

LITIGATION REVIEW

UP-TO-DATE ANALYSIS FOR CLIENTS AND FRIENDS OF THE FIRM

THE FIDUCIARY SHIELD DOCTRINE: GIVING EFFECT TO LIMITED LIABILITY BY REFUSING TO EXERCISE PERSONAL JURISDICTION OVER FIDUCIARIES AND OTHER AGENTS

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Limited liability is one of the fundamental protections afforded to officers, directors and shareholders of corporations and members of limited liability companies. The basic concept of limited liability is that only the business entity itself -- not the people who own or operate the business -- is responsible for the business' debts. Similarly, those who own or operate the business are not responsible for its torts, unless they participate in them.

Although there are exceptions to the rule of limited liability, the exceptions arise only in special situations and generally face high legal hurdles. The difficulty in overcoming those legal hurdles, however, does not always dissuade plaintiffs from trying to do so. When a complaint seeks to impose personal liability on a defendant for the obligations of a business entity, the prospect of facing the time-consuming and expensive tasks of discovery, dispositive motions or possibly a trial can be daunting. These burdens can be further exacerbated when the individual defendant is sued hundreds of miles from home. Even if such a claim is unlikely to prevail, it can increase the settlement value of a case. As a result, claims seeking to impose personal liability are made with some frequency.

When a claim is made against an individual, defense counsel may seek to give effect to the rule of limited liability by asserting the "fiduciary shield doctrine." The fiduciary

shield doctrine is a judicially-created rule arising from the law of personal jurisdiction, rather than corporate law.

The fiduciary shield doctrine provides that a court should not exercise personal jurisdiction over an out-of-state officer or agent of a corporation or LLC when that individual's conduct within the forum state was solely for the benefit of the business entity and not for any personal benefit. The rationale for the fiduciary shield doctrine is rooted in concepts of equity and fairness. Before explaining the fiduciary shield doctrine, a brief review of the law of personal jurisdiction is necessary.

1. PERSONAL JURISDICTION

A court must have personal jurisdiction to exercise its authority over a particular defendant. A plaintiff suing an out-of-state defendant bears the burden of demonstrating that the court hearing the case can exercise jurisdiction over that defendant. *E.g., McIlwee v. ADM Indus., Inc.*, 17 F.3d 222, 223 (7th Cir. 1994). So, for an Illinois court to assert jurisdiction over corporate officers who do not live in Illinois, a plaintiff must demonstrate that jurisdiction: (1) exists under an Illinois statute expressly concerning jurisdiction over foreign defendants (called a "long-arm statute"); (2) comports with the Due Process clause of the Fourteenth Amendment to the United States Constitution ("14th Amendment"); and (3) is "fair, just and reasonable" under the Illinois Constitution. *RAR, Inc. v. Turner Diesel, Ltd.*, 107 F.3d 1272, 1276 (7th Cir. 1997) (citing *Rollins v. Ellwood*, 565 N.E.2d 1302, 1316 (Ill. 1990)).

The Illinois long-arm statute allows the exercise of jurisdiction to the full extent permitted by the Illinois Constitution and the United States Constitution. 735 ILCS 5/2-209(c). Therefore, these three elements ultimately collapse into two constitutional inquiries -- one federal and one state. *RAR, Inc.*, 107 F.3d at 1276.

The federal requirement, which emanates from the 14th Amendment, requires proof that the defendant has sufficient “minimum contacts” with Illinois such that maintenance of the suit does not offend “traditional notions of fair play and substantial justice.” *Id.* at 1277 (quoting *Int’l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)). These standards are satisfied when a defendant takes purposeful action in a state and can reasonably expect to be sued there, requirements that are rather easy to meet.

But, even if an individual has “minimum contacts” with a state by virtue of his or her acts on behalf of a corporate entity, Illinois courts may choose not to exercise personal jurisdiction over that individual if doing so would not be “fair, just and reasonable.” *Brujis v. Shaw*, 876 F. Supp. 975, 979 (N.D. Ill. 1995) (citation omitted). It is under this state constitutional inquiry that the fiduciary shield doctrine arises.

2. THE FIDUCIARY SHIELD DOCTRINE

Based on the principles of fairness required by the Illinois Constitution when exercising personal jurisdiction, Illinois allows a non-resident defendant to raise a defense to personal jurisdiction under the fiduciary shield doctrine. *Rollins v. Ellwood*, 565 N.E.2d 1302, 1313-18 (Ill. 1990); *ISI Int’l Inc. v. Borden Ladner Gervais LLP*, 256 F.3d 548, 550 (7th Cir. 2001). As articulated by the Seventh Circuit Court of Appeals, the fiduciary shield doctrine “denies personal jurisdiction over an individual whose presence and activity in the state in which the suit is brought were solely on behalf of his employer or other principal.” *Rice v. Nova Biomedical Corp.*, 38 F.3d 909, 912 (7th Cir. 1994) (emphasis added).

Dick Corp. v. SNC-Lavalin Constructors, Inc. provides a good, recent example of how the fiduciary shield doctrine can arise. In that case, Dick Corp. sued SNC-Lavalin Constructors, Inc. and two of its officers in United States District Court for the Northern District of Illinois. No. 04 C 1043, 2006 WL 1049724 (N.D. Ill. Apr. 20, 2006). Personal jurisdiction over the corporate defendant was not at issue because the lawsuit arose out of the construction of two power plants in Illinois. But,

jurisdiction over the individual officers was contested.

Both of the individual officers in Dick Corp. were residents of the State of Washington. One of the officers was the company’s chief operating officer (the “COO”). *Id.* at *2. He signed several of the contracts at issue and attended monthly meetings in which the construction projects were discussed, but he never traveled to Illinois for any reason. *Id.* at *3 n.1. The other officer, a senior vice president, negotiated certain aspects of the agreements, oversaw the project managers and traveled to Illinois three times to attend meetings relating to the construction projects. *Id.* Further, both officers, through their retirement plans, owned stock in the publicly-traded company that owned their corporate employer. *Id.* at *5.

Based on, among other things, the foregoing factual scenario, the individual defendants in *Dick Corp.* challenged the court’s authority to exercise personal jurisdiction over them.

In *Dick Corp.*, the court ruled that although the two out-of-state officers had minimum contacts with Illinois on behalf of their company, subjecting them to jurisdiction here would offend traditional notions of fair play and substantial justice. *Id.* at *4 (citing *Rollins v. Ellwood*, 565 N.E.2d at 1313-18). This was because the two officers’ contacts with Illinois were solely the result of work they did in Illinois. Further, the court found that none of the recognized exceptions to the fiduciary shield applied. *Id.* at *4-*5.

3. EXCEPTIONS TO THE FIDUCIARY SHIELD DOCTRINE

The fiduciary shield doctrine is discretionary. *Plastic Film Corp. of Am. v. UNIPAC, Inc.*, 128 F. Supp. 2d 1143, 1146 (N.D. Ill. 2001) (citing *Washburn v. Becker*, 542 N.E.2d 764, 766 (1st Dist. 1989)). Accordingly, even when an employee’s contacts with a state consist solely of acts carried out for a corporate entity, courts will not apply the doctrine where it would be inequitable to do so. *Id.* In particular, courts tend to reject the doctrine in cases where: (1) the person’s actions were motivated

by his or her personal interests, rather than employer's interests; (2) the person had discretion as to the conduct of the company; and/or (3) the plaintiff alleges that the individual defendant created the corporate entity merely as a "sham" to protect himself or herself from personal liability.

A. *Personal Interests*

Courts considering whether to apply the fiduciary shield doctrine have declined to do so where an individual officer has allegedly acted to advance personal interests and not just the interests of his or her employer. Personal interests can take a variety of forms, but two of the most common are (a) financial interests and (b) personal motivations such as malice or spite.

1. *Financial Interests*

Often, courts refuse to apply the fiduciary shield doctrine to "high-ranking company officers or shareholders with a direct financial stake in company health." *Benda v. Per-Se Techs., Inc.*, No. 04 C 952, 2004 WL 1375361, at *2 (N.D. Ill. June 17, 2004). But, what if the individual defendant is an officer, but does not own stock or have a "direct financial stake" in the company? The most recent opinions deciding this question have held that it is shareholder status that is the "determinative" factor. *Id.* For example, in *Plastic Film Corp. of America v. UNIPAC, Inc.*, the court rejected the argument that the "personal interest" exception should apply to a high ranking company officer and director who was not a shareholder. 128 F. Supp. 2d at 1147.

Officers who own a modest number of shares or options in a company usually will not be denied the protections of the fiduciary shield doctrine. See *Dick Corp.*, 2006 WL 1049724 at *5. But, defendants who are significant shareholders, may not be protected. *Consumer Benefit Servs. v. Encore Mktg. Int'l Inc.*, No. 01 C 6985, 2002 WL 31427021, at *4 (N.D. Ill. Oct. 30, 2002) (refusing to apply the fiduciary shield doctrine to two individuals who owned 32.49% and 20.35%, respectively, of the defendant corporation's stock); *Brujic*, 876 F. Supp. at 980 (refusing to apply the fiduciary shield doctrine where the defendant

owned the "vast majority" of shares in the defendant company); *Burnhope v. Nat'l Mortgage Equity Corp.*, 567 N.E.2d 356, 364 (1st Dist.1990) (defendant's ownership of 84% of corporation's stock, coupled with plaintiff's allegations that the corporation was the defendant's alter ego, were sufficient to justify imposing personal jurisdiction).

Dick Corp. provides a good example of this principle. There, the individual defendants received, as part of their compensation and 401(k) plans, stock or stock options in their employer's parent company -- a publicly-traded entity. *Dick Corp.*, 2006 WL 1049724 at *5. In addition, the COO owned stock options in his employer. *Id.* The court found that these ownership interests were not the type of "direct" and "meaningful" financial interests that preclude the application of the fiduciary shield doctrine. *Id.* The court also determined that the fact that the officers' bonuses were based on their employer's profitability did not disqualify them from the protections of the fiduciary shield doctrine. *Id.* n. 10 (quoting *Glass v. Kemper*, 930 F. Supp. 332, 342 (N.D. Ill. 1996)). Accordingly, the court dismissed the two individual defendants from the suit.

2. *Personal Motives*

Acting out of non-monetary personal interests may also prevent an individual defendant from using the fiduciary shield doctrine. For example, courts have refused to apply the fiduciary shield doctrine when the defendant acts intentionally and maliciously toward the plaintiff. *Darovec Mktg. Group, Inc. v. Bio-Genics, Inc.*, 42 F. Supp. 2d 810, 819 (N.D. Ill. 1999). The *Darovec* decision, however, presented a unique set of circumstances. In that case, the plaintiff sued a corporation and one of its employees for defamation. *Id.* at 814. The defamation claim arose out of a memorandum the individual defendant wrote to the corporate defendant's customers explaining why it terminated its business dealings with the plaintiff. *Id.* The memorandum also attacked the honesty and integrity of the plaintiff. *Id.* The complaint alleged that the author of the memorandum attacked the plaintiff intentionally and maliciously. *Id.* at 819. The court read the complaint as alleging that a memorandum

written “solely” on behalf of the corporate defendant would have said little more than that the business relationship with the plaintiff had ended. *Id.* The court concluded that the complaint alleged that the attacks on the plaintiff’s honesty and integrity were motivated by the individual defendant’s malice and intent. Based on these allegations, the court refused to apply the fiduciary shield doctrine. *Id.*

Despite the ruling in *Darovec*, malice, spite or dislike alone generally are not enough to prevent the fiduciary shield doctrine from applying. Instead, the malice or dislike must “have created or exacerbated the harm to the [plaintiff].” *Id.* (quoting *Rice*, 38 F.3d at 912). In *Darovec* the court appears to have found that the individual defendant’s alleged malice in impugning the plaintiff’s integrity exacerbated the plaintiff’s injuries. *Id.*

B. Discretionary Conduct

Some early Illinois decisions have ruled that where an “employee has the power to decide what is to be done and chooses to commit the acts that subject him to long-arm jurisdiction,” then the fiduciary shield doctrine should not apply. *Darovec*, 42 F. Supp. 2d at 820 (citing *Brujic*, 876 F. Supp. at 978). This is referred to as the “discretionary conduct” exception to the fiduciary shield doctrine. *Id.* An example of this exception is found in a 1994 Illinois Appellate Court decision, *Renner v. Grand Trunk Western R.R.*, 641 N.E.2d 1 (1st Dist. 1994).

In *Renner*, a teenager who had been injured while hopping on and off of a moving train sued the railway and the train’s engineer, a Michigan resident, in Illinois state court. *Id.* at 1-2. The engineer sought to avoid personal jurisdiction because he was in Illinois solely for the benefit of his employer -- the railway. *Id.* at 2. In a remarkable decision, the court in *Renner* concluded that an engineer driving a train down a fixed set of tracks has sufficient discretion in carrying out his employer’s instructions -- driving a train from Chicago to Detroit -- so that the fiduciary shield doctrine should not apply to him. *Id.* at 3. In reaching this decision, the court read the Illinois Supreme Court’s seminal

decision on the fiduciary shield doctrine -- *Rollins v. Ellwood*, 565 N.E.2d 1302, 1316 (Ill. 1990) -- extremely narrowly.

In *Rollins*, Sergeant Ellwood, a police officer from Baltimore, Maryland, was named as an individual defendant based on actions he performed for the Baltimore Police Department. Ellwood traveled to Illinois to transport the plaintiff from Illinois to Maryland pursuant to a waiver of extradition the plaintiff signed. *Id.* at 1305. It turned out that the plaintiff was not the person who was wanted in Maryland, and, consequently, plaintiff sued the Baltimore Police Department, Ellwood and others. *Id.* The Supreme Court concluded that subjecting Ellwood to personal jurisdiction would be unfair as he was in the state solely for the benefit of his employer. *Id.* at 1318.

The court in *Renner* seized on Ellwood’s status as a police officer and found that because a police officer is a member of a “paramilitary organization,” he had little to no discretion in carrying out the orders of the chain of command. *Renner*, 641 N.E.2d at 3. The acts of a train engineer, however, were not similarly compelled, and, therefore, the court found that the fiduciary shield doctrine would not apply. *Id.*

While few courts have taken such a narrow reading of *Rollins*, the *Renner* decision is frequently cited for the proposition that the fiduciary shield doctrine will not apply where the individual defendant has the power to decide how to carry out the acts of a corporate employer. *See, e.g., Brujic*, 876 F. Supp. at 978.

Despite *Renner*, other decisions regard an employee’s discretion as only one “factor” to consider when applying the fiduciary shield doctrine. Such cases hold that discretion alone is not a basis for refusing to apply the fiduciary shield doctrine. *Banc Corp USA v. Perez*, No. 05 C 7307, 2006 WL 1594100, at *5 (N.D. Ill. June 5, 2006). The Seventh Circuit has gone further and written that an employee’s discretion is irrelevant and that if the fiduciary shield doctrine applies it does so “regardless of whether [the employee] exercised discretion rather than merely carrying out precise orders mechanically.” *Rice*, 38 F.3d at 912. *But*

see *Brujis*, 876 F. Supp. at 978-79 (rejecting the Seventh Circuit's statement as "dictum"). As another recent decision diplomatically explained, the role an employee's discretion plays in applying the fiduciary shield doctrine is of "mixed significance." *Glazer v. Quebecor World, Inc.*, No. 05 C 4501, 2006 WL 335791, at *4 (N.D. Ill. Feb. 13, 2006).

C. Alter-Ego/Sham Corporation

The fiduciary shield doctrine may not apply "where the plaintiff seeks to pierce the corporate veil" and alleges that the corporation was "a mere shell utilized by the individual defendant for his own personal benefit." *YKK USA, Inc. v. Baron*, 976 F. Supp. 743, 747 (N.D. Ill. 1997) (collecting cases). In such cases, the corporation's contacts with the state are attributed to the individual for the purposes of determining whether the individual is subject to personal jurisdiction. *Id.* The "alter ego" exception is similar to, but is less exacting than, the test for piercing the corporate veil. *Id.*; see also *Torco Oil Co. v. Innovative Oil Corp.*, No. 88 C 7323, 1989 WL 165057, at *9 (N.D. Ill. Dec. 28, 1989) (observing that the "alter ego" exception does not require a showing that a "sham" corporation was used to perpetrate a fraud, unlike a claim for piercing the corporate veil). For a plaintiff to satisfy this exception to the fiduciary shield doctrine, he or she need only make a "minimally viable" showing that the corporation is a "sham." *Id.* Such a showing would include alleging that the corporation is inadequately capitalized, commingles its funds with those of its principals, and/or fails to follow corporate formalities.

Conclusion

One of the purposes of forming a corporation or a similar limited liability organization is to insulate a business' owners and operators from its liabilities. The fiduciary shield doctrine can be a useful tool in effecting this purpose, but there are significant exceptions that limit its applicability.

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