

Case Dismissed: Illinois Appellate Court Holds Legal Malpractice Claims Were Time-Barred and Corporate Adverse Domination Tolling Doctrine Did Not Apply

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Edward Shrock, et. al. v. Ungaretti & Harris, Ltd., et. al., 2019 IL App (1st) 181698

Brief Summary

The First District Appellate Court in Illinois upheld the dismissal of a legal malpractice action brought by a limited liability company (LLC) and one of its individual members against the lawyers who had represented the LLC's managing member based on the two-year statute of limitations. The court held that the individual's claim was barred because pleadings in the underlying case established that he knew he was wrongfully injured more than two years before the malpractice action was filed. The court further held that the individual's knowledge, motivation, and ability to sue defendants was imputed to the LLC and precluded reliance on the adverse domination doctrine to toll the limitations period.

Complete Summary

The Underlying Action

Plaintiff, Baby Supermall, LLC ("BSM") is a limited liability company with three members: Robert Meier, who owns 87.5% of the stock; plaintiff Edward Shrock, who owns the remaining 12.5% of the stock; and Baby Supermall, Inc., a corporation. Under BSM's operating agreement, Meier, as its managing member, was afforded "full, exclusive, and complete discretion, power, and authority" to operate and direct company affairs.

The relationship between Meier and Shrock soured after Shrock rebuffed Meier's offer to buy out his shares. Thereafter, Meier drastically reduced Shrock's salary, increased his own, blocked Shrock from participating in any corporate decision-making, and, through so called "profit-sharing" agreements, purported to obligate BSM to paying Meier a higher percentage of profits. Additionally, at Meier's instance, BSM then hired Meier's wife and stepson, and paid them 20% and 10% of BSM's profits, respectively.

Shrock sued Meier—who was represented by the defendants, Ungaretti & Harris, Ltd.—for breach of fiduciary duty. In 2010, Shrock successfully secured a court order in the underlying action enjoining Meier from: (1) making any further payments to himself or his family members under the guise of "profit sharing," and (2) paying himself, his wife, or his son salaries in excess of \$350,000, \$120,000, and \$110,000, respectively.

Shrock returned to court several times in the ensuing years, alleging Meier had repeatedly violated the 2010 injunction order. Each time, the defendants denied any misconduct by Meier, and assured the court that Meier was not paying any money out.

In June 2013, Meier moved to modify the injunction, and swore he had not made any prohibited payments. Shrock opposed the motion in August 2013; he asserted that the prior assurances by the attorney defendants to the court that Meier had not paid out any money was false and soundly refuted by the Meiers' own W-2s and other financial data, which demonstrated that the Meiers did, in fact, pocket the money. According to Shrock's opposition, when confronted with this data, defendants "reversed [their] stance" and characterized the payments as bonuses and salary increases, not profit-sharing—assertions which were met with skepticism by the court. For these reasons, Shrock's August 2013 opposition included a request for a rule to show cause and sanctions not only against Meier, but also against defendants. Ultimately, the underlying action against Meier went before a jury, which ruled in Shrock's favor and awarded him \$11,164,500.

On March 12, 2014, shortly after the jury verdict, Shrock filed yet another motion claiming breaches by Meier of the 2010 injunction order. Shrock's March 2014 motion involved defendants' discredited claim that Meier had not violated the 2010 injunction order and the evidence that belied it.

Meanwhile, the adverse \$11 million jury verdict prompted a bankruptcy filing by Meier. Defendants attempted to file a claim in the Meier bankruptcy in July 2014. Shrock refuted the Ungaretti claim, contending that the attorney defendants were liable to him for conspiring with Meier to evade the injunction order and concocting Meier's "merger" and "dissolution" strategies to divest Schrock of his membership interest in BSM.

On October 31, 2014, BSM filed a complaint against Meier in bankruptcy court, based upon substantially the same grounds alleged by BSM and Shrock in their legal malpractice action. On November 7, 2014, Meier answered, and admitted to transferring over \$16.3 million in contravention of the injunction order.

On November 18, 2016, BSM and Shrock filed their malpractice action against the defendants. They alleged the defendants were complicit in Meier's wrongdoing, and had helped Meier circumvent the 2010 injunction order and deplete corporate assets. The defendants moved to dismiss based on the two-year statute of limitations, 735 ILCS 5/13-214.3, which requires all actions against attorneys arising out of an act or omission in the performance

of professional services to be commenced within two years from the time plaintiff “knew or reasonably should have known of the injury for which damages are sought.”

As to Shrock, the appellate court found ample evidence of requisite knowledge more than two years before suit was filed on November 18, 2016. The court noted that Shrock’s August 2013 opposition brief and March 2014 post-verdict motion, as well as his July 2014 objection to defendants’ bankruptcy claim, established that he knew long before November 18, 2014 that Meier, aided by the defendants, was violating the injunction to Shrock’s and BSM’s detriment. Certainly, by November 7, 2014, when Meier expressly admitted wrongdoing, Shrock’s knowledge was complete. He should have filed suit at that time. Instead, he waited until November 18, 2016 to do so. By then, his action was too late.

BSM tried to seek refuge behind the adverse domination doctrine. The doctrine typically tolls the statute of limitations for claims by a corporation against errant officers and directors, and those in cahoots with them, during the time the corporation is under their control. The rebuttable presumption is that the corporation does not “know” of the injury and is without any ability to act, as long as it is controlled by the wrongdoers.

The presumption, however, may be rebutted by evidence that someone other than the wrongdoing directors had knowledge of the cause of action and had both the ability and the motivation to bring suit. The appellate court concluded the presumption was rebutted here. Shrock had the motivation and knowledge to institute an action against the defendants. Shrock also had the ability to sue. Under Section 40-1 of Illinois’s Limited Liability Company Act (805 ILCS 180/15-1), a member can file a derivative action without waiting for authorization from the managing member where, as here, it would have been hopelessly futile to do so. The adverse domination doctrine thus did not toll the two-year statute of limitations as to BSM, and its claim was also time-barred.

Significance of Decision

The adverse domination doctrine is a variant of the discovery rule as it is applied to corporations. It is based on the notion that since corporations are legal entities which can act only through their officers, it may be legally impossible for a corporation to discover its cause of action where the requisite knowledge is under the control of wrongdoers acting adversely to it. This case demonstrates the limitations of the doctrine.

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