed because the bylaws at issue were not written to provide a basis for breach of contract, but to set forth a procedural process. Thus, the court held that there was no express intent to be bound by the provisions of the bylaws at issue, or any indicia of a promise, because the bylaws at issue referred to privileges, not rights.

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<sup>307</sup> *In re El Paso Pipeline Partners, L.P. Derivative Litig.*, 132 A.3d 67 (Del. Ch. 2015), *rev'd sub nom. El Paso Pipeline GP Co., L.L.C. v. Brinkerhoff*, 152 A.3d 1248 (Del. 2016).

<sup>308</sup> *See Lacey on behalf of S. Copper Corp. v. Mota-Velasco*, 2021 WL 508982, at \*6–7 (Del. Ch. Feb. 11, 2021) (holding that shareholders may not sue directors derivatively for breach of contract for failing to uphold the corporation's charter).

<sup>309</sup> 2022 WL 453607 (Del. Ch. Feb. 14, 2022).

<sup>310</sup> 2014 WL 1095331 (Del. Super. Ct. Mar. 19, 2014).

## Part Two

### Shareholders' Inspection Rights: Books and Records

Shareholders of a corporation generally have the right to inspect the corporation's books and records. The precise contours of this right are defined with the aim of balancing shareholders' interests with those of the corporation. Jurisdictions have different requirements for what a shareholder must show and do to exercise their inspection rights, but a shareholder must generally explain what documents they would like to inspect and why. If a shareholder's request for inspection is denied, they may seek a court order compelling the corporation to allow them to inspect the documents.

#### I. Applicable Statutes

In Illinois, Section 5/7.75 of the Illinois Business Corporation Act governs the rights of shareholders to demand and inspect a corporation's books and records.<sup>311</sup> To exercise this right, "a shareholder must make written demand upon the corporation, stating with particularity the records sought to be examined and the purpose therefor."<sup>312</sup> If the shareholder's written demand is refused, the shareholder can compel the records by filing an action for mandamus in the circuit court of the county containing either the corporation's registered agent or principal place of business.<sup>313</sup> Section 5/7.75(d) provides that a corporation that wrongfully refuses any shareholder's demand to inspect the corporation's books and records "shall be liable to such shareholder, in a penalty of up to ten percent of the value of the shares owned by such shareholder, in addition to any other damages or remedy afforded him or her by law."

*Comparison to Delaware:* The provision governing books and records demands in Delaware is Section 220 of the Delaware General Corporation Law. The statute states that, to initiate the inspection of a corporation's records, the shareholder must make a "written demand under oath."<sup>314</sup> If the corporation refuses the shareholder's request, the shareholder may bring an action in the Court of Chancery to compel the inspection.<sup>315</sup> The Court of Chancery has exclusive jurisdiction over such actions.<sup>316</sup>

#### II. Standing

The Illinois statute provides that "[a]ny person who is a shareholder of record shall have the right to examine, in person or by agent, at any reasonable time or times, the corporation's books and records of account, minutes, voting trust agreements filed with the corporation and record of shareholders, and to make extracts therefrom, but only for a proper purpose."<sup>317</sup> Shareholder is simply defined as "one who is a holder of record of shares in a corporation."<sup>318</sup> However, one Illinois court has indicated that being a "registered" shareholder may not be a strict requirement. In *Nugent v. Riemore Nugent Collins*, the original shareholder was deceased, and ownership of the

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<sup>311</sup> 805 ILCS 5/7.75.

<sup>312</sup> 805 ILCS 5/7.75(b).

<sup>313</sup> 805 ILCS 5/7.75(c).

<sup>314</sup> 8 Del. C. § 220(b).

<sup>315</sup> 8 Del. C. § 220(c).

<sup>316</sup> *Id.*

<sup>317</sup> 805 ILCS 5/7.75(b).

<sup>318</sup> 805 ILCS 5/1.80(g).

shares had passed to his wife, the plaintiff.<sup>319</sup> The court held that the plaintiff was a shareholder and thus had standing to vote in a shareholder meeting even though she never “re-registered” the stock in her name after her husband’s passing.<sup>320</sup>

Additionally, a person has standing to bring suit for statutory damages against a corporation refusing an inspection as long as he or she was a shareholder at the time the corporation denied the inspection. It does not matter if the shareholder sells his or her interest in the corporation prior to bringing suit.<sup>321</sup> However, once shareholders sell their interest in the corporation, they can no longer enforce a demand to examine the corporation’s books and records—they can only sue for statutory damages.<sup>322</sup>

Comparison to Delaware: Section 220 of the Delaware General Corporation Law defines a stockholder as “a holder of record of stock in a stock corporation, or a person who is the beneficial owner of shares of such stock held either in a voting trust or by a nominee on behalf of such person.”<sup>323</sup> Unlike Illinois, Delaware has also extended the right of inspection to beneficial owners by statute.<sup>324</sup> This allows investors who hold their shares indirectly to seek corporate records in their own name, even though they are not the holder of record.<sup>325</sup>

#### ***A. Shareholder of Parent Corporation***

Illinois law does not allow a shareholder of a parent entity to demand books and records from a subsidiary. *Logal v. Inland Steel Industries, Inc.* demonstrates this point.<sup>326</sup> There, after analyzing whether the subsidiary was a mere alter ego of the parent corporation, the court held that a shareholder of the parent was not entitled to inspect the books and records of the subsidiary because the shareholder was not also a shareholder of record in the subsidiary itself.<sup>327</sup>

Comparison to Delaware: In contrast, the Delaware statute provides that “[a]ny shareholder” has the right “to inspect for any proper purpose . . . [a] subsidiary’s books and records” as long as “[t]he corporation has actual possession and control of such records of such subsidiary” or “[t]he corporation could obtain such records through the exercise of control over such subsidiary.”<sup>328</sup>

<sup>319</sup> 412 N.E.2d 595, 598 (Ill. App. Ct. 1st Dist. 1980).

<sup>320</sup> *Id.*

<sup>321</sup> *McCormick v. Statler Hotels Del. Corp.*, 203 N.E.2d 697, 701 (Ill. App. Ct. 1st Dist. 1964) (holding that a shareholder’s claim is not moot if they sell their shares, even prior to filing); See also *W. Shore Assocs., Ltd. v. Am. Wilbert Vault Corp.*, 645 N.E.2d 494, 497–98 (Ill. App. Ct. 1st Dist. 1994) (preserving a shareholder’s right to appeal after losing shareholder status).

<sup>322</sup> *W. Shore Assocs., Ltd.*, 645 N.E.2d at 498.

<sup>323</sup> 8 Del. C. § 220(a)(3).

<sup>324</sup> *Seinfeld v. Verizon Commc’ns, Inc.*, 2005 WL 3272365, at \*2 n.7 (Del. Ch. Nov. 23, 2005) (“Section 220 was recently amended to allow beneficial owners, such as the plaintiff in this case, a right of inspection.”)

<sup>325</sup> *Id.*; See also 74 Del. Laws 84 (2003).

<sup>326</sup> 568 N.E.2d 152 (Ill. App. Ct. 1st Dist. 1991).

<sup>327</sup> *Id.* at 157. *Cf. Powell v. Gant*, 556 N.E.2d 1241, 1244 (Ill. App. Ct. 4th Dist. 1990) (holding that the plaintiffs could not bring a derivative suit on behalf of defendant corporations because they only held stock in electrical distribution cooperatives that were, in turn, members of the defendant corporations, and thus were not “shareholders of record” of the defendant parent corporations).

<sup>328</sup> 8 Del. C. § 220(b)(1); See also *In re Lululemon Athletica Inc. 220 Litig.*, 2015 WL 1957196, at \*5 (Del. Ch. Apr. 30, 2015) ([the right of inspection] “extends...to the books and records of a corporation’s subsidiary, but only the extent the corporation has actual custody and control of such records”) (internal citations omitted).

This gives shareholders of Delaware corporations a broader right to inspect the books and records of subsidiary companies than shareholders of Illinois corporations have.

### **B. Directors**

The Illinois statute governing books and records demands does not have a provision addressing the rights of directors.

In 2019, however, an Illinois court established the inspection rights of a corporation’s directors in *Munroe-Diamond v. Munroe*, a case that involved siblings who were the shareholders and directors of the Pickens-Kane Moving and Storage Company.<sup>329</sup> There, the plaintiffs, two sisters who were corporate directors and minority shareholders, brought a mandamus action against two brothers—other directors who were controlling shareholders—to compel production of requested corporate records and books.

The Illinois Appellate Court framed the inquiry as “[1] whether a corporate director has the unqualified right to examine corporate books and records, or whether that right is qualified by the director having a ‘proper purpose’ for doing so—and [2] if it’s the latter, which party bears the burden of proof on the question.”<sup>330</sup> The court determined that “corporate directors have the presumptive right to inspect corporate books and records,” and the burden falls on the corporation to show that the request is for an improper purpose.<sup>331</sup> Applying this rule to the facts of the case, the court noted that the defendants alleged that the lawsuit sought to force the defendants to either buy the plaintiffs’ stock at an inflated rate or to liquidate the corporation.<sup>332</sup> Without expressing any opinion on the merits of the controlling shareholders’ defense, the appellate court reversed the trial court’s judgment on the pleadings for the plaintiffs, reasoning that the defendants pled that the “object and purpose” of the inspection “was not legitimate,” and that it was intended to “injure the corporation.”<sup>333</sup> Accordingly, the appellate court remanded for further factfinding on whether the plaintiffs’ request for books and records was for a “proper purpose.”<sup>334</sup> However, the appellate court expressed skepticism about the merits of the controlling shareholders’ allegations of corporate injury, noting that, “[i]t is not altogether clear to us how asking the company to open its warehouse for the inspection of documents would threaten the company’s very existence.”<sup>335</sup>

See also:

- *Kunin v. Forman Realty Corp.*<sup>336</sup>: A director sought a writ of mandamus to obtain copies of two audit reports. The president of the corporation refused to furnish copies of the reports. The appellate court reversed the dismissal of the action, holding that the director had a right to examine the reports in order to carry out his function as a director.

<sup>329</sup> 139 N.E.3d 630 (Ill. App. Ct. 1st Dist. 2019).

<sup>330</sup> *Id.* at 633.

<sup>331</sup> *Id.* at 638.

<sup>332</sup> *Id.* at 639.

<sup>333</sup> *Id.*

<sup>334</sup> *Id.* at 640.

<sup>335</sup> *Id.*

<sup>336</sup> 157 N.E.2d 785 (Ill. App. Ct. 1st Dist. 1959).

- *Stone v. Kellogg*<sup>337</sup>: The plaintiff, a director and a shareholder, sought a writ to compel the defendants—the corporation and other directors—to allow him to inspect contracts between the corporation and another corporation and the corporation’s minute book to investigate potential wrongdoing. The appellate court held that the defendant may not limit the access of minority directors to records because directors have the right (and duty) to be informed regarding the management of the company.

Comparison to Delaware: Delaware law provides that a “director shall have the right to examine the corporation’s . . . books and records for a purpose reasonably related to the director’s position as a director.”<sup>338</sup> “A director who has a proper purpose . . . has virtually unfettered rights to inspect books and records,” which afford “access at least equal to that of the remainder of the board.”<sup>339</sup> “The public policy underlying that rule is plain: a director charged with fiduciary obligations to protect and preserve a corporation must have access to the corporation’s books and records if he reasonably can be expected to perform his duties.”<sup>340</sup>

A “director seeking inspection of books and records makes out a *prima facie* case when he shows that he is a director, he has demanded inspection and his demand has been refused.”<sup>341</sup> Once a director has made that showing, the “defendant corporation bears the burden of proving that any such inspection is for an improper purpose.”<sup>342</sup> “[T]he possibility that he may abuse his position as a director and make information available to persons hostile to the Corporation or otherwise not entitled to it” is not an impediment, because “[i]f [a director] does violate his fiduciary duty in this regard, then the Corporation has its remedy in the courts.”<sup>343</sup> If the corporation shows that the director’s “motives are improper, or that they are in derogation to the interest of the corporation,” however, “then [the] right to inspect ceases to exist.”<sup>344</sup>

See also:

- *Chammas v. NavLink, Inc.*<sup>345</sup>: Two directors and co-founders sought to inspect a variety of documents from other directors and managers, based on the belief that they were being excluded from board business and communications. Defendant argued that the plaintiffs’ true motive was not related to their role as directors, but was personally motivated. The court held that the plaintiffs were entitled to inspect the requested materials so long as the purpose was reasonably related to their position as a director.
- *Bizzari v. Suburban Waste Servs., Inc.*<sup>346</sup>: The plaintiff, a director and manager of two entities, sought to inspect their books and records. His stated purposes were to value his

<sup>337</sup> 1896 WL 4497 (Ill. App. Ct. 1st Dist. 1895), *aff’d*, 46 N.E. 222 (Ill. 1896).

<sup>338</sup> 8 Del. C. § 220(d).

<sup>339</sup> *Chammas v. NavLink, Inc.*, No. CV 11265-VCN, 2016 WL 767714, at \*6 (Del. Ch. Feb. 1, 2016) (internal citations omitted).

<sup>340</sup> *Bizzari v. Suburban Waste Servs., Inc.*, 2016 WL 4540292, at \*8 (Del. Ch. Aug. 30, 2016).

<sup>341</sup> *Id.* (internal citations omitted).

<sup>342</sup> *Chammas*, 2016 WL 767714, at \*6.

<sup>343</sup> *Henshaw v. Am. Cement Corp.*, 252 A.2d 125, 129 (Del. Ch. 1969).

<sup>344</sup> *Holdgreiwe v. Nostalgia Network, Inc.*, 1993 WL 144604, at \*3 (Del. Ch. Apr. 29, 1993) (internal citations omitted).

<sup>345</sup> 2016 WL 767714 (Del. Ch. Feb. 1, 2016).

<sup>346</sup> 2016 WL 4540292 (Del. Ch. Aug. 30, 2016).

interests in the entities, investigate potential wrongdoing, and fulfill his fiduciary duties. The entities denied his request for inspection on the grounds that his “motives are inconsistent with his fiduciary obligations.” The court held that the plaintiff had stated a proper purpose, and therefore he was entitled to inspect books and records related to the valuation of his shares, but refused to grant him access to additional “granular detail for which [he] could not articulate any need.” The court also imposed confidentiality requirements on the inspection.

- *Holdgreiwe v. Nostalgia Network, Inc.*<sup>347</sup>: A director sought to inspect books and records related to the company’s finances based on concern that the Form 10-K the company intended to file was not correct in light of alleged wrongdoing by the company’s CEO. The defendant company argued that an independent investigation was ongoing and, therefore, that the plaintiff director had no proper purpose for conducting his own investigation. The court held that the director had stated a proper purpose, and the corporation had not met its burden of showing why the director should not be allowed to exercise his right of inspection.
- *Henshaw v. Am. Cement Corp.*<sup>348</sup>: A shareholder and director sought to inspect books and records in order to communicate with other shareholders regarding the corporation’s affairs. After determining that the director had stated a proper purpose, the court held that the director was entitled to inspect the records he sought, despite the corporation’s contention that he could abuse the inspection right and furnish the records to others who were engaged in litigation against the corporation. The court, however, ordered that no information from the records be shared with the litigants or their attorneys.

### III. Scope of Documents Subject to Inspection

Illinois law confers on shareholders the right to inspect corporate records, including books and records of account, minutes of shareholder and director meetings, and committees thereof, and the record of shareholders so long as they make the demand with a “proper purpose.”<sup>349</sup> A shareholder also may request a balance sheet of the corporation’s latest fiscal year and a profit and loss statement for such fiscal year.<sup>350</sup>

“[B]ooks and records of account” encompass “all books and records necessary to make a searching investigation,” including a corporation’s books, records, minutes, voting trust agreements filed with the corporation, record of shareholders, and any documents received by any board member relating to a federal investigation of a company in which the corporation owned stock.<sup>351</sup> “A shareholder is legitimately entitled to know anything and everything which the records, books, and papers of the company would show so as to protect his interest.”<sup>352</sup>

<sup>347</sup> 1993 WL 144604 (Del. Ch. Apr. 29, 1993).

<sup>348</sup> 252 A.2d 125 (Del. Ch. 1969).

<sup>349</sup> 805 ILCS 5/7.75(a)–(b).

<sup>350</sup> 805 ILCS 5/7.75(e).

<sup>351</sup> *Corwin v. Abbott Laboratories*, 819 N.E.2d 1249, 1250–51 (Ill. App. Ct. 2d Dist. 2004) (internal citations omitted).

<sup>352</sup> *Weigel v. O’Connor*, 373 N.E.2d 421, 426 (Ill. App. Ct. 1st Dist. 1978).

The holding in *Corwin v. Abbot Laboratories* demonstrates the extent of what shareholders are entitled to review. There, a shareholder sought a corporation's internal investigatory reports. Although the defendant argued that "books and records of account" should be limited to financial records, the court held that a shareholder's inspection right "extends to all books and records necessary to make an intelligent and searching investigation," which, in that case, included nonfinancial records.<sup>353</sup>

See also:

- *Weigel v. O'Connor*<sup>354</sup>: The plaintiff sought to examine a variety of books and records for numerous purposes. Based on conversations with friends and business associates, the plaintiff testified that he was concerned about self-serving operations, including kickbacks and excessive executive compensation. The appellate court found that the shareholder's right to inspection included television logs, contracts with advertisers, and reports that the corporation filed with a federal agency, and reversed the trial court's decision that denied access to some books and records, finding that these types of records supported the plaintiff's good-faith fear of mismanagement.
- *Briskin v. Briskin Mfg Co.*<sup>355</sup>: The plaintiff sought a writ of mandamus to direct the corporation to allow inspection of two decades worth of corporate books and records to allow for her valuation of her shares and inspection of the corporation's fiscal condition following substantial losses. The appellate court affirmed summary judgment in favor of the plaintiff, finding that once she had demonstrated proper purpose, she had "every right to examine corporate books and records."<sup>356</sup>

Comparison to Delaware: The approach under Delaware law differs somewhat. A shareholder seeking access to corporate books and records must demonstrate a proper purpose reasonably related to such person's interest as a shareholder.<sup>357</sup>

The scope of materials available to a shareholder for inspection is "fact specific" and will turn upon "the context in which the shareholder's inspection demand arises."<sup>358</sup> The right is qualified, and Delaware courts have wide discretion to limit the breadth of inspections under § 220 and to specify the manner of the inspection so as to protect the interests of Delaware corporations.<sup>359</sup> In assessing inspection requests, Delaware courts tend to "give weight to the importance of

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<sup>353</sup> *Corwin*, 819 N.E.2d at 1250–51 (quoting *Weigel*, 373 N.E.2d at 428).

<sup>354</sup> 373 N.E.2d 421 (Ill. App. Ct. 1st Dist. 1978).

<sup>355</sup> 286 N.E.2d 571 (Ill. App. Ct. 1st Dist. 1972).

<sup>356</sup> *Id.* at 574.

<sup>357</sup> 8 Del. C. § 220.

<sup>358</sup> *Woods Trustee of Avery L. Woods Trust v. Sahara Enterprises, Inc.*, 238 A.3d 879, 898 (Del. Ch. 2020), judgment entered, 2020 WL 5110756 (Del. Ch. 2020) (quoting *Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW*, 95 A.3d 1264, 1272 (Del. 2014)).

<sup>359</sup> *United Technologies Corp. v. Treppel*, 109 A.3d 553, 559 (Del. 2014) (holding that the Court of Chancery has broad discretion to place reasonable restrictions on shareholder inspection rights to protect legitimate corporate interests).

maintaining § 220 actions as streamlined, summary proceedings that do not get bogged down in collateral issues.”<sup>360</sup>

A shareholder’s right to inspection is limited to records that are “essential and sufficient to the stockholder’s stated purpose.”<sup>361</sup> “That determination is ‘fact specific and will necessarily depend on the context in which the shareholder’s inspection demand arises.’”<sup>362</sup>

Upon a proper showing of necessity, the inspection may extend to<sup>363</sup>:

- “informal materials” showing “the directors’ deliberations, the information that they received, and the decisions they reached”;
- communications among “directors and the corporation’s officers and senior employees,” including “information distributed to the directors outside of formal channels, in between formal meetings, or in connection with other types of board gatherings”;
- “emails and other types of communication sent among the directors themselves, even if the directors used noncorporate accounts”; and
- communications and other documents that “were only shared among or reviewed by officers and employees.”

See also:

- *KT4 Partners LLC v. Palantir Techs.*<sup>364</sup>: A shareholder brought suit to inspect the defendant’s books and records. The Supreme Court of Delaware reversed the Court of Chancery in part, holding that it was an abuse of discretion for the court to deny a shareholder request to inspect a group of emails in full because shareholder had met its burden of showing that those documents were essential to its purpose.
- *Espinoza v. Hewlett-Packard*<sup>365</sup>: The plaintiff brought suit against the defendant to inspect a report prepared in connection with an internal investigation into sexual harassment allegations made against a former officer after the defendant refused to disclose it. The Court of Chancery denied inspection on privilege grounds. The Supreme Court of Delaware affirmed the denial, but on the alternate ground that the plaintiff did not show that the report was essential to his stated purpose—inspection of potential wrongdoing in the corporation’s handling of the allegations.
- *Thomas & Betts Corporation v. Leviton Manufacturing Co.*<sup>366</sup>: The plaintiff brought suit to compel inspection of a variety of defendant’s books and records, including the

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<sup>360</sup> *Id.* at 562.

<sup>361</sup> *KT4 Partners LLC v. Palantir Techs., Inc.*, 203 A.3d 738, 752 (Del. 2019) (quoting *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1054 (Del. 1996)).

<sup>362</sup> *Id.* at 751 (quoting *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 372 (Del. 2011)).

<sup>363</sup> *Woods Trustee of Avery L. Woods Trust*, 238 A.3d at 898.

<sup>364</sup> 203 A.3d 738 (Del. 2019).

<sup>365</sup> 32 A.3d 365 (Del. 2011).

<sup>366</sup> 681 A.2d 1026 (Del. 1996).

shareholder list, financial statements, organizational documents, and contracts between the defendant and its subsidiaries, with the stated purpose of inspecting suspected wrongdoing. After trial, the Court of Chancery determined that the plaintiff's true purpose for seeking the documents was to gain leverage to acquire the defendant, *see* discussion *infra* Part Two, Section IV, and therefore ordered a limited inspection only to the extent necessary for the plaintiff to value its own shares. The plaintiff appealed the limited scope of the documents and the Supreme Court of Delaware affirmed, holding that the Court of Chancery properly limited the inspection to those documents that were essential to valuation.

#### IV. Proper Purpose

In determining whether a shareholder is entitled to inspection, the threshold issue is whether they have stated a proper purpose to do so. Determining what is a proper purpose will vary depending on jurisdiction, but generally requires that the shareholder's reason for inspection be related to their position as a shareholder. Commonly stated purposes are investigation of wrongdoing and inquiry into the state of a corporation for valuation purposes. In evaluating whether there is a proper purpose, courts consider whether the shareholder has a basis for concern or whether the inspection is merely a fishing expedition.

##### A. The "Proper Purpose" Requirement

In Illinois, which party bears the burden of proof regarding a proper purpose depends on the type of records being sought. Under 805 ILCS 5/7.75, if the shareholder requests to inspect "books and records of account," then the burden is on the shareholder to prove a proper purpose. However, if the shareholder seeks to "examine minutes or the record of shareholder or a voting trust agreement, the burden of proof is upon the corporation to establish that the shareholder does not have a proper purpose."<sup>367</sup>

A proper purpose is one which seeks to protect the interests of the corporation as well as the interests of the shareholder seeking the information.<sup>368</sup> "A proper purpose is shown when a shareholder has an honest motive, is acting in good faith, and seeks to protect the interest of the corporation."<sup>369</sup> The right of inspection will not be enforced by the courts unless it meets those standards.<sup>370</sup>

See also:

- *Weigel v. O'Connor*<sup>371</sup>: The plaintiff sought to examine a variety of books and records for numerous purposes, including determining the value of his shares and the financial state of

<sup>367</sup> 805 ILCS 5/7.75(c).

<sup>368</sup> *Weigel v. O'Connor*, 373 N.E.2d 421, 427 (Ill. App. Ct. 1st Dist. 1978) (recognizing that shareholders have broad inspection rights but not the right to conduct "a general fishing expedition").

<sup>369</sup> *ICD Publ'ns, Inc. v. Gittlitz*, 24 N.E.3d 898, 922 (Ill. App. Ct. 1st Dist. 2014) (quoting *Corwin v. Abbott Laboratories*, 819 N.E.2d 1249 (Ill. App. Ct. 2d Dist. 2004)).

<sup>370</sup> *Sunlitz Holding Co., W.L.L. v. Trading Block Holdings, Inc.*, 17 N.E.3d 715, 721 (Ill. App. Ct. 1st Dist. 2014) (good-faith fear of mismanagement was sufficient to establish proper purpose); *Corwin*, 819 N.E.2d at 1252 (proper purpose shown when shareholder had honest motive, was acting in good faith, and sought to protect the interest of the corporation).

<sup>371</sup> 373 N.E.2d 421 (Ill. App. Ct. 1st Dist. 1978).

the corporation, assessing the corporation's revenue and expenditures, and promoting communication and informed voting among minority shareholders. Based on conversations with friends and business associates, the plaintiff testified that he was concerned about self-serving operations, including kickbacks and excessive executive compensation. The appellate court reversed the trial court's decision that denied access to some books and records, finding the plaintiff had shown a good-faith fear of mismanagement and he had therefore met his burden to state a proper purpose for the inspection.

- *Sunlitz Holding Co., W.L.L. v. Trading Block Holdings, Inc.*<sup>372</sup>: The shareholder-plaintiffs sought to examine a variety of books and records, including financial records and board agendas and meeting minutes, "to determine the financial condition of the company, the character of the management of the company, and whether the company's financial practices [we]re appropriate." To support their concerns, the plaintiffs cited a variety of circumstances and decisions made by the board. The court upheld the trial court, rejecting the defendants' contention that the "with particularity" requirement requires plaintiffs to state details of alleged mismanagement or establish actual wrongdoing and mismanagement and finding that plaintiffs had stated a proper purpose for the requested inspection.
- *Corwin v. Abbott Laboratories*<sup>373</sup>: Abbott Laboratories owned 50% of another corporation. That corporation was indicted for illegal marketing practices. A shareholder of the defendant corporation sought to inspect the books and records relating to the federal investigation of the subsidiary, citing concern that the defendant corporation knew of or was involved in the illegal conduct by the other corporation. The court held that this was a proper purpose.

Comparison to Delaware: In Delaware, "a stockholder has the burden of proof to demonstrate a proper purpose by a preponderance of the evidence."<sup>374</sup> This burden changes when the information demanded is a "corporation's stock ledger or a list of its stockholders."<sup>375</sup> In such a case, the burden of proof is "upon the corporation to establish that the inspection such shareholder seeks is for an improper purpose."<sup>376</sup>

Once a shareholder has met its burden of establishing a proper purpose, "the burden shifts to the corporation to prove that the stockholder's . . . actual purpose for conducting the inspection is improper."<sup>377</sup>

Delaware courts have liberally construed the proper purpose requirement to favor shareholders. Under Delaware law, a shareholder seeking to inspect a corporation's books and records must show that: (1) they are a shareholder, (2) they have "complied with [section 220] respecting the form and manner of making demand for inspection of such documents," and (3) they are seeking

<sup>372</sup> 17 N.E.3d 715 (Ill. App. Ct. 1st Dist. 2014).

<sup>373</sup> 819 N.E.2d 1249 (Ill. App. Ct. 2d Dist. 2004) (applying Illinois law).

<sup>374</sup> *Seinfeld v. Verizon Commc 'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) (affirming summary judgment for the corporation where the shareholder had not presented any evidence that wrongdoing had occurred).

<sup>375</sup> 8 Del. C. § 220.

<sup>376</sup> *Id.*

<sup>377</sup> *Woods Trustee of Avery L. Woods Trust*, 238 A.3d at 891.

inspection for a “proper purpose.”<sup>378</sup> A proper purpose is a “purpose reasonably related to such person’s interest as a shareholder.”<sup>379</sup>

One of the most common proper purposes that courts have recognized is the investigation of corporate mismanagement.<sup>380</sup> When making a books and records demand based on concerns of waste, mismanagement, or wrongdoing, plaintiffs are required to make an additional showing that their allegations are made on a “credible basis.”<sup>381</sup>

See also:

- *Security First Corp. v. U.S. Die Casting and Development Co.*<sup>382</sup>: The defendant corporation entered into a merger agreement with another, larger corporation, which led to a significant increase in the value of the defendant’s common stock. The merger agreement contained terms that would require defendant to pay a termination fee under certain circumstances. The merger fell through because of differences in philosophy, which triggered the termination fee and a drop in the value of the defendant’s common stock. The plaintiff shareholder (a third corporation) sought inspection of books and records related to the proposed merger and the termination. The court found that skepticism regarding the termination of the merger and concern of wrongdoing surrounding the merger constituted a proper purpose.

### ***B. Degree of Specificity Required to State a Proper Purpose for Inspection***

In Illinois, the proper purpose must be “specific” and cannot be “to gratify curiosity or for speculative or vexatious purposes.”<sup>383</sup> “[A] mere statement alleging a facially proper purpose is not enough.”<sup>384</sup> “[R]ather, the facts and circumstances of the request and the relationship of the shareholder to the corporation must be examined to ensure that the true purpose of the request is not contrary to the best interests of the corporation.”<sup>385</sup> Once the shareholder demonstrates a proper purpose, the shareholder is entitled to “a total examination of all reasonably required books and records of the corporation.”<sup>386</sup>

“Proper purpose c[an] be shown by attendance at shareholders’ meetings, examination of the books and records of the corporation and from the evidence of an effort on the part of the shareholder to determine the financial situation and the character of management of the corporation.”<sup>387</sup> When

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<sup>378</sup> 8 Del. C. § 220(c).

<sup>379</sup> 8 Del. C. § 220(b).

<sup>380</sup> *Security First Corp. v. U.S. Die Casting and Development Co.*, 687 A.2d 563 (Del. 1997); See also *Seinfeld*, 909 A.2d 117.

<sup>381</sup> See *Kosinski v. GGP Inc.*, 214 A.3d 944 (Del. Ch. 2019), *judgment entered*, (Del. Ch. 2020).

<sup>382</sup> 687 A.2d 563 (Del. 1997).

<sup>383</sup> *W. Shore Assocs., Ltd.*, 645 N.E.2d at 498, (quoting *Doggett v. N. Am. Life Ins. Co.*, 71 N.E.2d 686, 688, (Ill. 1947)).

<sup>384</sup> *W. Shore Assocs.*, 645 N.E.2d at 499.

<sup>385</sup> *Id.*

<sup>386</sup> *Weigel v. O’Connor*, 373 N.E.2d 421, 428 (Ill. App. Ct. 1st Dist. 1978).

<sup>387</sup> *Id.* at 426.

suspicious of corporate misconduct arise, “proof of actual mismanagement or wrongdoing is not necessary.”<sup>388</sup> Rather, “[g]ood faith fears of mismanagement are sufficient.”<sup>389</sup>

*Sunlitz Holding Co., W.L.L. v. Trading Block Holdings, Inc.*, is particularly instructive in elaborating on this standard.<sup>390</sup> There, the court compared *Weigel*, a case finding a proper purpose, to *Logal*, a case finding that plaintiffs had failed to state a proper purpose. In *Weigel*, the court held that there was a proper purpose based on the plaintiff’s testimony that “he had received information that the corporation’s officer used corporate assets to enrich themselves to the detriment of the corporation.”<sup>391</sup> The court noted the *Weigel* court’s holding that “proof of actual mismanagement or wrongdoing is not necessary.”<sup>392</sup> In contrast, the *Logal* court found no proper purpose where plaintiff sought to determine whether the closure of a corporation’s facility amounted to mismanagement, but alleged no circumstances suggesting fraud or mismanagement.<sup>393</sup> Rather, the court characterized the plaintiff’s demand as “an attempt to satisfy his curiosity.”<sup>394</sup> In balancing these two cases, the *Sunlitz* court found that the facts at hand more closely resembled those of *Weigel* and concluded that plaintiffs had satisfied the proper purpose standard. Namely, the *Sunlitz* court focused on the similarities in the alleged mismanagement presented by the plaintiffs and that in *Weigel*, which centered on potential self-dealing by the corporation’s executives and directors. Similar to the plaintiff in *Weigel*, the plaintiffs presented information to support a good faith fear of wrongdoing, and were not simply second-guessing an innocuous corporate decision as in *Logal*.

See also:

- *W. Shore Assocs., Ltd. v. Am. Wilbert Vault Corp.*<sup>395</sup>: A minority shareholder brought suit against the corporation following the denial of a request to inspect books and records, including some proprietary information. The stated purpose of the request was for valuation of the shares held. Despite valuation being the stated purpose, other circumstances suggested that it was not the true purpose. The plaintiff shareholder’s sole asset was its stock in the defendant corporation, it had no business outside of this ownership, and the president of the plaintiff corporation was also the president of the defendant’s main competitor. In light of these facts, the trial court dismissed the case, finding that the plaintiff failed to show that the request for inspection was for a proper purpose. The appellate court affirmed.

Comparison to Delaware: In Delaware, it is well-established that a shareholder’s desire to investigate wrongdoing or mismanagement is a “proper purpose.”<sup>396</sup> Where a shareholder seeks to investigate wrongdoing, the shareholder must also “show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation.”<sup>397</sup> The shareholder also “bears the burden of proving that

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<sup>388</sup> *Id.*

<sup>389</sup> *Id.* at 427.

<sup>390</sup> 17 N.E.3d 715 (Ill. App. Ct. 1st Dist. 2014).

<sup>391</sup> *Id.* at 720.

<sup>392</sup> *Id.*

<sup>393</sup> *Id.*

<sup>394</sup> *Id.*

<sup>395</sup> 645 N.E.2d 494 (Ill. App. Ct. 1st Dist. 1994).

<sup>396</sup> *Seinfeld v. Verizon Commc’ns, Inc.*, 909 A.2d 117, 121 (Del. 2006).

<sup>397</sup> *Id.* at 123.

each category of books and records is essential to accomplishment of the shareholder’s articulated purpose for the inspection.”<sup>398</sup> “[M]ere disagreement with a business decision” will fail to establish a proper purpose.<sup>399</sup> Once a shareholder shows that its primary purpose is reasonably related to its interest as a shareholder, the fact that it may also have “a further or secondary purpose . . . is irrelevant.”<sup>400</sup>

The “credible basis” standard has been described by the Delaware Supreme Court as “the lowest possible burden of proof.”<sup>401</sup> Countless proper purposes have been accepted under Delaware law including, for example:

- valuing a shareholder’s equity;
- evaluating an offer to purchase shares;
- inquiring into the independence of directors;
- investigating a director’s suitability for office;
- testing the adequacy of the corporation’s public disclosures;
- investigating corporate waste; and
- investigating possible mismanagement or self-dealing.<sup>402</sup>

The court’s rationale in *AmerisourceBergen Corp. v. Lebanon County Employees’ Retirement Fund*, demonstrates just how lenient the standard is. There, the Delaware Supreme Court ruled that, to establish a proper purpose for inspecting books and records, a shareholder need only show “a credible basis from which the [court] can infer there is possible mismanagement or wrongdoing warranting further investigation.”<sup>403</sup> Similarly, the shareholder is not required to show that the suspected mismanagement or wrongdoing is legally actionable. Rather, “a stockholder need only establish by a preponderance of the evidence that there is a credible basis to suspect a *possibility* of wrongdoing.”<sup>404</sup>

The court may deny inspection, however, where “the stockholder’s sole reason for investigating mismanagement or wrongdoing is to pursue litigation,” and such litigation is precluded by a “purely procedural obstacle, such as standing or the statute of limitations.”<sup>405</sup>

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<sup>398</sup> *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1035 (Del. 1996).

<sup>399</sup> *High River Ltd. P’ship v. Occidental Petroleum Corp.*, 2019 WL 6040285, at \*5 (Del. Ch. Nov. 14, 2019) (citing *Deephaven Risk Arb. Trading Ltd. v. UnitedGlobalCom, Inc.*, 2005 WL 1713067, at \*8 (Del. Ch. July 13, 2005)).

<sup>400</sup> *Gen. Time Corp. v. Talley Indus., Inc.*, 240 A.2d 755, 756 (Del. 1968).

<sup>401</sup> *AmerisourceBergen Corp. v. Lebanon Cnty. Employees Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan*, 243 A.3d 417, 426 (Del. 2020) (quoting *Seinfeld*, 909 A.2d at 123).

<sup>402</sup> *Id.* at 425–26.

<sup>403</sup> *Id.* at 437.

<sup>404</sup> *Petry v. Gilead Sciences, Inc.*, No. CV 2020-0132-KSJM, 2020 WL 6870461, at \*11 (Del. Ch. Nov. 4, 2020), judgment entered, 2020 WL 7773438 (Del. Ch. 2020) (emphasis in original).

<sup>405</sup> *AmerisourceBergen Corp.*, 243 A.3d at 437.

See also:

- *Seinfeld v. Verizon Communications, Inc.*<sup>406</sup>: A shareholder brought suit against the defendant corporation seeking to compel the corporation to produce for inspection its books and records related to compensation of particular executives. The plaintiff's stated purpose was to investigate mismanagement and waste related to these executives' compensation, and specifically, overcompensation for the work performed. In his deposition, the plaintiff admitted that he could not show duplicative work by the executives, nor could he guarantee that he correctly calculated the executives' compensation. The Delaware Supreme Court affirmed dismissal, holding that the shareholder failed to state a reasonable ground for suspicion regarding the executives' compensation, falling short of the burden of proof.
- *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*<sup>407</sup>: After purchasing an interest in a corporation in order to force a sale of the corporation to itself, a shareholder filed suit seeking to compel inspection of the target corporation's books and records, alleging that its stated purpose was to investigate alleged waste and mismanagement. The Delaware Supreme Court affirmed the denial of the inspection, holding that the plaintiff's actual motivation was to gain leverage in its ongoing efforts to purchase the defendant corporation, and this purpose was improper.
- *General Time Corp. v. Talley Industries, Inc.*<sup>408</sup>: The plaintiff shareholder, seeking to solicit proxies to oust defendant's management, sought a list of the defendant corporation's shareholders. At the deposition of the plaintiff's president, the corporation attempted to show that the request was for an improper purpose with a series of questions regarding acquisition of defendant's stock in furtherance of an illegal conspiracy. The president declined to answer the questions, as they were unrelated to the request for the list. The court denied the corporation's motion to compel the president to answer, holding that the desire to solicit proxies was a proper purpose, and any secondary purpose was irrelevant.

**V. Procedure to Request Inspection**

To exercise the right to inspect books and records under Illinois law, a shareholder must make written demand upon the corporation, stating with particularity the records sought to be examined and the purpose of the inspection.<sup>409</sup> Whether a shareholder has described the desired records with reasonable particularity necessarily depends upon the facts and circumstances of each case.<sup>410</sup> Adopting the reasoning of *Parsons v. Jefferson-Pilot Corp.*,<sup>411</sup> the Illinois Appellate Court held that the pleading burden is similar to the "reasonable particularity" requirement contained in Rule 34(b) of the Federal Rules of Civil Procedure.<sup>412</sup> As the North Carolina Supreme Court explained

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<sup>406</sup> 909 A.2d 117 (Del. 2006).

<sup>407</sup> 681 A.2d 1026 (Del. 1996).

<sup>408</sup> 240 A.2d 755 (Del. 1968).

<sup>409</sup> 805 ILCS 5/7.75(a).

<sup>410</sup> *Hagen v. Distributed Sols., Inc.*, 764 N.E.2d 1141, 1152 (Ill. App. Ct. 1st Dist. 2002) (recognizing generally that the purpose of a particularity requirement is to adequately inform someone of something).

<sup>411</sup> 426 S.E.2d 685 (N.C. 1993).

<sup>412</sup> *Hagen*, 764 N.E.2d at 1151.

in *Parsons*, the requesting party may, but is not required to, designate the type of documents to be produced, such precision is not required.<sup>413</sup> “Even a generalized designation should be sufficient[ . . .]. The goal is that the designation be sufficient to apprise a man of ordinary intelligence what documents are required.”<sup>414</sup>

See also:

- *Elleby v. Forest Alarm Service, Inc.*<sup>415</sup>: The plaintiff brought suit against the defendants—the corporation and directors—for violation of the Business Corporations Act, seeking damages and attorneys’ fees. The defendants argued that the BCA entitled her only to examine the books and records, not have them produced. The circuit court granted the corporation’s motion for judgment on the pleadings. The appellate court affirmed on other grounds, but noted that the plaintiff’s demand that specific books and records of the corporation be “produced,” was a sufficient request to entitle her to examine the corporation’s books and records in light of the detailed nature of the request.
- *Hagen v. Distributed Sols., Inc.*<sup>416</sup>: The plaintiff brought a writ of mandamus to compel the corporation to allow inspection of books and records after he had made multiple requests that had gone unanswered. The defendant argued that the request was not sufficiently particular, so the plaintiff was not entitled to the writ. The trial court granted the defendant’s motion for summary judgment on those grounds. The appellate court reversed and remanded, holding that because the plaintiff’s request clearly stated his purpose for inspection, as well as an enumerated list, it was sufficient to alert defendants to which records were being requested.

In order to make a proper request to inspect books and records under Section 5/7.75, a shareholder must make the request *to the corporation*. In Illinois, a shareholder’s written demands to examine a corporation’s books and records, directed to the attorney representing other shareholders as individuals only, were not demands made on the corporation, as required to entitle shareholders to examine records under the Illinois Business Corporation Act.<sup>417</sup> However, the shareholder eventually sent a demand letter to the corporation’s president and registered agent, which did constitute a demand made to the corporation.

Comparison to Delaware: 8 Del. C. § 220(b) provides that “[t]he demand . . . shall be directed to the corporation at its registered office in [Delaware] or at its principal place of business.”<sup>418</sup> The right to inspection is limited to those categories of books and records “essential and sufficient to [the shareholder’s] stated purpose.”<sup>419</sup> The Delaware Supreme Court has warned that § 220 orders should not be confused with the comprehensive production orders available in discovery, and that broad production orders are improper. While § 220 demands rarely may contain demands for a

<sup>413</sup> *Parsons*, 426 S.E.2d at 691.

<sup>414</sup> *Id.* (quoting 8 Charles A. Wright & Arthur R. Miller, Federal Practice and Procedure § 2211, at 628–31 (1970)).

<sup>415</sup> 164 N.E.3d 613 (Ill. App. Ct. 1st Dist. 2020).

<sup>416</sup> 764 N.E.2d 1141 (Ill. App. Ct. 1st Dist. 2002).

<sup>417</sup> *Elleby*, 164 N.E.3d at 623.

<sup>418</sup> 8 Del. C. § 220(b).

<sup>419</sup> *Security First Corp.*, 687 A.2d at 570.

specific document, they should be narrowly drawn, and limited to the documents needed to carry out the demand's stated purpose.<sup>420</sup>

See also:

- *Carapico v. Philadelphia Stock Exch., Inc.*<sup>421</sup>: After refusal of his request to inspect books and records, the plaintiff brought suit seeking an order to compel inspection. The defendant argued that the request was insufficient because the plaintiff lacked a proper purpose and because the demand was insufficiently specific. The court granted the plaintiff's request to inspect, holding that he had stated both a proper purpose and had made the request with adequate particularity. However, the court limited the production order, finding that the request was overbroad as written, as the plaintiff requested documents from outside the relevant time frame and documents that were irrelevant to the stated purpose of the inspection.

## VI. Denial or Failure to Respond to Request to Inspect

In Illinois, a corporation's failure to respond within a reasonable time to a shareholder's written demand for inspection of the corporation's books and records may be construed as a denial of access, in violation of the Business Corporation Act.<sup>422</sup> If the corporation refuses a proper request, the shareholder may sue the corporation and any officers or agents who refused, both to compel examination and for damages.<sup>423</sup> The shareholder may bring a mandamus action in the circuit court of the county in which either the registered agent or the principal office of the corporation is located.<sup>424</sup>

For example, in *Hagen*, prior to bringing the lawsuit, the plaintiff shareholder had made two demands on the defendant corporation, which the corporation ignored.<sup>425</sup> The court held that this was a denial of access. In *Elleby v. Forest Alarm Service*, the defendant corporation did not deny the plaintiff's request, but failed to produce *all* requested documents.<sup>426</sup> The *Elleby* court distinguished this failure from that in *Hagen*, finding that this failure did not amount to denial of access that constituted a violation of § 7.75 because the plaintiff had made earlier demands on individual defendants' attorneys, but did not make a demand on the corporation until two months prior to filing.<sup>427</sup>

In addition to compelling disclosure, the shareholder may recover, in addition to any damages caused by the improper refusal, a penalty of up to 10% of the value of his or her shares if a proper purpose for inspection is found to have existed.<sup>428</sup>

<sup>420</sup> *Carapico v. Philadelphia Stock Exch., Inc.*, 791 A.2d 787, 792, n.13 (Del. Ch. 2000).

<sup>421</sup> 791 A.2d 787 (Del. Ch. 2000).

<sup>422</sup> *Hagen v. Distributed Sols., Inc.*, 764 N.E.2d 1141, 1150 (Ill. App. Ct. 1st Dist. 2002).

<sup>423</sup> 805 ILCS 5/7.75(c)–(d).

<sup>424</sup> 1983 BCA § 7.75(c); 805 ILCS 5/7.75(c).

<sup>425</sup> 764 N.E.2d. at 1149.

<sup>426</sup> *Elleby v. Forest Alarm Service, Inc.*, 164 N.E.3d 613, 623 (Ill. App. Ct. 1st Dist. 2020).

<sup>427</sup> *Id.*

<sup>428</sup> 1983 BCA § 7.75(d); 805 ILCS 5/7.75(d); See also *McCormick v. Statler Hotels Delaware Corp.*, 195 N.E.2d 172 (Ill. 1963) (affirming the constitutional validity of the penalty provision).

See also:

- *In re Estate of Kaplan*<sup>429</sup>: The plaintiffs brought suit seeking construction of a stock alienation agreement, as well as seeking access to the defendant's books and records. Although it was not dispositive in the case, the appellate court affirmed that failure to respond to a proper request for inspection of books and records constitutes denial of access.

Comparison to Delaware: In Delaware, Section 220 provides that in cases of refusal of inspection or failure to respond within five business days of the demand, the shareholder may seek an order to compel inspection from the Court of Chancery.<sup>430</sup>

The statute leaves ample discretion to the courts regarding relief, providing that an order compelling disclosure may contain conditions and that the court may “award such other or further relief as the Court may deem just and proper.”<sup>431</sup> “While the trial court has wide latitude in determining the proper scope of inspection, it is the responsibility of the trial court to tailor the inspection to the shareholder’s stated purpose.”<sup>432</sup> In *Security First Corp.*, the Delaware Supreme Court remanded in part an order that it found was not properly tailored to balance the interests of the shareholder with those of the corporation.

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<sup>429</sup> 384 N.E.2d 874 (Ill. App. Ct. 1st Dist. 1978).

<sup>430</sup> 8 Del. C. § 220(c).

<sup>431</sup> *Id.*

<sup>432</sup> *Security First Corp.*, 687 A.2d at 569.

**Part Three**  
**Common Shareholder Claims For Breach of the Duty of Loyalty**

Illinois law requires corporate officers, directors, and controlling shareholders to act for the benefit of the corporation in all matters related to the entity. The duty of loyalty prohibits directors and officers from “actively exploiting their positions within a corporation for their own personal benefit” or “hinder[ing] the ability of a corporation to continue the business for which it was developed.”<sup>433</sup> Common types of claims brought when alleging that directors or officers breached their duty of loyalty are discussed below.

**I. Self-Interested Transactions**

One common type of breach of the duty of loyalty claim concerns situations where directors or officers participate in or approve a self-interested transaction that benefits them rather than the corporation. Under Illinois law, interested transactions—transactions that benefit the director or officer—are not prohibited per se, but they are subject to higher scrutiny. Article 8 of the Illinois Business Corporation Act of 1983 (“BCA”) governs interested transactions of directors and officers.<sup>434</sup> If a transaction is fair at the time of its authorization or approval, the fact that a director is a party to the transaction does not automatically void the transaction at issue.<sup>435</sup> In determining whether a transaction is “fair,” courts consider the following non-exclusive factors<sup>436</sup>:

- (1) whether the corporation received in the transaction full value in all the commodities purchased;
- (2) the corporation’s need for the property [at issue];
- (3) [the corporation’s] ability to finance the purchase;
- (4) whether the transaction was at the market price, or below, or constituted a better bargain than the corporation could have otherwise obtained in dealings with others;
- (5) whether there was a detriment to the corporation as a result of the transaction;
- (6) whether there was a possibility of corporate gain siphoned off by the directors directly or through corporations they controlled; and
- (7) whether there was full disclosure.

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<sup>433</sup> *Veco Corp. v. Babcock*, 611 N.E.2d 1054, 1059 (Ill. App. Ct. 1st Dist. 1993); See also *supra* Part One Section II.C.

<sup>434</sup> See 805 ILCS 5/8.

<sup>435</sup> See 805 ILCS 5/8.60.

<sup>436</sup> *Shlensky v. S. Parkway Bldg. Corp.*, 166 N.E.2d 793, 802–03 (Ill. 1960) (holding that directors failed to show that certain transactions between corporations with common directors were fair where the corporation charged less rent and installed expensive fixtures for one tenant that shared a common director).

Illinois courts have also defined “fair” as market value.<sup>437</sup>

See also:

- *Conant, Jr. v. Delman*<sup>438</sup>: Plaintiff shareholder brought suit against directors alleging that directors breached their duty of loyalty by participating in a self-interested transaction. The defendants distributed 85% of certain funds to themselves even though the operating agreement only allowed for a 50% distribution. The court found that the defendant directors failed to show that their over-distribution was fair and found them in breach of their fiduciary duties.
- *Tully v. McLean*<sup>439</sup>: The appellate court upheld punitive damages against the managing member of an Illinois limited liability corporation who, under the guise of “inter-company loans,” transferred money to other companies he owned.
- *Romanik v. Lurie Home Supply Ctr., Inc.*<sup>440</sup>: Defendant director had purchased property six years prior for \$125,000. The defendant then rented the property to the corporation for \$36,000 a year. However, an appraisal of the property at the time the lease was executed valued the property at only \$41,000. In reversing the circuit court, the appellate court rejected the defendant’s argument that the lease amount was fair based on his initial purchase price of the property.
- *Shlensky v. S. Parkway Bldg. Corp.*<sup>441</sup>: After the appellate court reversed the circuit court’s finding of a breach of loyalty, the Supreme Court of Illinois held that a breach of the duty of loyalty occurred when the directors of a company entered into multiple business transactions with other companies that the directors had significant interests in through their ownership interests and various positions as corporate executives, board members, and legal counsel. Under circumstances such as these, the defendant directors had the burden to establish the fairness and reasonableness of the various transactions, which they failed to do.
- *O’Connell v. Pharmaco, Inc.*<sup>442</sup>: On appeal, the circuit court’s finding that the defendant, as CEO and a director of the corporation, had engaged in a transaction that violated his duty of loyalty was upheld. The court concluded that sufficient evidence existed to support the judgment against the defendant where the defendant loaned the corporation money via a promissory note and then obtained a default judgment against the corporation that was satisfied by an assignment of corporate assets to the defendant. The defendant’s wife, as

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<sup>437</sup> *Hicks v. Midwest Transit, Inc.*, 500 F.3d 647, 654 (7th Cir. 2007) (“[a] transaction is ‘fair’ to a corporation when it receives at least what it would have obtained following arms’ length bargaining in competitive markets.”) (applying Illinois law and quoting *Olsen v. Floit*, 219 F.3d 655, 657 (7th Cir. 2000)).

<sup>438</sup> No. 13CH15361, 2016 WL 675755 (Ill. Cir. Ct. Cook Cnty. Jan. 29, 2016).

<sup>439</sup> 948 N.E.2d 714 (Ill. App. Ct. 1st Dist. 2011).

<sup>440</sup> 435 N.E.2d 712 (Ill. App. Ct. 5th Dist. 1982).

<sup>441</sup> 166 N.E.2d 793 (Ill. 1960).

<sup>442</sup> 493 N.E.2d 1175 (Ill. App. Ct. 4th Dist. 1986).

the corporate secretary, executed the promissory note, accepted service on behalf of the corporation, and executed the assignment of corporate assets to the defendant.

**B. Safe Harbors and Other Defenses**

There is no ability to waive director liability of self-interested transactions in the articles of incorporation.<sup>443</sup>

Illinois courts do not provide any “safe harbors” for a duty of loyalty claim. However, Illinois statutes do shift the burden of proof to the plaintiff if certain conditions are met. “If a transaction is fair to a corporation at the time it is authorized, approved, or ratified, the fact that a director of the corporation is directly or indirectly a party to the transaction is not grounds for invalidating the transaction or the director’s vote regarding the transaction.”<sup>444</sup>

Furthermore, in a proceeding contesting the validity of such a transaction, the person asserting that a transaction is valid has the burden of proving fairness unless<sup>445</sup>:

- (1) the material facts of the transaction and the director’s interest or relationship were disclosed or known to the board of directors or a committee of the board and the board or committee authorized, approved or ratified the transaction by the affirmative votes of a majority of disinterested directors, even though the disinterested directors be less than a quorum; or
- (2) the material facts of the transaction and the director’s interest or relationship were disclosed or known to the shareholders entitled to vote and they authorized, approved or ratified the transaction without counting the vote of any shareholder who is an interested director.

In contrast to Delaware case law, Illinois courts have closely scrutinized the disinterestedness of directors or shareholders in connection with the authorization of transactions involving a conflict of interest.<sup>446</sup>

Comparison to Delaware: Unlike Illinois law, which only shifts the burden of proof for whether the conflicted transaction was fair, 8 Del. C. § 144 provides that a conflicted transaction is not

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<sup>443</sup> See *supra* Part One Section VI. *Boucher v. 111 E. Chestnut Condo. Ass’n, Inc.*, 117 N.E.3d 1123, 1136 (Ill. App. Ct. 1st Dist. 2018).

<sup>444</sup> 805 ILCS 5/8.60(a).

<sup>445</sup> *Id.*

<sup>446</sup> Compare *Shlensky v. S. Parkway Bldg. Corp.*, 166 N.E.2d at 796 (analyzing the backgrounds of the board and finding that close business associates of the defendant were not “disinterested” board members) and *O’Connell*, 493 N.E.2d 1175, 1181–82 (Ill. App. Ct. 4th Dist. 1986) (questioning the independence of a wife and husband where the wife was the corporation’s secretary and was the sole corporate officer involved in some of the alleged corporate transactions with her husband) with *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 179 (Del. Ch. 2005), *aff’d*, 906 A.2d 114 (Del. 2006) (“Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence.”) and *Kaplan v. Wyatt*, 499 A.2d 1184 (Del. 1985) (finding the director to be independent when he had (i) a 16% stake in a company that did \$266 million in business with the corporation in question, and (ii) a 50% interest in another company in which the corporation had invested large sums of money).

voidable (1) if it was approved by a majority of the disinterested directors; (2) if it was approved by a majority of the shareholders; or (3) if the transaction was fair.

In contrast to Illinois' various factors for evaluating a fair transaction, Delaware courts have articulated the entire fairness standard. Delaware courts apply the entire fairness standard when a corporate fiduciary "labors under an actual conflict of interest."<sup>447</sup> In making their determination, Delaware courts hold that "[a]ll aspects of the issue must be examined as a whole since the question is one of entire fairness."<sup>448</sup> The "entire fairness standard is exacting and requires judicial scrutiny regarding both 'fair dealing' and 'fair price.' Fair dealing focuses upon the conduct of the corporate fiduciaries in effectuating the transaction, such as its initiation, structure, and negotiation. Fair price relates to the economic and financial considerations of the [contract], including all relevant factors [such as] assets, market value, earnings, [or] future prospects[.]"<sup>449</sup> Additionally, "[t]he possibility that the entire fairness standard of review may apply tends to preclude the Court from granting a motion to dismiss under Rule 12(b)(6) unless the alleged controlling stockholder is able to show, conclusively, that the challenged transaction was entirely fair based solely on the allegations of the complaint and the documents integral to it."<sup>450</sup>

However, like under Illinois law, finding the transaction fair means only that the transaction at issue is not voidable solely because of the presence of director or officer interest. It does not preclude liability for directors and officers for breach of a duty of loyalty with regards to their actions relating to the transaction.<sup>451</sup>

## II. Usurpation of Corporate Opportunities

"The corporate opportunity doctrine prohibits a corporation's fiduciary from misappropriating corporate property and from taking advantage of business opportunities belonging to the corporation."<sup>452</sup> "A corporate opportunity exists when a proposed activity is reasonably incident to the corporation's present or prospective business and is one in which the corporation has the capacity to engage."<sup>453</sup> A claim brought under this doctrine is a breach of the fiduciary duty of loyalty, as it is a form of self-dealing.<sup>454</sup>

<sup>447</sup> *Firefighters Pension Sys. of City of Kansas City v. Found. Bldg. Materials, Inc.*, 318 A.3d 1105, 1140 (Del. Ch. 2024).

<sup>448</sup> *Id.* (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

<sup>449</sup> *Toedtman*, No. CV N17C-08-210 RRC, 2019 WL 328559, at \*10 (holding that the employment agreement that included a 12-month severance was entirely fair because it was a common term in the employment contracts for officers in the company). See also *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) (holding that an auction that was biased towards one of the buyers was not a fair transaction).

<sup>450</sup> *Klein v. H.I.G. Cap., LLC*, 2018 WL 6719717, at \*16 (Del. Ch. Dec. 19, 2018) (internal quotation marks omitted) (quoting *Hamilton P's L.P. v. Highland Cap. Mgmt., L.P.*, 2014 WL 1813340, at \*12 (Del. Ch. May 7, 2014)); *accord Salladay v. Lev*, 2020 WL 954032, at \*8 (Del. Ch. Feb. 27, 2020).

<sup>451</sup> See *Benihana of Tokyo*, 891 A.2d at 185 (analyzing separately whether the transaction was fair and whether directors breached their duty of loyalty in approving the transaction).

<sup>452</sup> *Advantage Mktg. Grp.*, 143 N.E.3d at 147.

<sup>453</sup> *Id.*

<sup>454</sup> *Id.*

Under long-settled Illinois law, self-dealing by fiduciaries injures the corporation and, thus, “must be brought derivatively.”<sup>455</sup> Usurpation of corporate opportunity claims may lie against employees that owe fiduciary duties to a corporation, whether or not they are officers or directors.<sup>456</sup>

**Elements.** To succeed on a claim under the corporate opportunity doctrine, plaintiffs must prove two elements<sup>457</sup>:

- (1) the existence of a corporate opportunity, and
- (2) misappropriation of that opportunity.

These elements are satisfied where (1) the corporation “had an interest, actual or in expectancy,” in the opportunity, or (2) the fiduciary’s pursuit of the opportunity “would hinder or defeat plans and purposes of the corporation in carrying on or developing the legitimate business for which it was created.”<sup>458</sup>

Notwithstanding the above, a fiduciary is “free to pursue the opportunity himself” where the corporation declines to pursue it after receiving “full disclosure of the pertinent facts” from the fiduciary.<sup>459</sup> However, Illinois law requires more than merely “disclosure and tender of the corporate opportunity” to prevail on this defense.<sup>460</sup> The fiduciary must also obtain the corporation’s prior consent and must disclose to the corporation not just the existence of the opportunity, but also the fiduciary’s interest in it.<sup>461</sup>

**Comparison to Delaware:** A claim for usurpation of a corporate opportunity under Delaware law exists where a “fiduciary has seized for himself an opportunity that, because of its nature, loyalty dictates should have been presented to his corporation.”<sup>462</sup> Generally, the corporate opportunity doctrine is applied in circumstances where the director and the corporation compete against each other to buy something, such as a patent, license, or an entire business.<sup>463</sup>

**Elements.** The Delaware Supreme Court has identified four factors required to state a viable claim<sup>464</sup>:

- (1) the opportunity is within the corporation’s line of business;
- (2) the corporation has an interest or expectancy in the opportunity;
- (3) the corporation is financially able to exploit the opportunity; and

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<sup>455</sup> *Hamilton*, 827 N.E.2d at 955.

<sup>456</sup> *See Advantage Mktg. Grp.*, 143 N.E.3d at 150.

<sup>457</sup> *Id.*

<sup>458</sup> *Id.*

<sup>459</sup> *Kerrigan v. Unity Sav. Ass’n*, 317 N.E.2d 39, 43 (Ill. 1974).

<sup>460</sup> *Advantage Mktg. Grp.*, 2019 IL App (1st) 181126, at ¶40.

<sup>461</sup> *Id.* at ¶¶ 40–42.

<sup>462</sup> *In re Riverstone Nat’l, Inc. S’holder Litig.*, No. CV 9796-VCG, 2016 WL 4045411, at \*9 (Del. Ch. July 28, 2016).

<sup>463</sup> *Thorpe by Castleman v. CERBCO*, 676 A.2d 436, 443 (Del. 1996).

<sup>464</sup> *In re Mobilactive Media, LLC*, C.A. No. 5725–VCP, 2013 WL 297950, at \*21 (Del. Ch. Jan. 25, 2013).

- (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimica[l] to his duties to the corporation.

Generally, a board's rejection of a corporate opportunity that was presented to it by a corporate fiduciary creates a safe harbor where the interested fiduciary is free to pursue the corporate opportunity themselves.<sup>465</sup> While formal presentation to the board is not a necessary prerequisite to a finding that a corporate opportunity has not been usurped, formal presentation is often the safe approach.<sup>466</sup> Even if the opportunity is not presented to the corporation, a corporate director or officer may take a corporate opportunity if<sup>467</sup>:

- (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity;
- (2) the opportunity is not essential to the corporation;
- (3) the corporation holds no interest or expectancy in the opportunity; and
- (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.

See also:

- *Advantage Mktg. Grp., Inc. v. Keane*<sup>468</sup>: Reversing the circuit court's granting of summary judgment in favor of an employee, the appeals court held that an employee that held themselves out as an owner to third parties and had substantial corporate duties had a fiduciary duty of loyalty to the corporation despite not being a corporate officer. This duty can be breached when the employee usurps a corporate opportunity such as when they fail to disclose to the corporation that the owners of a competitor in the same line of business are interested in selling the competing business and that they intend to pursue purchase of the competing business themselves, especially when the employee has not obtained the consent of the corporation to pursue the purchase.
- *Lindenhurst Drugs, Inc. v. Becker*<sup>469</sup>: On appeal, the appellate court affirmed that a corporate officer breached his fiduciary duty of loyalty when he purchased a store franchise himself after initially negotiating on behalf of the corporation. The corporate officer's negotiations on behalf of the corporation consisted of a low-ball offer that was rejected; however, the corporate officer knew that the corporation remained interested in continuing

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<sup>465</sup> *Telxon Corp. v. Meyerson*, 802 A.2d 257, 263 (Del. 2002).

<sup>466</sup> *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 157–58 (Del. 1996); compare *Kaplan v. Fenton*, 278 A.2d 834, 836 (Del. 1971) (holding that no usurpation occurred by corporate directors where the corporation's board had unanimously rejected an almost identical offer only one month prior and where the president and CEO of the corporation had responded no to the directors' question of whether the new opportunity should be presented to the board) with *Telxon Corp.*, 802 A.2d at 263 (“[r]ejection of a corporate opportunity by the CEO is not a valid substitute for consideration by the full board of directors”).

<sup>467</sup> *Triple H Fam. Ltd. P'ship v. Neal*, No. CV 12294-VCMR, 2018 WL 3650242, at \*15 (Del. Ch. July 31, 2018), *aff'd*, 208 A.3d 703 (Del. 2019).

<sup>468</sup> 143 N.E.3d 139, 148–53 (Ill. App. Ct. 1st Dist. 2019).

<sup>469</sup> 506 N.E.2d 645, 651–52 (Ill. App. Ct. 2d Dist. 1987).

negotiations and he was charged with continuing negotiations. Because the corporation's ability to continue negotiations was undercut by the officer's failure to communicate material facts about the negotiation to the corporation, the officer was found to not have disclosed the opportunity to the corporation. Therefore, the corporation's failure to act could not be seen as the corporation declining the opportunity.

### III. Competing with Corporation

The duty of loyalty also requires directors and officers not to “(1) actively exploit their positions within the corporation for their own personal benefits; or (2) hinder the ability of the corporation to conduct the business for which it was developed.”<sup>470</sup> Accordingly, an officer or director cannot compete with the corporation to which he or she owes a fiduciary duty. Generally, “competing with corporation” is found to have occurred when an officer or director leaves the corporation and sets up or joins a competing corporation afterwards.<sup>471</sup> To that end, much of the case law in this area discusses the permissible activities of directors or officers either before or after their official termination from the corporation.

Courts have generally held that officers and directors are liable for competing with the corporation when they solicit employees or customers prior to leaving the former corporation.<sup>472</sup> Officers and directors have also been found to have breached their fiduciary duties when, while still employed by the company, they “(1) fail to inform the company that employees are forming a rival company or engaging in other fiduciary breaches . . . ; (2) solicit the business of a single customer before leaving the company . . . ; (3) use the company's facilities or equipment to assist them in developing their new business . . . ; or (4) solicit fellow employees to join a rival business . . . .”<sup>473</sup>

Other instances where directors and officers have been held liable for competing with the corporation include when they:

- take customer lists that are “confidential, not subject to memory, are not publicly listed or otherwise readily obtainable”;<sup>474</sup>
- appropriate trade secrets;<sup>475</sup> or

<sup>470</sup> *Foodcomm Int'l v. Barry*, 328 F.3d 300, 303 (7th Cir. 2003) (applying Illinois law).

<sup>471</sup> *Cooper Linse Hallman Cap. Mgmt., Inc. v. Hallman*, 856 N.E.2d 585, 589 (Ill. App. Ct. 1st Dist. 2006).

<sup>472</sup> *ABC Trans Nat. Transp., Inc. v. Aeronautics Forwarders, Inc.*, 413 N.E.2d 1299, 1308 (Ill. App. Ct. 1st Dist. 1980) (holding defendants liable because there was “pretermination solicitation” of customers).

<sup>473</sup> *Foodcomm*, 328 F.3d at 303 (7th Cir. 2003); *but see Cooper Linse Hallman Cap. Mgmt., Inc. v. Hallman*, 856 N.E.2d 585, 590 (Ill. App. Ct. 1st Dist. 2006) (affirming that the defendants did not breach their fiduciary duties even though defendants “failed to inform plaintiff of their plans to form a rival corporation, conspired with one another to form a rival corporation and used plaintiff's computer to type a business plan and advertisements,” because “the evidence proved that [defendants] neither exploited their positions with plaintiff for their own benefit nor hindered the ability of plaintiff to continue business”).

<sup>474</sup> *Revcor, Inc. v. Fame, Inc.*, 228 N.E.2d 742, 746 (Ill. App. Ct. 2d Dist. 1967) (holding that a salesman who took no customer lists or confidential information with him when he quit did not breach his fiduciary duty of loyalty).

<sup>475</sup> *Schulenburg v. Signatrol Inc.*, 200 N.E.2d 615 (Ill. App. Ct. 4th Dist. 1964) (finding breach of fiduciary duty where confidential blueprints appeared to be copied because competing business's blueprints exactly matched), *aff'd in part, rev'd in part*, 212 N.E.2d 865 (Ill. 1965) (affirmed trade secret issue, reversed length of injunction).

- seize an opportunity of which they became aware while serving in a fiduciary capacity and with respect to which they had an obligation to pursue on behalf of the corporation.<sup>476</sup>

Illinois courts have also concluded that it would be considered corporate competition for a defendant to use “the fact that he originally disclosed the opportunity to the [corporation], who then made a low initial offer, to excuse his breach of fiduciary duties in taking the opportunity for himself.”<sup>477</sup>

Generally, courts have held that directors and officers “may not undertake any activities that would hurt the corporation’s ability to continue as a business or exploit their status as an officer in any way, while employed.”<sup>478</sup> Thus, directors and officers are held to a higher standard than regular employees and a breach of their fiduciary duties can be found, for example, when a corporate officer uses their insider knowledge of prior negotiations and circumstances surrounding the termination of a lease to obtain the lease for themselves and the new company they started or when a corporate officer hires away key personnel from his prior company that he knew to possess specialized skills and knowledge due to his working at the prior company.<sup>479</sup>

After fiduciaries leave a corporation, they are generally free to solicit employees and customers.<sup>480</sup> Directors and officers are also allowed to engage in preliminary or planning activities prior to termination but, as noted previously, they may not exploit their position as an officer nor undertake activities that would hinder the corporation’s ability to conduct business.<sup>481</sup> Permissible activities include the organization of a new corporation and purchasing machinery for the new corporation.<sup>482</sup> One Illinois court has held that “obtaining financing for [the new company], designing a production plant, [and] purchasing equipment and supplies” is allowable.<sup>483</sup>

See also:

- *Foodcomm Intern. v. Barry*<sup>484</sup>: After a district court granted a preliminary injunction barring former employees from providing services to the employer’s customers, the Court of Appeals affirmed that, under Illinois law, non-executive employees with exclusive control over the purchasing and sales of one of the corporation’s products have a fiduciary duty to the corporation. This duty would have been breached if it could be shown at trial

<sup>476</sup> *Nw. Podiatry Ctr., Ltd. v. Ochwat*, 990 N.E.2d 347, 361 (Ill. App. Ct. 1st Dist. 2013) (“[T]he corporate officer’s termination of his former employment does not end potential liability for transactions that began, or were based on information learned, while the officer was employed.”).

<sup>477</sup> *Lindenhurst Drugs, Inc. v. Becker*, 506 N.E.2d 645, 651–52 (Ill. App. Ct. 2d Dist. 1987).

<sup>478</sup> *Oliver v. Isenberg*, 2019 IL App (1st) 181551-U, ¶ 88.

<sup>479</sup> *Id.* ¶¶ 89–90 (discussing cases).

<sup>480</sup> *Veco*, 611 N.E.2d at 1059 (“In the absence of a contractual restrictive covenant, the improper taking of a customer list, or fraud, former employees may compete with their former employer and solicit former customers so long as there was no demonstrable business activity by the former employee before the termination of employment”).

<sup>481</sup> *Oliver*, 2019 IL App (1st) 181551-U, ¶ 88.

<sup>482</sup> *James C. Wilborn & Sons, Inc. v. Heniff*, 237 N.E.2d 781, 786 (Ill. App. Ct. 1st Dist. 1968); *Veco*, 611 N.E.2d at 1059 (“In general, employees may plan, form, and outfit a competing corporation while still working for the employer, but may not commence competition.”).

<sup>483</sup> *Lawter Intern., Inc. v. Carroll*, 451 N.E.2d 1338, 1349 (Ill. App. Ct. 1st Dist. 1983).

<sup>484</sup> 328 F.3d 300, 303–04 (7th Cir. 2003).

that they conspired with a supplier to create a new company that would compete directly with the corporation while still employed by the corporation.

- *Cooper Linse Hallman Cap. Mgmt., Inc. v. Hallman*<sup>485</sup>: The appellate court affirmed that employees that planned to form a competing company together while employed by a corporation did not breach their fiduciary duty to the corporation. While the employees had used the corporation’s computer to create a business plan and advertisements, there was no evidence showing that the employees actually began competing with the corporation before they resigned. Thus, they did not breach their fiduciary duty to the corporation because the evidence at trial showed that the employees “neither exploited their positions for their personal benefit and to the detriment of [the corporation] nor impeded [the corporation’s] ability to do business.”
- *Nw. Podiatry Ctr., Ltd. v. Ochwat*<sup>486</sup>: The circuit court issued a preliminary injunction barring a former corporate officer from entering into an agreement with the corporation’s former customer. The corporate officer was also a major shareholder, director, and trustee. The appellate court affirmed that he violated his fiduciary duty of loyalty by starting a competing company and subsequently undercutting the corporation’s contractual rates with one of its clients. The circuit court found that the corporate officer had used information (e.g., pricing) obtained while still an officer, director, shareholder, and trustee of the corporation in order to interfere with the corporation’s contract with this particular client.
- *Oliver v. Isenberg*<sup>487</sup>: The appellate court affirmed the circuit court’s finding that a corporate officer who was also a one-third shareholder violated his fiduciary duty of loyalty when he retired and, within a month, had managed to transfer all of his clients to his new company. Despite his assertion that no competitive activities occurred before he left the corporation, the circuit court inferred, based on testimony, that the officer had “greased the machinery to some extent before his retirement” with the officer’s former clients and had taken advantage of information that he had acquired as a corporate officer in soliciting these former clients.

Comparison to Delaware: Similar to Illinois law, Delaware law allows corporate fiduciaries to make arrangements or preparations to compete with their employer while still employed but not to act unfairly or injuriously to the corporation.<sup>488</sup> Therefore, similar to in Illinois, a corporate officer that recruits key employees or uses confidential information obtained while employed—like trade secrets, presentations, customer lists, proposal templates, pricing information, or a bottle of a key chemical compound—in order to compete with their prior employer may have breached their duty of loyalty.<sup>489</sup>

Delaware courts extend these limits on a corporate fiduciary’s ability to compete to key managerial employees and employees that do not owe fiduciary duties to the corporation generally, but do

<sup>485</sup> 856 N.E.2d 585, 589–93 (Ill. App. Ct. 1st Dist. 2006).

<sup>486</sup> 2013 IL App (1st) 120458, ¶¶58–62.

<sup>487</sup> 2019 IL App (1st) 181551-U, ¶¶90–95.

<sup>488</sup> See *Triton Const. Co. v. E. Shore Elec. Servs., Inc.*, No. CIV.A 3290-VCP, 2009 WL 1387115, at \*9 (Del. Ch. May 18, 2009), *aff’d*, 988 A.2d 938 (Del. 2010).

<sup>489</sup> *Beard Rsch.*, 8 A.3d at 602–03.

owe duties as the corporation's agent in a particular area.<sup>490</sup> For employees that are not key managerial employees, the employee's privilege to prepare to compete with their employer before the termination of their employment relationship may be limited if the employee misappropriates trade secrets, misuses confidential information, solicits the employer's customers before cessation of employment, conspires to effectuate a mass resignation of key employees, or usurps a business opportunity of the employer.<sup>491</sup> Whether an employee is a key managerial employee depends on whether the employee exhibits the hallmarks of such a crucial employee such as running a division of a company or supervising tiers of employees.<sup>492</sup>

#### IV. Failure of Oversight (Caremark Claims)

Claims alleging a failure to monitor or to implement controls are commonly referred to as "Caremark" claims, based on the seminal Delaware case articulating the pleading standard for claims alleging failure of oversight.<sup>493</sup> While no Illinois court has addressed whether Illinois would follow *Caremark*, at least one federal court sitting in Illinois has predicted that Illinois law would follow Delaware law in this regard.<sup>494</sup>

The *Caremark* standard requires a plaintiff asserting a failure of oversight claim to plead and prove either that the board utterly failed to implement a reasonable information and reporting system, or that the board consciously failed to monitor the company's operations despite the existence of internal controls. Because *Caremark* claims attempt to impose personal liability on directors, plaintiffs often plead demand futility on the theory that no director would impose such liability on themselves. Demand futility is discussed *supra* at Part One, Section III.B.2.

Comparison to Delaware: Delaware law provides that directors need only make a good-faith effort to put into place a reasonable board-level system of monitoring and reporting in order to satisfy their duty of good-faith oversight.<sup>495</sup> Because a plaintiff must prove not only that the directors failed to implement or supervise a reasonable information and reporting system, but also that the directors did so in bad faith, *Caremark* claims have been called "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."<sup>496</sup> Thus, *Caremark*

<sup>490</sup> *Triton Const.*, 2009 WL 1387115, at \*10 (noting that the employee was not a key managerial employee but that the employee might still owe a duty to the corporation as an agent of the corporation because of the employee's ability to bind the corporation with bids he submitted using confidential information); See also *Sci. Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 962 (Del. 1980) (identifying key managerial employees).

<sup>491</sup> *Sci. Accessories Corp.*, 425 A.2d at 965 (collecting cases).

<sup>492</sup> *Mitchell Lane Publishers, Inc. v. Rasemas*, No. CIV.A 9144-VCN, 2014 WL 4925150, at \*4 (Del. Ch. Sept. 30, 2014).

<sup>493</sup> See *In re Abbott Lab'ys*, 325 F.3d at 805 (7th Cir. 2003) (analyzing under Delaware precedent); *In re Abbott Depakote S'holder Derivative Litig.*, 909 F. Supp. 2d 984, 993 (N.D. Ill. 2012) (same).

<sup>494</sup> See *In re Abbott Lab'ys*, 325 F.3d at 803–05 (7th Cir. 2003).

<sup>495</sup> *Caremark*, 698 A.2d at 970. Delaware law considers the duty of good faith to be a subsidiary element of the fundamental duty of loyalty. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006). Because "a showing of bad faith conduct . . . is essential to establish director oversight liability [under *Caremark*], the fiduciary duty violated by that conduct is the duty of loyalty." *Id.* at 370.

<sup>496</sup> *In re Boeing Co. Derivative Litig.*, No. CV 2019-0907-MTZ, 2021 WL 4059934, at \*24 (Del. Ch. Sept. 7, 2021); see *Marchand v. Barnhill*, 212 A.3d 805, 820 n.99 (Del. 2019).

claims have failed even when the corporation and some of its officers were indicted on federal charges because the controls have represented a good-faith attempt to stay informed.<sup>497</sup>

Though rare, courts have found *Caremark* claims adequately pled where particularized facts were alleged to support an inference that a corporation failed to implement any system to monitor safety and compliance. For example, *Caremark* claims were allowed to proceed where the plaintiff alleged numerous regulatory compliance failures and positive test results for listeria.<sup>498</sup>

Because *Caremark* claims ultimately plead a breach of the fiduciary duty of loyalty, the remedies available to *Caremark* plaintiffs are the same as those available for a breach of the duty of loyalty discussed *supra* at Part One, Section II A–C.

See also:

- *In re Caremark Intern. Inc. Derivative Litig.*<sup>499</sup>: There was no evidence that corporate directors failed in their duty of good-faith oversight where the board had reasonably relied on their experts who opined that the company’s practices were contestable but lawful, and where the evidence indicated that the corporation’s information systems appeared to represent a “good faith attempt to be informed of relevant facts.”
- *Stone ex rel. AmSouth Bancorporation v. Ritter*<sup>500</sup>: Affirming the Court of Chancery’s dismissal of a complaint, the Supreme Court of Delaware held that a compliance program that regulators had concluded lacked adequate board and management oversight was still a reasonable reporting system because the corporation had a longstanding compliance program that allowed the directors to periodically monitor compliance with regulations.
- *In re Abbott Lab’s Derivative Shareholders Litigation*<sup>501</sup>: The Court of Appeals reversed the district court’s dismissal of a complaint for failure to adequately plead demand. The Court of Appeals held that there was a sufficient probability of liability under a *Caremark* theory to establish demand futility in a situation where sufficient facts were pled to allege an unconsidered failure of the board to act. The pled facts showed that a reporting system was in place, violations had occurred, the directors on an audit committee were aware of

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<sup>497</sup> *Stone*, 911 A.2d at 365, 371 (holding no liability even when the corporation paid \$50 million in fines and penalties to resolve government investigations because a reasonable reporting system existed, even though regulators had specifically concluded that the corporation’s compliance program lacked adequate board and management oversight); *City of Detroit Police & Fire Ret. Sys. on Behalf of NiSource, Inc. v. Hamrock*, No. CV 2021-0370-KSJM, 2022 WL 2387653, at \*24 (Del. Ch. June 30, 2022) (finding no liability when the corporation was subject to criminal and regulatory sanctions following an explosion that caused significant damage, because controls existed).

<sup>498</sup> See *Marchand*, 212 A.3d at 812; See also *In re Clovis Oncology, Inc. Derivative Litig.*, No. CV 2017-0222-JRS, 2019 WL 4850188, at \*15 (Del. Ch. Oct. 1, 2019) (facts sufficient to support an inference that a board consciously ignored red flags that revealed a mission-critical failure to comply with controls); *Hughes v. Hu*, No. CV 2019-0112-JTL, 2020 WL 1987029, at \*14 (Del. Ch. Apr. 27, 2020) (facts sufficient to support an inference that a company’s audit committee met only sporadically, devoted patently inadequate time to its work, and had clear notice of irregularities but consciously turned a blind eye to them).

<sup>499</sup> 698 A.2d 959, 967 (Del. Ch. 1996).

<sup>500</sup> 911 A.2d 362, 365, 371–72 (Del. 2006).

<sup>501</sup> 325 F.3d 795, 808–09 (7th Cir. 2003).

violations, regulators had met with corporation representatives at least ten times over the violations, and still the board did not act.

## V. Minority Shareholder Oppression

Illinois law permits minority shareholders to bring a claim against the corporation and directors for minority shareholder oppression.<sup>502</sup>

Though the Illinois Business Corporation Act includes no definition of “oppression,” Illinois courts have established that minority shareholder oppression is “not limited to actions defined as ‘illegal’ or ‘fraudulent’ or necessarily including misapplication of corporate assets or mismanagement of funds.”<sup>503</sup> Rather, oppression can contemplate a “continuing course of heavy-handed conduct.”<sup>504</sup> Oppression commonly involves terminating the minority shareholder’s office or employment with the corporation.<sup>505</sup> However, the Illinois Supreme Court does not require proof of such a loss.<sup>506</sup> Oppressive conduct may also include: failure to call board meetings; failure to consult with minority shareholders regarding corporate management; and delay in responding to minority shareholders’ requests for information.<sup>507</sup> For example, in *Vanco*, the court found that a minority shareholder adequately alleged oppression against a corporation and majority shareholders where he alleged that he was denied the opportunity to participate in the affairs of the corporation because the corporation either never called a shareholder meeting or never notified him of such a meeting and the company diluted his shares and prevented him from selling the shares for any sum approaching their fair value.<sup>508</sup>

Section 12.55 of the Act provides that an Illinois court may dissolve a public corporation or order other relief if:

- The directors are deadlocked in the management of the corporate affairs, the shareholders cannot break the deadlock, and<sup>509</sup>:
  - irreparable injury to the corporation is caused or threatened; or
  - the corporation can no longer conduct its business to the general advantage of its shareholders.
- The directors or those in control of the corporation have acted, are acting, or will act in an illegal, oppressive, or fraudulent manner with respect to the shareholder bringing the action.
- The corporation’s assets are being misapplied or wasted.

<sup>502</sup> 805 ILCS 5/12.55(a)(2) (public corporations); 805 ILCS 5/12.56(a)(3) (non-public corporations).

<sup>503</sup> *Springer v. Libr. Store*, 2017 IL App (3d) 160577-U, at ¶ 23.

<sup>504</sup> *Id.*

<sup>505</sup> *Vanco*, 495 F. Supp.3d at 721 (collecting cases and applying Illinois law).

<sup>506</sup> *Id.* (citing *Gidwitz*, 170 N.E.2d at 138).

<sup>507</sup> See, e.g., *Compton v. Paul K. Harding Realty Co.*, 285 N.E.2d 574, 581 (Ill. App. Ct. 5th Dist. 1972).

<sup>508</sup> *Vanco*, 495 F. Supp.3d at 721.

<sup>509</sup> 805 ILCS 5/12.55(a), (b)(3).

The Act provides that, on the motion of the shareholder bringing the action, the court may order the corporation to purchase the shareholder's shares at a court-determined fair price.<sup>510</sup> The corporation or any shareholder or group of shareholders may petition the court to purchase the shares of the shareholder bringing the action. If the court determines that the purchase is equitable, the court will then determine the fair value of the shares according to the appraisal procedures set forth in the Act and then dismiss the action.<sup>511</sup>

Section 12.56 of the Act, meanwhile, provides remedies to shareholders who are oppressed by the conduct of their fellow shareholders in non-public, closely held corporations.<sup>512</sup> The rationale is that shareholders in non-public, closely held corporations are especially vulnerable to acts of shareholder oppression, "because they are likely to have a heavy personal investment in the corporation and cannot easily sell their stock and leave the company."<sup>513</sup> Claims for minority shareholder oppression involving private corporations may be brought directly because the oppression has more likely targeted them individually.<sup>514</sup> While no court has addressed whether a minority shareholder oppression claim involving a public corporation can be brought directly, the same rationale would most likely hold.<sup>515</sup>

Section 12.56 of the Act was enacted to provide trial courts with broader discretion and flexibility in tailoring alternative equitable remedies to judicial dissolution in shareholder disputes involving closely held corporations.<sup>516</sup> To accomplish this purpose, Section 12.56(b) of the Act provides that the relief a trial court may order in an action under the Act "includes but is not limited to" twelve alternative remedies outlined in Section 12.56(b) of the Act.<sup>517</sup> Moreover, Section 12.56(c) of the Act provides that the remedies set forth in Section 12.56(b) of the Act are not "exclusive of other legal and equitable remedies which the court may impose."<sup>518</sup>

Statutory remedies for minority shareholder oppression depend on whether the corporation is public or private. Claims involving public corporations may seek the appointment of a custodian to manage the corporation, the appointment of a provisional director, the dissolution of the company, and a forced buyout of the complaining shareholder at a fair value.<sup>519</sup> Claims involving private corporations may seek the same relief as those involving public corporations, plus the performance, prohibition, alteration, or setting aside of any action of the corporation or its

<sup>510</sup> *Id.* 5/12.55(c).

<sup>511</sup> *Id.* 5/11.70 and 5/12.55(d).

<sup>512</sup> *Roberts*, 2021 IL App (2d) 191088-U, ¶ 113.

<sup>513</sup> *Id.* (citations omitted).

<sup>514</sup> 805 ILCS 5/12.56(a)(3); *Roberts*, 2021 IL App (2d) 191088-U, ¶ 118, ("[P]laintiffs have pled an individual harm distinct from the harm to the corporation: pursuant to Section 12.56(a)(3), their rights as individual shareholders and directors have been oppressed."); *Toscano v. Koopman*, 148 F. Supp. 3d 679, 688 (N.D. Ill. 2015) (interpreting 805 ILCS 5/12.56(a)(3) to waive the requirement).

<sup>515</sup> *Cf. Apostolou v. Aynessazian*, 2016 IL App (1st) 140696-U, ¶ 48 ("Section 12.56 creates a cause of action in favor of an individual shareholder."); compare 805 ILCS 5/12.56(a)(3) ("with respect to the petitioning shareholder") with 805 ILCS 5/12.55(a)(2) ("with respect to the petitioning shareholder").

<sup>516</sup> *See, e.g.*, 8 Charles W. Murdock, Illinois Practice, Business Organizations § 18:22 (2d ed. 2021) ("[T]he Illinois legislature transferred the alternative remedy Section for closely held corporations to new Section 12.56, expanded the list of remedies that a court could order from three to 11, provided that dissolution was a remedy of last resort, and provided that even the expanded list of alternative remedies was not exclusive.").

<sup>517</sup> 805 ILCS 5/12.56(b).

<sup>518</sup> *Id.* 12.56(c).

<sup>519</sup> *Id.* 12.55(b)–(d).

shareholders, directors, or officers; the modification of the corporation’s articles of incorporation or by-laws; the removal of any director or officer; an accounting; the use of alternative dispute resolution; the payment of dividends; and the award of damages.<sup>520</sup> For private corporations, the statutory remedies are not exclusive of other legal and equitable remedies which a court might impose.<sup>521</sup>

See also:

- *Springer v. Libr. Store*<sup>522</sup>: The appellate court affirmed the circuit court’s finding that heavy-handed conduct did not exist where the board of directors terminated an employee who was unable to work due to disability and voted to remove the employee from the board after they began interfering with board’s ability to effectively run the corporation.
- *Hager-Freeman v. Spircoff*<sup>523</sup>: Reversing the circuit court’s dismissal, the appellate court held that the plaintiff adequately pled a claim for shareholder oppression when she alleged facts showing that the controlling shareholders had taken control of the corporation, enriched themselves and their son with corporate assets, and intended to halt dividends for the minority shareholder while writing off their son’s debt to the corporation.
- *Compton v. Paul K. Harding Realty Co.*<sup>524</sup>: The appellate court held that oppressive conduct existed where board of director meetings were not called, plaintiff officer (and shareholder) was not consulted regarding management of corporate affairs, defendant president displayed an “imperious attitude” when questioned about his salary, and defendant president was dilatory in his responses to the plaintiff shareholders’ requests.
- *Gidwitz v. Lanzit Corrugated Box Co.*<sup>525</sup>: The appellate court held that oppressive conduct existed where the president of a corporation was able to run the corporation as they saw fit because they controlled one-half of the shares and were completely deadlocked with the other half of shareholders such that the board could not act and, thus, the non-executive shareholders were excluded from control of the corporation.

Comparison to Delaware: Unlike Illinois, “[t]here is no standalone remedy for stockholder oppression in Delaware.”<sup>526</sup> Rather, “[t]he entire fairness test, correctly applied and articulated, is the proper judicial approach” to resolving claims of minority shareholder oppression.<sup>527</sup> That is, where a controlling shareholder causes a corporation to take an action that benefits the controlling shareholder at the expense of minority shareholders, the controlling shareholder necessarily “stand[s] on both sides of the transaction,” such that the action is void if not fair. But in Delaware,

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<sup>520</sup> *Id.* 12.56(b).

<sup>521</sup> *Id.* 12.56(c).

<sup>522</sup> 2017 IL App (3d) 160577-U, ¶¶ 29–33.

<sup>523</sup> 593 N.E.2d 821, 830–31 (Ill. App. Ct. 1st Dist. 1992).

<sup>524</sup> 285 N.E.2d 574, 582 (Ill. App. Ct. 5th Dist. 1972).

<sup>525</sup> 170 N.E.2d 131, 138 (Ill. 1960).

<sup>526</sup> *Verdantus Advisors, LLC v. Parker Infrastructure Partners, LLC*, C.A. No. 2020-0194-KSJM, 2020 WL 5951368, at \*5 (Del. Ch. Oct. 8, 2020) (citing *Nixon v. Blackwell*, 626 A.2d 1366, 1380–81 (Del. 1993)).

<sup>527</sup> *Id.*

fairness and equal treatment are not synonymous.<sup>528</sup> Thus, discriminatory treatment of minority shareholders does not per se fail the entire fairness test, even where it might qualify as “oppressive” under the laws of other jurisdictions.

Minority shareholders often complain of “oppressive” controlling shareholder conduct, subject to entire fairness review, in two situations: dilution, where the controlling shareholder’s proportional ownership increases at the expense of the minority shareholder’s proportional ownership, and squeeze-out mergers, where the minority shareholder’s ownership interest is eliminated in exchange for appraisal rights.

Prior to the overruling of *Gentile*, Delaware law permitted shareholders to bring “classically derivative” dilution claims as direct claims where the shareholders successfully alleged that a “control group” of shareholders acted to the detriment of minority shareholders (the so-called “dual” claim).<sup>529</sup> However, after the *Brookfield* decision overruled *Gentile* by eliminating the identity of the alleged wrongdoer as a factor in the direct-or-derivative inquiry, dilution claims are derivative claims in all circumstances.<sup>530</sup> In contrast, minority shareholders are often permitted to bring direct suits to challenge squeeze-out mergers. A stockholder who “directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation, and may pursue such a claim even after the merger at issue has been consummated.”<sup>531</sup> These direct claims usually arise by “charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price.”<sup>532</sup> In rare circumstances, however, challenges to the “mere wrongs associated with the merger,” if “sufficiently remote from the merger itself, give rise to derivative claims, which target stockholders typically cannot pursue post-merger.”<sup>533</sup>

Because Delaware law does not recognize a standalone remedy for minority stockholder oppression, remedies for minority stockholder oppression are the same as those available for a breach of the duty of loyalty discussed *supra* at Part One, Section II.C.

See also:

- *Nixon v. Blackwell*<sup>534</sup>: The Supreme Court of Delaware reversed a decision by the Court of Chancery where the Court of Chancery had found a breach of the corporation’s directors’ fiduciary duties by maintaining a liquidity policy that favored stockholders who were employees over nonemployees. The Supreme Court also rejected the minority

<sup>528</sup> *Nixon*, 626 A.2d at 1376 (“It is well established in our jurisprudence that stockholders need not always be treated equally for all purposes.”).

<sup>529</sup> See *Sheldon v. Pinto Tech. Ventures, L.P.*, No. CV 2017-0838-MTZ, 2019 WL 336985, at \*8 (Del. Ch. Jan. 25, 2019), *aff’d*, 220 A.3d 245 (Del. 2019).

<sup>530</sup> See *Brookfield Asset Mgmt., Inc.*, 261 A.3d at 1267–68 (overruling *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), and holding that corporation overpayment and dilution claims are exclusively derivative). See also *Siegel v. Cantor Fitzgerald, L.P.*, No. 2024-0146-LWW, 2025 WL 1074604, at \*12 (Del. Ch. Apr. 10, 2025) (“Delaware courts have interpreted *Brookfield* to hold that dilution claims are derivative, regardless of the nature or purpose of the underlying transaction”).

<sup>531</sup> *Brookfield Asset Mgmt.*, 261 A.3d at 1272 n.103.

<sup>532</sup> *Id.* at 1277 n.135.

<sup>533</sup> *In re Straight Path Commc’ns Inc. Consol. S’holder Litig.*, C.A. No. 2017-0486-SG, 2018 WL 3120804, at \*10 (Del. Ch. June 25, 2018), *aff’d sub nom. IDT Corp. v. JDSI, LLC*, 206 A.3d 260 (Del. 2019).

<sup>534</sup> 626 A.2d 1366, 1378, 1380–81 (Del. 1993).

shareholders' argument that there should be a standalone remedy for stockholder oppression by noting that a shareholder intending to buy into a minority shareholder position could bargain for protection against oppression prior to purchasing the stock.

**Part Four**  
**Other Common Types of Claims Brought Against Directors and Officers**

**I. Improper Distribution of Assets**

Directors may be held personally liable under certain specific circumstances, such as (1) assenting to a distribution that causes the corporation to become insolvent;<sup>535</sup> (2) failing to notify all creditors of the corporation's dissolution;<sup>536</sup> and (3) carrying on the corporation's business after dissolution, other than as necessary for winding up the corporation.<sup>537</sup> Nevertheless, a corporation's directors and officers may avoid exposure to liability by delegating responsibility for decision-making to experts or other professionals.

**A. Nonliability for Prohibited Distributions**

Section 5/8.65(a)(1) of the Illinois Business Corporation Act imposes liability on any director who assents<sup>538</sup> to a distribution to shareholders prohibited by Section 9.10.<sup>539</sup> Such distributions include those that would (1) make the corporation insolvent or (2) leave the corporation with net assets less than zero or less than the maximum amount payable at the time of distribution to shareholders having preferential rights in liquidation if the corporation were then to be liquidated.<sup>540</sup>

However, Section 5/8.65(c) of the Illinois Business Corporation Act provides that a director is *not* liable for a distribution that would otherwise be prohibited by Section 9.10 if<sup>541</sup>:

- (1) the director relied and acted in good faith on a "balance sheet and profit and loss statement" that was represented to be correct by the president or officer who is in charge of the corporation's books of account;
- (2) the director relied and acted in good faith on a "balance sheet and profit and loss statement" that was certified by an independent accountant to fairly reflect the corporation's financial condition; or
- (3) the director, in good faith, considered the assets to be "of their book value" in determining the amount available for any dividend or distribution.

In making a determination as to whether a distribution is legal from a statutory standpoint, Section 9.10 of the 1983 Act permits the directors to rely upon financial statements that are prepared not

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<sup>535</sup> 805 ILCS 5/8.65(a)(1).

<sup>536</sup> 805 ILCS 5/8.65(a)(2).

<sup>537</sup> 805 ILCS 5/8.65(a)(3).

<sup>538</sup> 805 ILCS 5/8.65(b) ("A director who is present at a meeting . . . is conclusively presumed to have assented to the actions taken unless his or her dissent is entered in the minutes of the meeting or unless he or she files his or her written dissent to such action with the person acting as the secretary of the meeting before the adjournment thereof or forwards such dissent by registered or certified mail to the secretary...").

<sup>539</sup> 805 ILCS 5/8.65; 805 ILCS 5/9.10.

<sup>540</sup> 805 ILCS 5/9.10(c)(1).

<sup>541</sup> See 805 ILCS 5/8.65(c).

only on the basis of generally accepted accounting procedures but also on the basis of accounting practices and principles that are reasonable under the circumstances.<sup>542</sup>

Section 8.65(a)(2) of the Illinois Business Corporation Act provides that directors are jointly and severally liable “for all loss and damage occasioned” by a failure to give notice to potential claimants against a dissolved corporation as required by 805 ILCS 5/12.75.<sup>543</sup> The measure of liability is not the amount of the creditor’s loss but rather the amount of the loss that would have been avoided had the creditor received the required notice.<sup>544</sup>

Further, Section 8.65(a)(3) provides that upon dissolution and winding up, directors will be personally liable for any loss incurred in business activity that is not consistent with winding up the affairs of the corporation.<sup>545</sup>

A director who is found liable for the improper distribution of assets of a corporation is also entitled to contribution from the other directors who are likewise liable, as well as from the shareholders who knowingly accepted or received any such distribution, in proportion to the amounts received by each.<sup>546</sup>

Case law in Illinois provides little guidance in this area and, while Illinois does have the above statutory provision, it is generally limited to situations in which imposition of liability is sought for improper distributions under Section 9.10. In making a determination as to whether a distribution is legal from a statutory standpoint, Section 9.10 permits the directors to rely upon financial statements that are prepared not only on the basis of generally accepted accounting procedures but also on the basis of accounting practices and principles that are reasonable under the circumstances—hence Section 8.65(c) is something akin to the business judgment rule.<sup>547</sup>

For example, in *Lower v. Lanark Mut. Fire Ins. Co.*, the Illinois Appellate Court reversed summary judgment in a derivative suit for recovery of certain service fees, which were allegedly misappropriated and converted by defendant secretary-treasurer (also a director) of the nominal defendant insurance company.<sup>548</sup> There, the directors, among other things, neglected to do an accounting to settle the shareholders’ claims and distributions prior to “settling” those claims in a board meeting. The court noted that even if the directors voted for the settlement “because they felt it was in the best interest of the company” there was a serious question of fact as to “whether the board had before it sufficient facts upon which to base an appropriate exercise of business judgment and therefore whether they acted in a diligent and careful manner in performing the duty they had undertaken” at the settlement meeting.<sup>549</sup>

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<sup>542</sup> 805 ILCS 5/9.10(d).

<sup>543</sup> 805 ILCS 5/8.65(a)(2).

<sup>544</sup> *Swager v. Couri*, 395 N.E.2d 921 (Ill. 1979).

<sup>545</sup> 805 ILCS 5/8.65(a)(3).

<sup>546</sup> 805 ILCS 5/8.65(d).

<sup>547</sup> See, e.g., *Fed. Deposit Ins. Corp. v. Patel*, No. 19-CV-6917, 2021 WL 5278715, at \*2 (N.D. Ill. Sept. 17, 2021) (“The Court cannot foreclose the possibility that the decision whether to disclose the information that NRB’s Board needed to make an informed decision on whether to issue dividends was itself a business decision subject to the business judgment rule.”) (applying Illinois law).

<sup>548</sup> 448 N.E.2d 940 (Ill. App. Ct. 2d Dist. 1983).

<sup>549</sup> *Id.* at 943.

*Muniz v. Herrin Med. Clinic, Ltd.*<sup>550</sup> is exemplary of an instance where an officer was not shielded from liability for improper distribution despite having relied on counsel. There, the Illinois Appellate Court upheld a jury finding that a director violated Section 8.65. The plaintiff and the defendants were all medical doctors who, for a period of time, had an employment and ownership interest in the medical practice. After exiting from the medical practice in 2003, the plaintiff obtained an arbitration award against the defendants. The defendant claimed that, upon learning of the award, he believed, based on advice of the practice’s legal counsel, that the arbitration award did not contain a final and collectable amount and testified at trial that disapproval of a loan request by a bank had “completely destroyed” his confidence to continue the operations of the practice and that he therefore dissolved the practice on advice of counsel. The plaintiff alleged that substantially all of the assets of the practice were then transferred to a newly created practice for less than fair value. The court upheld the lower court’s finding explaining that “[h]ad the individual defendant physicians not transferred their income stream to the new practice, the prior practice would have remained viable and solvent.”<sup>551</sup> The court upheld liability notwithstanding the defendant’s testimony that he had relied on counsel and diligently worked with lenders.

*Comparison to Delaware:* Directors of Delaware corporations who approve the payment of unlawful dividends, redemptions, or stock purchases are liable to the corporation, and to the corporation’s creditors, for the unlawful portion of the payment. A director is liable only if the violation was “willful or negligent.”<sup>552</sup> Any director who is held liable for amounts unlawfully paid is entitled to contribution from stockholders who accepted the dividend or asset with knowledge of the violation of the law.<sup>553</sup> Directors are liable for a period of six years after such event for the full amount plus interest, unless the director recorded his dissent in the corporate minutes.<sup>554</sup>

## II. Corporate Waste

Corporate waste is another type of claim commonly brought against directors and officers. It is often understood as related to, but separate from, a breach of fiduciary duty claim.<sup>555</sup> For that reason, corporate waste is often alleged as a separate claim alongside a breach of fiduciary duty claim.<sup>556</sup>

The law of corporate waste in Illinois is codified by statute, but there is little reported case law interpreting it.<sup>557</sup> One court applying Illinois law observed that “[t]ransferring the assets of a corporation to another corporation for *no* consideration . . . can easily be considered corporate waste.”<sup>558</sup> Furthermore, “when a plaintiff seeks relief for ‘illegal, oppressive, or fraudulent’ conduct or the misapplication or wasting of corporate assets, he or she must establish that the

<sup>550</sup> 2011 IL App (5th) 090614-U at \*1.

<sup>551</sup> *Id.* at \*9.

<sup>552</sup> 8 Del. C. § 174(a).

<sup>553</sup> 8 Del. C. § 174(c).

<sup>554</sup> 8 Del. C. § 174(a).

<sup>555</sup> See HARWELL WELLS, *The Life (and Death?) of Corporate Waste*, 74 WASH. & LEE L. REV. 1239 (2017).

<sup>556</sup> See, e.g., *Caulfield*, 56 N.E.3d at 515.

<sup>557</sup> See 805 ILCS 5/12.55–56 (allowing certain causes of action for shareholders where “[t]he corporation assets are being misapplied or wasted”).

<sup>558</sup> *In re Wolf*, 595 B.R. 735, 785 (Bankr. N.D. Ill. 2018) (emphasis added).

defendant engaged in the alleged statutory misconduct.”<sup>559</sup> The rarity of these claims may suggest their relative weakness. Because of the paucity of Illinois case law, Illinois courts might look to Delaware law to inform their analysis of corporate waste claims.<sup>560</sup>

While waste claims are prototypical derivative claims, under Illinois law, they may be brought directly by shareholders of non-public corporations by statute.<sup>561</sup>

Comparison to Delaware: Delaware law defines corporate waste as “an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.”<sup>562</sup> But if the corporation receives “any substantial consideration [and] there is a good faith judgment [by directors] that in the circumstances the transaction is worthwhile,” then a court will let it stand, even if the deal looks unreasonably risky in hindsight.<sup>563</sup> Judicial intervention is appropriate only in “unconscionable cases where directors irrationally squander or give away corporate assets.”<sup>564</sup> “Waste is a standard rarely satisfied in Delaware courts.”<sup>565</sup>

See also:

- *Brehm v. Eisner*<sup>566</sup>: The Delaware Supreme Court found that a board did not commit waste by entering into an employment agreement that allegedly incentivized the employee to find a way to exit the company via a non-fault termination rather than finish out his or her employment term. The Court further found that the board did not commit waste in terminating the employee on a non-fault basis even though the board had arguable grounds to fire the employee for cause. The Court reasoned that the plaintiff failed to allege with particularity facts tending to show that no reasonable businessperson would have made the decision that the board made.
- *In re DSI Renal Holdings, LLC*<sup>567</sup>: The Bankruptcy Court denied in part a motion to dismiss a corporate waste claim based on a restructuring transaction, finding that the trustee adequately alleged that, at the time of the transaction in question, internal documents showed that it served no rational business purpose and defendant’s insider counsel had sent an email stating that they would be hard-pressed to prove that the transaction was fair to the shareholders. The Court reasoned that “[w]hen a company’s own restructuring counsel

<sup>559</sup> *Airy’s Inc. v. Hill*, 2021 IL App (3d) 210143-U, ¶ 18.

<sup>560</sup> *See, e.g., Caulfield*, 56 N.E.3d at 517.

<sup>561</sup> 805 ILCS 5/12.56(a)(4); *see In re Wolf*, 595 B.R. at 785 (finding a direct basis for recovery by a shareholder in a closely held corporation for any damages caused by corporate waste under Section 12.56); *Toscano v. Koopman*, 148 F. Supp. 3d 679, 687–88 (N.D. Ill. 2015) (interpreting Section 12.56); *Roberts*, 2021 IL App (2d) 191088-U, ¶ 118 (“[P]laintiffs have pleaded an individual harm distinct from the harm to the corporation: pursuant to Section 12.56(a)(3) [relating to shareholder-oppression], their rights as individual shareholders and directors have been oppressed.”).

<sup>562</sup> *Brehm*, 746 A.2d at 263 (quoting *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997)).

<sup>563</sup> *Id.*

<sup>564</sup> *Wert v. Cohn*, 2019 WL 1584563, at \*7 (N.D. Ill. Apr. 12, 2019) (applying Delaware law).

<sup>565</sup> *Off. Comm. of Unsecured Creditors of Integrated Health Sers., Inc. v. Elkins*, No. Civ.A. 20228-NC, 2004 WL 1949290, at \*17 (Del. Ch. Aug. 24, 2004).

<sup>566</sup> 746 A.2d 244 (Del. 2000).

<sup>567</sup> 574 B.R. 446, 477 (Bankr. D. Del. 2017).

cannot imagine obtaining a fairness opinion, a reasonable inference can be drawn that no businessperson of ordinary sound judgment could believe that adequate consideration was received.”<sup>568</sup>

### Remedies for Waste

Actions that constitute waste are null and void as an unlawful use of corporate funds.<sup>569</sup> The particular remedy depends on the nature of the waste itself. There is not substantial case law regarding remedies in corporate waste cases, largely because these claims are often unsuccessful.<sup>570</sup>

See also:

- *Fidanque v. American Maracaibo Co.*<sup>571</sup>: Shareholders claimed that an employment contract with a former executive was invalid for lack of adequate consideration. The Delaware Chancery Court held that the contract amounted to waste because the evidence strongly suggested that an executive would be doing little, if any, work, so the contract was illegal and therefore null and void.
- *Seinfeld v. Slager*<sup>572</sup>: The plaintiff sought to invalidate a number of payments made by the board on the ground that they were wasteful because they lacked consideration. However, the court dismissed the claims because they did not plead with particularity any facts indicating that the payments were unreasonable, or that the payments constituted a waste of company assets.

### III. Excessive Executive Compensation

Illinois courts may allow waste or breach of fiduciary duty claims on the basis of excessive compensation. However, “unless the majority shareholders and directors are clearly managing the affairs of the corporation dishonestly or the compensation is so unreasonable as to constitute ‘waste’ or ‘spoliation,’ courts [generally] have not substituted their judgment for that of the directors” when analyzing claims of excessive compensation.<sup>573</sup> In assessing reasonableness, courts consider factors such as<sup>574</sup>:

- the employee’s ability,
- quantity and quality of services he renders,

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<sup>568</sup> *Id.* at 477.

<sup>569</sup> See generally *Wells*, *supra* note 555.

<sup>570</sup> See, e.g., *Off. Comm. of Unsecured Creditors*, 2004 WL 1949290, at \*17; See also *Sutherland v. Sutherland*, C.A. No. 2399-VCN, 2010 WL 1838968, at \*14 (Del. Ch. May 3, 2010).

<sup>571</sup> 92 A.2d 311 (Del. Ch. 1952).

<sup>572</sup> No. 6462-VCG, 2012 WL 2501105, at \*1 (Del. Ch. June 29, 2012).

<sup>573</sup> *Gehrke v. Fettes, Love & Sieben, Inc.*, 2018 IL App (1st) 170434-U, ¶ 64 (quoting *Romanik v. Lurie Home Supply Ctr., Inc.*, 435 N.E.2d 712, 718 (Ill. App. Ct. 5th Dist. 1982)).

<sup>574</sup> *Id.*

- the time he devotes to the company,
- the difficulties involved and responsibilities assumed in his work,
- the success he has achieved,
- profitability due to his efforts,
- the company’s financial condition, and
- the compensation paid for comparable work by similar companies.

See also:

- *Gehrke v. Fettes, Love & Sieben, Inc.*<sup>575</sup>: The plaintiff’s mere assertion that executives’ compensation was excessive without additional facts was not sufficient to overcome the deference given to directors with respect to compensation. Accordingly, the appellate court affirmed the trial court’s grant of summary judgment in favor of the defendants.
- *Jaffe Com. Fin. Co. v. Harris*<sup>576</sup>: An appellate record showing that the defendants enjoyed an annual salary increase of 11% during a period where the annual rate of inflation was 10% failed to demonstrate “corporate waste or spoliation sufficient to render the finding of reasonable compensation contrary to the manifest weight of the evidence.”<sup>577</sup>

Comparison to Delaware: Delaware’s standard for a successful excessive compensation claim is similarly stringent.<sup>578</sup> Although the business judgment rule presumes that decisions of corporate directors are made in a loyal and informed manner absent a showing to the contrary, directors’ self-interested decisions, such as setting their own compensation, are inherently likely to be disloyal. These decisions would be subject to review under the “entire fairness” standard, which is more onerous. Thus, where director compensation is challenged, directors bear the burden of demonstrating fair price and process.<sup>579</sup>

To state a claim for excessive compensation, the plaintiff must allege that the compensation was (1) awarded *ultra vires* (i.e., without legal authority), and the recipients knew this, or (2) repriced advantageously in light of confidential and sensitive business information which the recipients knew, and which they used to the company’s detriment.<sup>580</sup> Delaware courts have recognized that an officer or a director can breach their fiduciary duties “by accepting compensation that is clearly improper or by wrongfully influencing compensation decisions.”<sup>581</sup>

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<sup>575</sup> 2018 IL App (1st) 170434-U.

<sup>576</sup> 456 N.E.2d 224 (Ill. App. Ct. 1st Dist. 1983).

<sup>577</sup> *Id.* at 231.

<sup>578</sup> *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 136 (Del. Ch. 2009).

<sup>579</sup> *Stein v. Blankfein*, C.A. No. 2017-0354-SG, 2019 WL 2323790 at \*5 (Del. Ch. May 31, 2019).

<sup>580</sup> *Garfield v. Allen*, 277 A.3d 296, 335 n.10 (Del. Ch. 2022), *abrogated by In re Match Group, Inc. Derivative Litig.*, 315 A.3d 446 (Del. 2024).

<sup>581</sup> *Friedman v. Dolan*, C.A. No. 9425-VCN, 2015 WL 4040806, at \*9 (Del. Ch. June 30, 2015).

See also:

- *Garfield v. Allen*<sup>582</sup>: The plaintiffs sufficiently pled a breach of loyalty claim by alleging that the CEO, a fiduciary of the corporation, had knowingly accepted a compensation plan that violated the company's shareholder-approved equity compensation plan.
- *Pfeiffer v. Leedle*<sup>583</sup>: The plaintiff adequately pled a breach of fiduciary duty claim against an executive by alleging that the executive knew or should have known that acceptance of the stock options in excess of a stock incentive plan that had been approved by shareholders and adopted by the corporation.

**IV. Fraud**

Under Illinois law, a plaintiff must plead and prove the following elements to prevail on a claim for fraud: “(1) a false statement of material fact; (2) defendant’s knowledge that the statement was false; (3) defendant’s intent that the statement induce the plaintiff to act; (4) plaintiff’s reliance upon the truth of the statement; and (5) plaintiff’s damages resulting from reliance on the statement.”<sup>584</sup> Similar to federal courts, Illinois courts apply a heightened pleading standard for fraud claims and require that they be pled with specific and particular facts from which fraud is the necessary or probable inference.<sup>585</sup> These facts include what misrepresentations were made, when they were made, who made them, and to whom they were made.<sup>586</sup> For fraudulent concealment, a plaintiff must prove: “(1) concealment of a material fact; (2) intent to induce a false belief where there exists a duty to speak; (3) that the other party could not have discovered the truth through reasonable inquiry and relied upon the silence as an indication that the concealed fact did not exist; (4) that the other party would have acted differently had it known of the concealed information; and (5) that its reliance resulted in injury.”<sup>587</sup>

In general, directors and officers are not liable for the fraud of the corporation or its agents “merely because of [their] official character,” but they are liable for “fraudulent acts of [their] own or in which [they] participate[.]”<sup>588</sup> Mere knowledge of the fraudulent acts is not enough; some degree of activity and active involvement by the director or officer is required.<sup>589</sup>

In Illinois, statements of projected future facts or mere opinion, such as financial projections with calculations based on assumptions, cannot support claims for fraud.<sup>590</sup> Additionally, cautionary

<sup>582</sup> 277 A.3d 296, 335 (Del. Ch. 2022).

<sup>583</sup> C.A. No. CV 7831-VCP, 2013 WL 5988416 (Del. Ch. 2013).

<sup>584</sup> *Connick v. Suzuki Motor Co.*, 675 N.E.2d 584, 591 (Ill. 1996).

<sup>585</sup> *Id.* at 592.

<sup>586</sup> *Id.*

<sup>587</sup> *Vandenberg v. Brunswick Corp.*, 90 N.E.3d 1048, 1056 (Ill. App. Ct. 1st Dist. 2017).

<sup>588</sup> *Murphy v. Walters*, 410 N.E.2d 107, 110 (Ill. App. Ct. 2d Dist. 1980) (quoting *Citizens Savs. & Loan Ass. v. Fischer*, 214 N.E.2d 612, 615-16 (Ill. App. Ct. 5th Dist. 1966)).

<sup>589</sup> See *Nat'l Acceptance Co. of Am. v. Pintura Corp.*, 418 N.E.2d 1114, 1117 (Ill. App. Ct. 2d Dist. 1981) (sufficient involvement where officer endorsed and deposited checks in a case where conversion of funds was alleged); See also *Itofca, Inc. v. Hellhake*, 8 F.3d 1202, 1205 (7th Cir. 1993) (applying Illinois law to hold there was sufficient involvement where officer terminated lease at superior's direction); *Firstar Bank, N.A. v. Faul Chevrolet, Inc.*, 249 F. Supp. 2d 1029, 1046 (N.D. Ill. 2003) (under Illinois law, a director could not be held personally liable where there was no evidence that the director themselves wrote improper drafts or participated in drafting process).

<sup>590</sup> *Murphy*, 410 N.E.2d at 113.

language, such as noting that the representations are projections<sup>591</sup> or providing explicit language about the sources of data, that accompanies alleged misrepresentations “renders any reliance on the alleged misrepresentations . . . unreasonable,” thus defeating a claim for common-law fraud.<sup>592</sup>

See also:

- *Murphy v. Walters*<sup>593</sup>: After the circuit court initially ruled in favor of defendant owners based on a finding that the owners had not acted outside of their corporate existence, the circuit court reversed its prior ruling and found that the defendant owners had acted individually and outside their corporate existence. On appeal, the appellate court reversed the circuit court and held that the employment negotiations at issue were conducted in the name of the corporation and the employment contract had been signed by the defendants in their corporate capacity. Because the allegedly fraudulent statements were not misstatements of fact but calculations based on assumptions, the court found that there was no basis for fraud and the defendant owners could not be reached personally.

Comparison to Delaware: Under Delaware law, a fraud claim requires five elements: “(1) a false representation, usually one of fact, made by the defendant; (2) the defendant’s knowledge or belief that the representation was false, or was made with reckless indifference to the truth; (3) an intent to induce the plaintiff to act or to refrain from acting; (4) the plaintiff’s action or inaction taken in justifiable reliance upon the representation; and (5) damage to the plaintiff as a result of such reliance.”<sup>594</sup> Thus, the main difference between Illinois law and Delaware law is in the knowledge element, as Delaware law permits not just claims where the defendant knew or believed the representations were false, but also claims where the defendant acted with reckless indifference to the truth.<sup>595</sup> Like Illinois law, Delaware law imposes liability for fraudulent concealment where a defendant “by omission fails to reveal that which it is his duty to disclose in order to prevent statements actually made from being misleading.”<sup>596</sup> And like Illinois law, Delaware law does not recognize fraud based on statements of opinion or commentary on future events.<sup>597</sup> Delaware also applies a heightened pleading standard requiring particular facts regarding the time, place, and contents of the misrepresentations as well as who made the misrepresentations, to whom they were made, and what the purported misrepresenter gained.<sup>598</sup>

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<sup>591</sup> *Id.* at 113 (projections).

<sup>592</sup> *Avon Hardware Co. v. Ace Hardware Corp.*, 998 N.E.2d 1281, 1289 (Ill. App. Ct. 1st Dist. 2013) (sources of data).

<sup>593</sup> 410 N.E.2d 107 (Ill. App. Ct. 2d Dist. 1980).

<sup>594</sup> *Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1074 (Del. 1983).

<sup>595</sup> Compare *Stephenson*, 462 A.2d at 1074 (discussing the elements of fraud under Delaware law), with *Connick*, 675 N.E.2d at 591 (discussing the elements of fraud under Illinois law).

<sup>596</sup> *Stephenson*, 462 A.2d at 1074.

<sup>597</sup> See *Consol. Fisheries Co. v. Consol. Solubles Co.*, 112 A.2d 30, 37 (Del. 1955) (“It is the general rule that mere expressions of opinion as to probable future events, when clearly made as such, cannot be deemed fraud or misrepresentations.”).

<sup>598</sup> See Del. R. Civ. Proc. Super. Ct. 9; Del. Ch. Ct. R. 9(b); *Metro Comm’n Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 144 (Del. Ch. 2004).

See also:

- *In re Dole Food Co., Inc. Stockholder Litig.*<sup>599</sup>: A corporate officer that also served as a board member was held personally liable for breaching his fiduciary duty of loyalty during a buyout because he had committed fraud. The corporate officer committed fraud when he made false disclosures about potential savings the company could make by selling some of its business, cancelled a stock repurchase program for pretextual reasons, and provided lowball management estimates to the independent committee reviewing the merger while giving accurate data to the purchaser’s agents. Another corporate officer, who was also a board member, was found not to be liable because he did not personally participate in or know about the other officer’s misconduct.

### A. *Election of Remedies*

Plaintiffs can seek various types of legal and equitable relief when alleging fraud in the corporate context, including injunctive relief, contract rescission or reformation, compensatory damages, and punitive damages. However, Illinois law holds that a party alleging fraudulent inducement of a contract “has an election of remedies: he may seek rescission of the contract or he may seek money damages for breach of contract or he may seek money damages on a tort claim.”<sup>600</sup> These claims should be brought promptly because, in Illinois, “[o]ne is not permitted to lie back and speculate as to whether avoidance or affirmance of a contract will ultimately prove more profitable” and a party waives their fraud claim entirely where, “after discovering the alleged fraud and with full knowledge of its material aspects, [the party] engages in conduct which is inconsistent with an intention to sue.”<sup>601</sup>

Comparison to Delaware: Delaware law appears to pose the same election of remedies as Illinois, though it characterizes a fraud action following affirmance of a contract as sounding only in tort.<sup>602</sup> There is little Delaware case law addressing waiver of fraud causes of action, but an older case suggests that waiver, where possible, must result from more than mere affirmance of a contract.<sup>603</sup>

### B. *Non-Reliance Clauses*

Non-reliance clauses are clauses which state that a party is not relying on any representations or warranties outside of those specifically listed in an agreement.<sup>604</sup> Non-reliance clauses operate to negate the reliance element of a fraud claim by explicitly disclaiming reliance on any

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<sup>599</sup> C.A. No. CV 8703-VCL, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).

<sup>600</sup> *Estes v. Smith*, 614 N.E.2d 469, 473 (Ill. App. Ct. 1st Dist. 1993); See also *First Mercury Ins. Co. v. Ciolino*, 107 N.E.3d 240, 252–53 (Ill. App. Ct. 1st Dist. 2018) (seeking reformation of a contract based on a fraudulent misrepresentation claim).

<sup>601</sup> *Boatmen’s Bank of Benton v. Durham*, 561 N.E.2d 206, 212 (Ill. App. Ct. 5th Dist. 1990).

<sup>602</sup> See *Clark v. Teeven Holding Co.*, 625 A.2d 869, 877 (Del. Ch. 1992); *Sannini v. Casscells*, 401 A.2d 927, 931 (Del. 1979).

<sup>603</sup> *Mackenzie Oil Co. v. Omar Oil & Gas Co.*, 154 A. 883, 891 (Del. Super. Ct. 1929), *aff’d sub nom. Phoenix Oil Co. v. Mackenzie Oil Co.*, 154 A. 894 (Del. 1930) (“[T]he mere election to be bound by the provisions of a contract of sale induced by fraud does not operate as a waiver of the fraud or of the damages resulting therefrom.”).

<sup>604</sup> *Walls v. Vre Chicago Eleven, LLC*, No. 16-CV-4048, 2016 WL 5477554, at \*2 (N.D. Ill. Sept. 29, 2016) (applying Illinois law).

representations not found in the agreement.<sup>605</sup> Exculpatory clauses are generally disfavored in Illinois and therefore are strictly construed. A discussion on the limits of exculpatory clauses can be found *supra* in Part One, Section VI.

While Illinois does enforce non-reliance clauses in corporate contracts, the existence of a non-reliance clause is often not sufficient to prevail on a motion to dismiss. Courts typically deem the existence of reliance to be a question of fact; inclusion of a non-reliance clause in the contract is one important factor to consider in that factual determination, but it is not dispositive.<sup>606</sup>

Non-reliance clauses may not apply in some situations. At least one court has held that non-reliance clauses may not apply to fraudulent concealment claims if the clause does not expressly encompass omissions.<sup>607</sup> Similarly, general merger or integration clauses which do not address reliance are not specific enough to negate the reliance element of fraud and therefore do not afford a defense to fraud allegations.<sup>608</sup>

See also:

- *Vigortone AG Prod., Inc. v. PM AG Prod., Inc.*<sup>609</sup>: In reversing a jury verdict against the seller of a company, the Seventh Circuit adopted the rule that the majority of states had adopted where an integration clause does not bar a fraud claim. The Seventh Circuit examined contradictory Illinois precedent and found that Illinois law on the question was unclear.
- *W.W. Vincent & Co. v. First Colony Life Ins. Co.*<sup>610</sup>: The appellate court upheld the circuit court's dismissal of fraudulent concealment and fraudulent misrepresentation claims, holding that the presence of an integration clause in an agreement does not bar a fraud claim. The appellate court cited *Vigortone AG Prod., Inc. v. PM AG Prod., Inc.*<sup>611</sup> with approval.
- *Walls v. Vre Chicago Eleven, LLC*<sup>612</sup>: The district court denied a motion to dismiss a fraudulent concealment claim where the contract had an explicit non-reliance clause because the non-reliance clause referred only to representations and warranties but not omissions. Additionally, the court found that there was an ambiguity about whether the non-reliance clause covered everything related to a lease or if it was restricted to the narrow definition of "Project" contained in the contract. Additionally, the court noted that justifiable reliance is a question of fact and the existence of a non-reliance clause is merely one of the factors to consider.

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<sup>605</sup> *Id.*

<sup>606</sup> *See id.* at \*7.

<sup>607</sup> *See id.* at \*3 (citing to *Benson v. Stafford*, 941 N.E.2d 386, 410 (Ill. App. Ct. 1st Dist. 2010)).

<sup>608</sup> *See W.W. Vincent & Co. v. First Colony Life Ins. Co.*, 814 N.E.2d 960, 968 (Ill. App. Ct. 1st Dist. 2004); *See also Vigortone AG Prod., Inc. v. PM AG Prod., Inc.*, 316 F.3d 641, 644 (7th Cir. 2002) (noting Illinois law on whether an integration clause barred a fraud claim before applying the rule in the majority of the states where it does not).

<sup>609</sup> 316 F.3d 641 (7th Cir. 2002).

<sup>610</sup> 814 N.E.2d 960 (Ill. App. Ct. 1st Dist. 2004).

<sup>611</sup> 316 F.3d 641 (7th Cir. 2002).

<sup>612</sup> No. 16-CV-4048, 2016 WL 5477554 (N.D. Ill. Sept. 29, 2016).

Comparison to Delaware: An anti-reliance clause in a fully integrated agreement defeats the justifiable reliance element of fraud.<sup>613</sup> Delaware courts “routinely enforce these anti-reliance provisions as long as the contractual language, when read as a whole, ‘can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract’s four corners in deciding to sign the contract.’”<sup>614</sup> Thus, for a non-reliance clause to be operative under Delaware law, it must contain explicit anti-reliance representations and other contractual provisions demonstrating agreement that a party was not relying on facts outside of the contract.<sup>615</sup>

See also:

- *Infomedia Grp., Inc. v. Orange Health Sols., Inc.*<sup>616</sup>: Non-reliance provisions in a purchase agreement were found to be operative where one clause stated that the seller was not making any representations or warranties outside of those found in the purchase agreement and another clause stated that the buyer was not relying on any representations or warranties made outside of the purchase agreement. The buyer’s clause also acknowledged that it was a sophisticated party who had conducted its own independent investigation and that it was proceeding with the transaction based on this investigation. Fraudulent concealment was found to be covered by the non-reliance provisions because the provisions defined the universe of information on which the seller relied.
- *Kronenberg v. Katz*<sup>617</sup>: The Delaware Chancery Court found that an integration provision did not bar a fraud claim because the contract did not contain a clear and unambiguous provision in which the plaintiffs forthrightly affirmed that they were not relying on any representations or statements of fact that were not contained within the agreement. The court noted that the parties to the contract were both sophisticated.
- *Fortis Advisors LLC v. Johnson & Johnson*<sup>618</sup>: A contract containing anti-reliance language was found to not bar a fraud claim because only one party, the defendant, disclaimed reliance. The plaintiff had not disclaimed reliance on extra-contractual statements anywhere in the agreement. The court viewed the fact that the defendant had disclaimed reliance while the plaintiff had not as suggesting that the plaintiff was permitted to rely on the defendant’s extra-contractual statements.

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<sup>613</sup> See *Infomedia Grp., Inc. v. Orange Health Sols., Inc.*, No. CV N19C-10-212 AML, 2020 WL 4384087, at \*4 (Del. Super. Ct. July 31, 2020).

<sup>614</sup> *Id.* (quoting *Kronenberg v. Katz*, 872 A.2d 568, 593 (Del. Ch. 2004)).

<sup>615</sup> *Fortis Advisors LLC v. Johnson & Johnson*, C.A. No. 2020-0881-LWW, 2021 WL 5893997, at \*12 (Del. Ch. Dec. 13, 2021) (finding that a contract with anti-reliance language that applied only to one party did not bar a fraud claim from the party that did not disclaim reliance); *Kronenberg v. Katz*, 872 A.2d 568, 593 (Del. Ch. 2004).

<sup>616</sup> No. CV N19C-10-212 AML, 2020 WL 4384087 (Del. Super. Ct. July 31, 2020).

<sup>617</sup> 872 A.2d 568 (Del. Ch. 2004).

<sup>618</sup> No. CV 2020-0881-LWW, 2021 WL 5893997 (Del. Ch. Dec. 13, 2021).

## V. Remedies

### A. *For Breach of Fiduciary Duties Generally*

For general breach of fiduciary duties claims, including claims for gross negligence and *Caremark* claims, there are various remedies available under Delaware and Illinois laws. Under Illinois law, the appropriate remedy for a breach of fiduciary duty lies within the equitable discretion of the court.<sup>619</sup>

#### 1. Available Legal Remedies

##### a. Lost profits

Lost profits is a measure of compensatory damages calculated by determining the profits that the complaining party lost as the natural and probable consequence of the breach.<sup>620</sup> In short, lost profits are measured by how much the party would have made if not for the breach.

See also:

- *Everen Securities, Inc. v. A.G. Edwards and Sons, Inc.*<sup>621</sup>: A corporation filed suit against defendants alleging, among other things, breach of fiduciary duty in connection with the departure of two employees. An Illinois appellate court affirmed the trial court upholding an arbitral award that accounted for lost profits due to a former officer's breach of fiduciary duties.
- *Simpson v. Saggezza, Inc.*<sup>622</sup>: The corporation brought a breach of fiduciary duty claim against the defendant, a former manager, for diverting clients from the corporation to his own company. Denying the defendant's motion to dismiss, the court confirmed that Illinois law allows for recovery of lost profits inferred by lost business opportunities.
- *Vendo Co. v. Stoner*<sup>623</sup>: An employee breached covenants not to compete contained in sales and employment contracts by, inter alia, contributing substantial financial support to the development of a superior candy-vending machine which would be competitive with the older model produced by his employer. The court held that the employer was entitled to be compensated for the difference between profits which it could reasonably be expected to make if it had been the owner of the new candy-vending machine and the profits which it did in fact earn from the sale of candy-vending machines. The court further held that the employer was not limited to the recovery of profits obtained by the new corporation but could recover for its own lost profits, explaining "loss of profits, whether past or future, claimed to arise out of exclusion from a market is customarily not susceptible of detailed

<sup>619</sup> *Tully*, 948 N.E.2d at 738.

<sup>620</sup> *Everen Securities, Inc. v. A.G. Edwards and Sons, Inc.*, 719 N.E.2d 312 (Ill. App. Ct. 3d Dist. 1999).

<sup>621</sup> 719 N.E.2d 312 (Ill. App. Ct. 3d Dist. 1999) (applying Illinois law).

<sup>622</sup> No. 17-CV-04165, 2018 WL 4538781 (N.D. Ill. Sept. 21, 2018) (applying Illinois law).

<sup>623</sup> 321 N.E.2d 1 (Ill. 1974).

or direct proof, and that unless proof of an inferential character is permitted, the result would be to immunize a defendant from the consequences of his wrongful acts.”<sup>624</sup>

b. Out-of-pocket losses

Compensation for out-of-pocket losses seeks to place the complaining party where they should have been if not for the breach. These damages are measured as the difference between the price paid and the price that should have been paid.

See also:

- *Neil v. Zell*<sup>625</sup>: Former employees brought suit against their stock ownership plan’s trustee alleging breach of fiduciary duty in connection with the defendant’s approval of the plan’s purchase of stock in a company that became worthless. Following the entrance of summary judgment for the plaintiffs on the issue of liability, the court denied summary judgment on the issue of damages because calculating damages required information that was still at issue, including what the actual value of the stock purchased was. The court noted that measuring damages as “the difference between the price paid and the price that should have been paid” is well-supported by case law.<sup>626</sup>

c. Mental anguish damages

Mental anguish damages compensate the complaining party for their mental suffering as a result of the breach. These damages are separate from the harm of any economic loss and must have been a foreseeable result of the breach.

See also:

- *Bloch v. Frischholz*<sup>627</sup>: The plaintiffs alleged that the defendants breached their fiduciary duty pursuant to the Illinois Condominium Property Act by removing their Mezuzah from their doorpost during their religious mourning period and while the plaintiffs attended their loved one’s funeral, causing them great anguish and humiliation because of its significance in their religion. In denying the defendants’ motion to dismiss, the court found that damages for mental anguish are available for breaches of fiduciary duty where a defendant has reason to know that such breach is likely to cause emotional distress unrelated to any pecuniary loss.

d. Exemplary damages

Exemplary damages seek to punish the breaching party, rather than to compensate the harmed party. These are imposed to shift the incentives involved in breaching a fiduciary duty and deter similar future conduct.<sup>628</sup>

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<sup>624</sup> *Id.* at 13.

<sup>625</sup> 767 F. Supp. 2d 933 (N.D. Ill. 2011) (applying federal law).

<sup>626</sup> *Id.* at 944 (quoting *Reich v. Valley National Bank of Arizona*, 837 F. Supp. 1259 (S.D.N.Y. 1993)).

<sup>627</sup> No. 05 C 5377, 2011 WL 2633791 (N.D. Ill. July 5, 2011) (applying Illinois law).

<sup>628</sup> See *infra* Part Four, Section V.D on Punitive Damages.

See also:

- *Seerveld v. Gerstenberg and Co., Inc.*<sup>629</sup>: The plaintiff brought a fiduciary duty claim against the defendant. The jury found for the plaintiff and awarded compensatory and punitive damages. The court denied the defendant's motion for judgment notwithstanding the verdict or in the alternative for a new trial, upholding the award of punitive damages for breach of fiduciary duty.
- *Masi v. Ford City Bank and Trust Co.*<sup>630</sup>: The plaintiff brought suit against the defendant for breach of fiduciary duty in connection with alleged wrongful conversion of funds in his IRA account. The district court granted the plaintiff summary judgment on his breach of fiduciary duty claim, but summarily and without explanation denied punitive damages. On appeal, the Seventh Circuit remanded to the district court for a full hearing on exemplary damages after finding that Illinois law does allow for such damages in claims for breach of fiduciary duty.

2. Available Equitable Remediesa. Avoidance or rescission of a contract that is the basis of the claim

Avoidance or rescission of a contract is an equitable remedy intended to place both parties to the contract in the position they were in prior to entering into the contract.<sup>631</sup>

See also:

- *Mintjal v. Professional Benefit Trust*<sup>632</sup>: The plaintiffs sued fiduciaries of their employer's welfare benefit trust for breach of fiduciary duty. After granting summary judgment on the issue of liability, the court opined that equitable relief for breaches of fiduciary duty under ERISA parallels "traditional equitable remedies" that are ordinarily available for such breaches under federal law, including rescission.<sup>633</sup>
- *Howington v. Ghourdjian*<sup>634</sup>: The plaintiff brought a derivative claim for breach of fiduciary duty against defendants with regard to certain transactions that the corporation entered into. After a finding in favor of the plaintiff on the merits of the claim, the court considered the appropriate remedy. Acknowledging that ordinarily the appropriate remedy for an improper transaction is rescission, the court rejected the defendants' contention that shareholder ratification was an appropriate remedy because the circumstances of the case suggested danger of undue influence by the defendants. However, this particular transaction could not be properly unwound because both parties could not be returned to the *status quo ante*. In such cases, the court found that rescissory damages would be

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<sup>629</sup> No. 84 C 10385, 1986 WL 2609 (N.D. Ill. Feb. 21, 1986) (applying Illinois law).

<sup>630</sup> 779 F.2d 397 (7th Cir. 1985) (applying Illinois law).

<sup>631</sup> See *Howington v. Ghourdjian*, No. 00 C 7394, 2002 WL 265179, at \*2 (N.D. Ill. Feb. 25, 2002) (applying Delaware law).

<sup>632</sup> No. 08-CV-5681, 2018 WL 11353294 (N.D. Ill. Apr. 23, 2018) (applying federal law).

<sup>633</sup> *Id.* at 5 (citation omitted).

<sup>634</sup> No. 00 C 7394, 2002 WL 265179 (N.D. Ill. Feb. 25, 2002) (applying Delaware law).

adequate substitute relief. The court noted that typically, rescissory damages are the “repayment of the benefit that the self-dealing fiduciaries received from the transaction.”<sup>635</sup>

b. Profit disgorgement

Profit disgorgement is intended to deprive the wrongdoer of the gains from the breach.<sup>636</sup>

See also:

- *Chao v. Linder*<sup>637</sup>: The court discussed the proper scope of disgorgement damages for a breach of fiduciary duty. Because the purpose of disgorgement is to deter such conduct by removing the financial benefit, the court determined that the defendants were liable for any profits that they made as a result of the breaches of fiduciary duties, not just those that caused damage to the beneficiaries.

c. Forfeiture

Under Illinois law, as a matter of public policy, “when a breach of fiduciary duty is egregious, or it is willful and deliberate, the trial court may order forfeiture of compensation.”<sup>638</sup> Forfeiture can be of gross compensation.<sup>639</sup> Several Illinois appellate court cases have found that, as a matter of public policy, “a willful and deliberate breach of a fiduciary duty requires complete forfeiture of all compensation during the period of the breach.”<sup>640</sup> “The purpose of ordering forfeiture of a fiduciary’s compensation earned during the period of a breach is not to compensate the injured party but rather to deprive the wrongdoer of the gains from the breach of duty and to deter disloyalty.”<sup>641</sup>

See also:

- *Cahnman v. Timber Court LLC*<sup>642</sup>: The First District found that the defendants’ breaches of fiduciary duty—which were based on unauthorized loans, disbursements, and cash transfers; mismanagement; and improper diversion of funds to various entities, some of which were solely owned by defendant—were “sufficiently egregious to warrant a complete forfeiture of all benefits that they received.”<sup>643</sup> Specifically, the court forfeited \$226,428.50 in commissions and management fees for breach of fiduciary duty against the defendants with respect to one entity, and \$106,216 for breach of fiduciary duty with respect to two others. The plaintiff had also asked for treble punitive damages, but the court

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<sup>635</sup> *Id.* at \*2.

<sup>636</sup> See Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. Rev. 851, 852, 857 (2011) (disgorgement is an appropriate remedy to deprive the fiduciary of the benefit obtained through the breach; liability does not attach to assets acquired in a manner unrelated to the breach).

<sup>637</sup> No. 05-CV-3812, 2007 WL 1655254 (N.D. Ill. May 31, 2007) (applying federal law).

<sup>638</sup> *Jehle v. Jehle*, 2022 IL App (4th) 210547-U, ¶ 99.

<sup>639</sup> *ICD Publ’ns, Inc. v. Gittlitz*, 24 N.E.3d 898, 914 (Ill. App. Ct. 1st Dist. 2014).

<sup>640</sup> *LID Associates v. Dolan*, 756 N.E.2d 866, 886 (Ill. App. Ct. 1st Dist. 2001); See also *ICD Publ’ns*, 24 N.E.3d at 914; *Tully v. McLean*, 948 N.E.2d 714, 738 (Ill. App. Ct. 1st Dist. 2011).

<sup>641</sup> *Tully*, 948 N.E.2d at 738.

<sup>642</sup> 196 N.E.3d 151 (Ill. App. Ct. 1st Dist. 2021).

<sup>643</sup> *Id.* at 160.

awarded punitive damages in the ratio of 1:1 to compensatory damages, because it had also forfeited the defendants' compensation.

- *Flynn v. Maschmeyer*<sup>644</sup>: The court held that the trial court acted within its discretion in its determination that partial forfeiture of distributions that the chief executive manager of the member-managed limited liability company (LLC) had received was an appropriate award to co-managers in their action against the executive manager for breach of fiduciary duty. However, while the trial court was permitted to award punitive damages in addition to forfeiture, it was not required to award both. The trial court found that the LLC's business more than doubled, in substantial part due to the executive manager's efforts, and the trial court found that the co-managers' actions had an opportunistic element in that they were aware that the executive manager was performing at least some of the disputed jobs and that the disputed jobs were ones that it was "highly unlikely" the LLC would pursue.<sup>645</sup>
- *In re Edgewater Medical Ctr.*<sup>646</sup>: The Bankruptcy Court noted that "Illinois law permits, rather than requires, complete forfeiture of all compensation received by a defendant during the course of the breach of fiduciary duty."<sup>647</sup>
- *Caparos v. Morton*<sup>648</sup>: The First District found that "a breach of fiduciary duty requires the complete forfeiture of all compensation during the period of the breach"<sup>649</sup> and affirmed the trial court's forfeiture of \$833,190 of management fees that were paid to the general partners by the limited partnership over a three-year period in which the general partners engaged in self-dealing.
- *Tully v. McLean*<sup>650</sup>: The plaintiffs brought an action individually and on behalf of a company, accusing its managers of fraud and breach of fiduciary duty because they concealed that they had been giving themselves, and separate businesses that they owned, monetary transfers on behalf of the company, with full awareness that these loans caused the company to become unable to pay its mortgage and real estate taxes and incur late fees and penalties during the period. The First District affirmed the trial court's order requiring the defendants to disgorge all management fees they received from the company, and reimburse all loan fees they charged during their time as managers.
- *ICD Publ'ns, Inc. v. Gittlitz*<sup>651</sup>: The First District affirmed the trial court's finding that the former president of a corporation should forfeit all compensation from the years in which he breached his fiduciary duties by embezzling funds from the corporation. The former president contested the forfeiture amount, arguing that complete forfeiture was improper

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<sup>644</sup> 156 N.E.3d 540, 560 (Ill. App. Ct. 1st Dist. 2020).

<sup>645</sup> *Id.* at 562.

<sup>646</sup> 344 B.R. 864, 871 (Bankr. N.D. Ill. 2006) (permissible forfeiture).

<sup>647</sup> *Id.* at 871.

<sup>648</sup> 845 N.E.2d 773, 788 (Ill. App. Ct. 1st Dist. 2003) (required forfeiture).

<sup>649</sup> *Id.* at 788.

<sup>650</sup> 948 N.E.2d 714 (Ill. App. Ct. 1st Dist. 2011) (applying Illinois law).

<sup>651</sup> 24 N.E.3d 898 (Ill. App. Ct. 1st Dist. 2014) (applying Illinois law).

and that he should only have to forfeit his net compensation. The First District rejected this argument and affirmed the trial court’s complete forfeiture finding.

d. Receivership

A court may appoint a receiver to take over and manage a corporation; however, the appointment of a receiver is an “extraordinary and drastic remedy” appropriate only in cases of “urgent necessity when there is a present danger to the interests of the investors, consisting of a serious suspension of the business and an imminent danger of waste or dissipation of corporate assets.”<sup>652</sup>

See also:

- *Witters v. Hicks*<sup>653</sup>: The Fifth District upheld a trial court’s appointment of a receiver, pursuant to 805 ILCS 5/12.60, where the evidence supported the trial court’s finding that third-party intervention was necessary because the corporation’s existence was in imminent jeopardy. The facts that led the trial court to this conclusion in this shareholder action included fraud perpetrated by a corporate officer, improper and illegal accounting practices, and the corporate officer treating the corporation’s assets as his own.

e. Injunction

Injunctions are court orders that restrain, or enjoin, a party from performing a particular action such as signing a contract or competing with their former employer.<sup>654</sup> An injunction can be issued at the end of a suit as a permanent injunction or prior to the end of a suit as a temporary restraining order or preliminary injunction. Temporary restraining orders and preliminary injunctions are “not meant to resolve the merits of the case, but to preserve the status quo until the merits can be decided.”<sup>655</sup>

See also:

- *Northwest Podiatry Ctr., Ltd. v. Ochwat*<sup>656</sup>: The First District upheld a trial court’s preliminary injunction prohibiting former employees, including a former corporate officer, from entering into a contract with their former employer’s former client. Because the trial court had found that the former corporate officer had used information he learned as a corporate officer to attempt to usurp the contract, the trial court held that he had breached his fiduciary duty to the corporation and enjoined him in order to protect the corporation’s rights by preventing him from gaining a competitive advantage through the unlawful appropriation.
- *Schulenburg v. Signatrol Inc.*<sup>657</sup>: The Supreme Court of Illinois modified a trial court’s injunction restricting former employees from using trade secrets that they had stolen from

<sup>652</sup> *Witters v. Hicks*, 780 N.E.2d 713, 717 (Ill. App. Ct. 5th Dist. 2002).

<sup>653</sup> 780 N.E.2d 713 (Ill. App. Ct. 5th Dist. 2002).

<sup>654</sup> See *Northwest Podiatry Ctr., Ltd. v. Ochwat*, 990 N.E.2d 347, 361–62 (Ill. App. Ct. 1st Dist. 2013) (contract); *Schulenburg v. Signatrol Inc.*, 212 N.E.2d 865, 869–70 (Ill. 1965) (competition).

<sup>655</sup> *Northwest Podiatry*, 990 N.E.2d at 356.

<sup>656</sup> 990 N.E.2d 347 (Ill. App. Ct. 1st Dist. 2013) (applying Illinois law).

<sup>657</sup> 212 N.E.2d 865 (Ill. 1965) (applying Illinois law).

the corporation. While the Court agreed that the injunction was the proper remedy for the employees' actions, it held that an injunction that was not geographically or temporally restricted was improper because the trade secrets that were stolen could have been legally reverse engineered. Thus, the Court limited the duration of the injunction to the amount of time it would reasonably have taken to reverse engineer the trade secrets.

f. Accounting

An accounting is an equitable remedy that permits a court to examine a set of business decisions or transactions and to render judgment on the balance that is due to a party based on that examination.<sup>658</sup> The equitable remedy of an accounting is available to plaintiffs who allege breach of a fiduciary duty; however, it appears to be rarely awarded because the information that an accounting would produce is generally uncovered during discovery or impracticable to obtain.

See also:

- *Gifford v. Gallano Farms, LLC*<sup>659</sup>: The Second District affirmed a trial court's denial of the plaintiffs' accounting claim. The Second District agreed with the trial court's determination that the plaintiff LLC members had "essentially had their accounting through this lawsuit."<sup>660</sup> There was extensive discovery in the case, including the production of all LLC records and a two-week trial.
- *Tufo v. Tufo*<sup>661</sup>: The First District affirmed the trial court's denial of a plaintiff shareholder's accounting claim. After first affirming the trial court's determination that the plaintiff lacked standing to bring a derivative action and noting that this lack of standing was sufficient to deny the plaintiff's accounting claim, the First District affirmed the denial on the alternate grounds that the plaintiff had obtained access to the relevant financial information through discovery. The plaintiff had access to tax returns, check registers, the corporation's accounting software files, and other financial documentation through discovery.
- *Netisingha v. End of the Line, Inc.*<sup>662</sup>: The First District affirmed the trial court's refusal to order an accounting because an accurate accounting was impracticable given the accounting practices. The court noted that the plaintiff shareholders not only were familiar with the accounting practices in use by the corporation but that they had played an integral role in setting them up.

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<sup>658</sup> See *Gifford v. Gallano Farms, LLC*, No. 2-10-0055, 2011 WL 10109462, at \*22 (Ill. App. Ct. 2d Dist. May 18, 2011) (Zenoff, J., concurring in part and dissenting in part).

<sup>659</sup> No. 2-10-0055, 2011 WL 10109462 (Ill. App. Ct. 2d Dist. May 18, 2011) (applying Illinois law).

<sup>660</sup> *Id.* at \*15.

<sup>661</sup> 196 N.E.3d 58 (Ill. App. Ct. 1st Dist. 2021) (applying Illinois law).

<sup>662</sup> 437 N.E.2d 857 (Ill. App. Ct. 1st Dist. 1982) (applying Illinois law).

g. Reformation

Reformation allows a court to judicially modify a written contract so that it conforms with the agreement that was actually reached between the parties.<sup>663</sup> Reformation is most often premised on mutual mistake between the two parties; however, reformation is also available when there is a unilateral mistake by one party that was caused by the other party's fraud.<sup>664</sup>

See also:

- *Van Schouwen v. Connaught Corp.*<sup>665</sup>: A corporation brought a counterclaim for rescission or reformation after it was sued by a former shareholder for the breach of a stock sale agreement. The corporation claimed that faulty bookkeeping had led to a mutual mistake of fact regarding the book value of the company and, thus, the amount that the shareholder would be paid under the stock agreement. The district court, applying Illinois law at the motion to dismiss phase, accepted the corporation's argument that the agreement had been to pay one-eighth of the corporation's book value rather than the amount specified in the contract and found that the corporation had alleged a sufficient set of facts for their contract reformation counterclaim to survive. The corporation's rescission counterclaim was dismissed because the corporation had not alleged facts that would support a conclusion that enforcement of the stock agreement would be unconscionable.

h. Constructive trust

Constructive trusts "may be imposed to redress unjust enrichment caused by a party's wrongful conduct."<sup>666</sup> To impose a constructive trust, the proceeds of the alleged wrongful conduct must exist as an identifiable fund traceable to that conduct, such that it can become the *res* of the proposed trust.<sup>667</sup>

See also:

- *Kovac v. Barron*<sup>668</sup>: The Second District affirmed the trial court's imposition of a constructive trust on the estate of the plaintiff's business partner by noting that constructive trusts have "long been the appropriate remedy where . . . there is a breach of fiduciary duty."<sup>669</sup> The plaintiff had alleged that his business partner, an equal shareholder in the corporation, had secretly arranged to pay himself substantially more in salary than the plaintiff through the use of a wholly owned payroll processing subsidiary despite there being an agreement that the two would take the same salaries and bonuses. After a bench trial, the trial court found in favor of the plaintiff and imposed a constructive trust on the business partner's estate.

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<sup>663</sup> *Van Schouwen v. Connaught Corp.*, 782 F. Supp. 1240, 1244 (N.D. Ill. 1991).

<sup>664</sup> *Id.*; *Aetna Screw Prod. Co. v. Borg*, 451 N.E.2d 1260, 1264 (Ill. App. Ct. 1st Dist. 1983).

<sup>665</sup> 782 F. Supp. 1240 (N.D. Ill. 1991) (applying Illinois law).

<sup>666</sup> *Charles Hester Enters., Inc. v. Illinois Founders Insurance Co.*, 499 N.E.2d 1319, 1326 (Ill. 1986); *Kovac v. Barron*, 6 N.E.3d 819, 833 (Ill. App. Ct. 2d Dist. 2014).

<sup>667</sup> *Eychaner v. Gross*, 779 N.E.2d 1115, 1143 (Ill. 2002).

<sup>668</sup> 6 N.E.3d 819 (Ill. App. Ct. 2d Dist. 2014) (applying Illinois law).

<sup>669</sup> *Id.* at 833.

- *Jackson v. Callan Publ'g, Inc.*<sup>670</sup>: Members of a fraternal police organization brought a class action suit against an organization and telemarketers that solicited donations on the organization's behalf, alleging that the organization and telemarketers had breached their duty as trustees of the donations. The plaintiffs sought an accounting, creation of a charitable or constructive trust on behalf of the class, damages for unjust enrichment, and attorney fees and costs. The First District held that the trial court did not abuse its discretion when it chose not to impose a constructive trust in the absence of unjust enrichment. The trial court concluded that neither the fraternal police organization nor the telemarketers soliciting donations on the organization's behalf had obtained money to which they were not entitled under such circumstances that, "in equity and good conscience," they ought not be allowed to retain. The First District also noted that there was no basis for finding an abuse of a fiduciary relationship and members of the organization did not even allege a fiduciary relationship against the organization, and, although there was evidence of wrongdoing in the form of misleading representations by some solicitors, the organization and telemarketers were not responsible for that wrongdoing, as there was no principal-agent relationship.

### ***B. Comparison to Delaware: For Breach of Fiduciary Duties Generally***

The Delaware Court of Chancery has broad discretion to remedy breaches of fiduciary duty. Depending on the case, the remedies appropriate might be legal, equitable, or a combination of both.

1. Available Legal Remedies
  - a. Compensatory damages

Compensatory damages, also known as actual damages, are the amount that the complaining party actually lost as a result of the breach. Compensatory damages seek to make the claimant "whole." These can be measured in a variety of ways, but lost profits is commonly used.<sup>671</sup>

See also:

- *Ravenswood Investment Company, L.P. v. Estate of Winmill*<sup>672</sup>: The plaintiff brought derivative claims against the defendants alleging breaches of fiduciary duty in connection to alleged self-dealing by members of the board of directors. In discussing the appropriate remedy, the court noted that compensatory damages are an appropriate remedy for a breach of the duty of loyalty. However, the court did underscore that there must be evidence of damages in the record to support an award of compensatory damages.

<sup>670</sup> 198 N.E.3d 1099 (Ill. App. Ct. 1st Dist. 2021), *appeal denied*, 175 N.E.3d 119 (Ill. 2021) (applying Illinois law).

<sup>671</sup> *See supra* Part Four, Section V.A.1.i on lost profits.

<sup>672</sup> No. CV 3730-VCS, 2018 WL 1410860 (Del. Ch. Mar. 21, 2018), *as revised* (Mar. 22, 2018), *aff'd*, 210 A.3d 705 (Del. 2019).

b. Consequential damages

Consequential damages seek to compensate the harmed party for damage suffered as a result of the breach, even if they do not arise directly from the breach. Types of consequential damages might include liability to a third party as a result of the breach, out-of-pocket losses, or mental anguish damages.<sup>673</sup>

See also:

- *Metro Communication Corporation BVI v. Advanced Mobilcomm Technologies Inc.*<sup>674</sup>: The plaintiffs brought suit against the defendants in connection with a bribery scheme and the collapse of an investment fund, asserting a variety of claims. Despite some issues with the pleading of the claim, the court declined to dismiss the plaintiffs' claim for compensatory damages based on a diminution in the value of the fund.

2. Available Equitable Remedies

a. Rescission or rescissory damages

- *Crescent/Mach I Partners, L.P. v. Turner*<sup>675</sup>: The plaintiffs brought suit against the defendants for breaches of fiduciary duty in connection with the approval of a merger. Deciding on a motion to dismiss, the court declined to reject rescission or rescissory damages as a potential remedy for the breach.
- *In re Shoe-Town, Inc. Stockholders Litigation*<sup>676</sup>: Former shareholders brought suit against the defendants alleging breaches of fiduciary duty—among other things—in connection with the defendants' conduct surrounding the corporation's going private. The plaintiffs sought rescission of the “going private” transaction, or rescissory damages in the alternative. The court denied the defendants' motion to dismiss on the breach of fiduciary duty claims against the defendant-directors.
- *In re Orchard Enterprises, Inc. Stockholder Litigation*<sup>677</sup>: The plaintiffs filed suit against the defendants following a squeeze-out merger. The court, in considering the available remedies in the action, discussed rescissory damages as an option given the passage of time since the alleged breach and concluded that they were a viable form of relief if the plaintiffs ultimately prevailed.

b. Accounting<sup>678</sup>

- *Garfield on behalf of ODP Corporation v. Allen*<sup>679</sup>: Shareholders brought suit against the defendants alleging breaches of fiduciary duties based on alleged overcompensation of the

<sup>673</sup> See *supra* Part Four, Section V.A.1.ii–iii on out-of-pocket losses and mental anguish damages.

<sup>674</sup> 854 A.2d 121 (Del. Ch. 2004).

<sup>675</sup> 846 A.2d 963 (Del. Ch. 2000).

<sup>676</sup> 16 Del. J. Corp. L. 404 (Del. Ch. 1990).

<sup>677</sup> 88 A.3d 1 (Del. Ch. 2014).

<sup>678</sup> See definition *supra* Part Four, Section V.A.2.vi.

<sup>679</sup> 277 A.3d 296 (Del. Ch. 2022).

defendant CEO. In denying the defendants' motion to dismiss, the court cited case law supporting an accounting to determine the scope of unjust enrichment.

- *Carlson v. Hallinan*<sup>680</sup>: The plaintiffs brought suit against the defendants alleging breach of contract and breach of fiduciary duty. In denying the defendants' post-trial motion to supplement, the court concluded that an accounting was one of the proper remedies.

c. Constructive trust<sup>681</sup>

- *Jackson National Life Insurance Co. v. Kennedy*<sup>682</sup>: The plaintiffs sued the former president and director for breach of fiduciary duty and unjust enrichment in connection with the sale of assets to another corporation. In denying in part the defendants' motion to dismiss, the court found that the plaintiffs' breach of fiduciary duty was pled such that they had properly stated an actionable claim for unjust enrichment and imposition of a constructive trust.
- *Teachers' Retirement System of Louisiana v. Aidinoff*<sup>683</sup>: The plaintiff brought suit against the defendants, alleging breach of fiduciary duty and unjust enrichment by the corporation's executives. In denying the defendants' motion to dismiss, the court posited that the claims against the defendants could support the imposition of a constructive trust.

d. Disgorgement<sup>684</sup>

- *Metro Storage Int'l LLC v. Harron*<sup>685</sup>: The plaintiffs, limited liability corporations, brought suit against the president of those companies for offering outside consulting services, disclosure of confidential information, and offering opportunities to other companies and not to the LLCs. The court found that the plaintiffs proved that the president had breached his duty of loyalty to the companies and concluded that the disgorgement of the fees that he had earned was part of an appropriate remedy.
- *Brophy v. Cities Service Co.*<sup>686</sup>: The plaintiff brought suit against a former employee alleging that he breached his duty to the corporation by using information that he had by virtue of his employment to acquire and sell stock in the company at a profit. In denying the defendant's motion to dismiss, the court noted that a person in breach of duty is "accountable for [any] profit" gained by the breach.<sup>687</sup>

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<sup>680</sup> 925 A.2d 506 (Del. Ch. 2006).

<sup>681</sup> See definition *supra* Part Four, Section V.A.2.viii.

<sup>682</sup> 741 A.2d 377 (Del. Ch. 1999).

<sup>683</sup> 900 A.2d 654 (Del. Ch. 2006).

<sup>684</sup> See definition *supra* Part Four, Section V.A.2.ii.

<sup>685</sup> 275 A.3d 810 (Del. Ch. 2022).

<sup>686</sup> 70 A.2d 5 (Del. Ch. 1949).

<sup>687</sup> *Id.* at 8 (citation omitted).

### C. *For Self-Interested Transactions*

Generally, in Illinois, “the remedy for a conflict of interest is to rescind or cancel the transaction, though damages may be assessed in lieu of rescinding the transaction.”<sup>688</sup> Thus, where a fiduciary engages in self-dealing without the knowledge or permission of the corporation, the corporation may choose to void the transaction.<sup>689</sup>

Comparison to Delaware: In Delaware, too, a conflicted transaction may be cancelled or rescinded in lieu of an assessment of damages.<sup>690</sup>

### D. *Punitive Damages*

Under Illinois law, punitive damages are also available for breach of fiduciary duty claims.<sup>691</sup> Punitive damages is not the same remedy as forfeiture of compensation, although a court may consider forfeiture and punitive damages together and style an award of forfeiture as one of punitive damages.<sup>692</sup> “Punitive damages ‘are not awarded as compensation, but serve instead to punish the offender and to deter that party and others from committing similar acts of wrongdoing in the future.’”<sup>693</sup> They may be awarded “when the defendant’s tortious conduct evinces a high degree of moral culpability, that is, when the tort is committed with fraud, actual malice, deliberate violence or oppression, or when the defendant acts willfully, or with such gross negligence as to indicate a wanton disregard of the rights of others.”<sup>694</sup> “To determine whether punitive damages are appropriate, ‘the trier of fact can properly consider the character of the defendant’s act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.’”<sup>695</sup> However, because they are penal in nature, punitive damages are not favored under the law, and courts take caution to ensure that they are not improperly or unwisely awarded.<sup>696</sup>

Punitive damages are available in Illinois for cases involving “gross fraud, breach of trust, or ‘other extraordinary or exceptional circumstances clearly showing malice and willfulness.’”<sup>697</sup> Illinois courts weigh five factors when deciding whether to award punitive damages: “(1) whether the harm caused was physical as opposed to economic; (2) whether the tortious conduct evinced an

<sup>688</sup> See § 14:1. Duty of loyalty—In general, 8 Ill. Prac., Business Organizations § 14:1 (2d ed.); See also *Shlensky v. S. Parkway Bldg. Corp.*, 166 N.E.2d 793, 802 (Ill. 1960) (“[W]here the corporate directors fail to establish the fairness of the challenged transaction, it may either be set aside, or affirmed and damages recovered for the losses sustained by the corporation.”).

<sup>689</sup> See *Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co.*, 221 F. Supp. 2d 874, 879–80 (N.D. Ill. 2002) (applying Illinois law and collecting cases nationally) (noting that where a fiduciary engages in self-dealing without the knowledge or permission of the principal, the principal has the option to void the contract).

<sup>690</sup> *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, No. CIV.A. 8922-VCG, 2014 WL 4418169, at \*6 (Del. Ch. Sept. 10, 2014); *In re S. Peru Copper Corp. S’holder Derivative Litig.*, 52 A.3d 761, 813 (Del. Ch. 2011).

<sup>691</sup> *Tully*, 948 N.E.2d at 729.

<sup>692</sup> *Jehle v. Jehle*, 2022 IL App (4th) 210547-U, ¶ 99 (citing *Flynn*, 156 N.E.3d at 531).

<sup>693</sup> *Slovinski v. Elliot*, 927 N.E.2d 1221, 1224–25 (Ill. 2010) (quoting *Loitz v. Remington Arms Co.*, 563 N.E.2d 397 (Ill. 1990)).

<sup>694</sup> *Id.* at 1225 (internal quotations and citations omitted).

<sup>695</sup> *Id.* (quoting Restatement (Second) of Torts § 908(2) (1979)).

<sup>696</sup> *Id.*

<sup>697</sup> *AMPAT/Midwest, Inc. v. Illinois Tool Works, Inc.*, 896 F.2d 1035, 1043 (7th Cir. 1990) (quoting *Home Sav. and Loan Ass’n of Joliet v. Schneider*, 483 N.E.2d 1225 (Ill. 1985) (applying Illinois law)).

indifference to or a reckless disregard for the health and safety of others; (3) whether the target of the conduct was financially vulnerable; (4) whether the conduct involved repeated actions or was an isolated incident; and (5) whether the harm was the result of intentional malice, trickery, or deceit, or mere accident.”<sup>698</sup>

The amount of a punitive damages award “should be a reflection of the court’s determination as to the degree of maliciousness evidenced by defendants’ actions.”<sup>699</sup> Illinois courts will review the computation of the punitive damages awards “to determine whether the amount was excessive or the result of passion, partiality, or corruption.”<sup>700</sup> “In reviewing [the] determination of the amount of punitive damages, if any, [the court] will reverse only if the award was so excessive [as] to indicate passion, partiality, or corruption.”<sup>701</sup> The assessment of punitive damages is a highly factual decision and, as noted, should be a reflection of the factfinder’s determination as to the degree of maliciousness evidenced by a defendant’s actions.<sup>702</sup>

See also:

- *In re Edgewater Medical Ctr.*<sup>703</sup>: The Bankruptcy Court found that the defendant breached his fiduciary duty toward the Medical Center in providing information on whether the Medical Center should exercise an option to purchase adjacent property. The court found that he did so willfully “with the intent to defraud [the company].”<sup>704</sup> The Court awarded damages of nearly \$3 million, and punitive damages of the same amount finding that the defendant engaged in “exactly the type of conduct for which punitive damages are appropriate.”<sup>705</sup>
- *Tully v. McLean*<sup>706</sup>: The First District affirmed an award of \$1,010,671.96 in compensatory damages (50% of the total compensatory amount) and \$3,231,550.26 in punitive damages (3x (100% compensatory award minus forfeiture amounts)), for a total of \$4,242,222.22. The plaintiff, a member of a member-managed limited liability company, brought suit for fraud and breach of fiduciary duty against the company, the original member-manager, the successor member-manager, two other members, and the former property manager. The plaintiff accused the defendants of loaning themselves, and separate businesses that they owned, money from the plaintiff LLC that they were managing with full awareness that these loans had caused the plaintiff to (i) become unable to pay its mortgage and real estate taxes or use its own funds or earn interest during the period and (ii) incur late fees and penalties as a result. The First District affirmed the grant of punitive damages because both the fourth and fifth factors were “strongly present.”<sup>707</sup> The trial record established “well

<sup>698</sup> *International Union of Operating Eng’rs, Local 150 v. Lowe Excavating Co.*, 870 N.E.2d 303, 313 (Ill. 2006).

<sup>699</sup> *Tully*, 948 N.E.2d at 732 (citing *Gambino v. Boulevard Mortgage Corp.*, 922 N.E.2d 380, 424 (Ill. App. Ct. 1st Dist. 2009)).

<sup>700</sup> *Gambino*, 922 N.E.2d at 424 (citing *Franz v. Calaco Development Corp.*, 818 N.E.2d 357, 366–67 (Ill. App. Ct. 2d Dist. 2004)).

<sup>701</sup> *Gambino*, 922 N.E.2d at 424 (internal quotation omitted).

<sup>702</sup> *Id.*

<sup>703</sup> 373 B.R. 845 (Bankr. N.D. Ill. 2007) (applying Illinois law).

<sup>704</sup> *Id.* at 862.

<sup>705</sup> *Id.*

<sup>706</sup> 948 N.E.2d 714 (Ill. App. Ct. 1st Dist. 2011).

<sup>707</sup> *Id.* at 737.

over 100 misappropriations over a period of six years,” in the form of intercompany loans and transfers to entities owned by the defendants.<sup>708</sup> The trial court reasoned that 3:1 was more reasonable than a lower ratio, reasoning that “a 1:1 ratio [would be] insufficient to deter future misconduct as strong medicine is required to cure defendants’ disrespect for the law.”<sup>709</sup>

- *Pistone v. Carl*<sup>710</sup>: The First District affirmed the trial court’s award of compensatory damages and \$40,000 in punitive damages. The plaintiff alleged that the defendant—an LLC manager—made withdrawals from company funds for his own personal use. Because the conduct was intentional, the Court found “[i]t cannot be seriously argued that the defendant’s conduct in the misappropriation of [company] funds for his personal use did not constitute a breach of that duty.”<sup>711</sup> The defendant did “not dispute that the facts support[ed] an award of punitive damages.”<sup>712</sup>
- *Kovac v. Barron*<sup>713</sup>: The Second District affirmed the trial court’s award of \$450,000 in punitive damages following a bench trial involving claims fraud and breach of fiduciary duty against a defendant officer and director. The plaintiff alleged that the defendant paid excessive compensation to himself through diversion of company income without the knowledge or consent of the board of directors. In affirming the punitive damages award, the Court reasoned that the defendant “violated a strong and clearly articulated public policy by disobeying court orders, he defrauded his equal partner out of millions of dollars, and he diverted repair business income from the Operating Companies . . . . We cannot say that the trial court’s determination to award punitive damages was an abuse of discretion.”<sup>714</sup>
- *Wolinsky v. Kadison*<sup>715</sup>: The First District affirmed the trial court’s grant of summary judgment on the issue of punitive damages, finding that there were no aggravating circumstances warranting punitive damages because the defendants’ alleged fiduciary duty breach was grounded in a failure to conduct a necessary vote in accordance with the company’s bylaws. There were no allegations of fraud, and the Court ultimately found that the defendants’ failure to comply with the bylaws was based on an erroneous interpretation rather than “outrageous conduct akin to a criminal act.”<sup>716</sup>

Comparison to Delaware: In the Delaware Court of Chancery, punitive damages are generally unavailable.<sup>717</sup> This is because the Court of Chancery lacks jurisdiction to award punitive or

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<sup>708</sup> *Id.* at 730.

<sup>709</sup> *Id.* at 732.

<sup>710</sup> 2020 IL App (1st) 181183-U.

<sup>711</sup> *Id.* at ¶ 55.

<sup>712</sup> *Id.* at ¶ 53.

<sup>713</sup> 6 N.E.3d 819 (Ill. App. Ct. 2d Dist. 2014).

<sup>714</sup> *Id.* at 837.

<sup>715</sup> 987 N.E.2d 971 (Ill. App. Ct. 1st Dist. 2013).

<sup>716</sup> *Id.* at 989.

<sup>717</sup> *Adams v. Calvarese Farms Maint. Corp., Inc.*, No. CIV.A. 4262-VCP, 2010 WL 3944961, at \*21 n.204 (Del. Ch. Sept. 17, 2010), *judgment entered*, 2010 WL 3640819 (Del. Ch. Sept. 17, 2010) (“The Legislature has not authorized punitive damages for a director’s breach of fiduciary duty[.]”).

exemplary damages unless it has received express statutory authority from the Delaware Legislature.<sup>718</sup>

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<sup>718</sup> *Id.*; *cf. Clark v. Teeven Holding Co., Inc.*, 625 A.2d 869, 878 (Del. Ch. 1992) (noting the Court of Chancery “still retains jurisdiction to hear nearly all claims for breach of fiduciary duty.”).