2018 IL App (1st) 171700-U

No. 1-17-1700

Third Division
May 2, 2018

IN THE

APPELLATE COURT OF ILLINOIS

FIRST DISTRICT

IRVIN V. PLOWDEN, EAKLE PARTNERS, MICHAEL J. DeSIMONI, MJD WILD HORSE INVESTMENTS, LLC, DAN DeSIMONI, DJD WILD HORSE INVESTMENTS, LLC, MASSIMO DeSIMONI, CABALLO SALVAJE PARTNERS, WILD HORSE PARTNERS, CHANNEL LUMBER CO., ADOBE LUMBER CO., HAMMOND HUNT, WILLIAM H. HUNT, JR., WH ABINGTON PLACE INVESTMENTS, LLC, CHARLES O. BYRD, COB TANGLEWOOD INVESTMENTS, LLC, DENNIS R. OWENS, DR OVERBROOK INVESTMENTS, LLC, J. TURNER HUNT, TH WEST INVESTMENTS, LLC, OVERBROOK PARTNERS, MAXINE KELLEY, WRK INVESTMENT PARTNERS, DOUG REINHART, JDR ROLLING HILLS INVESTMENTS, LLC, PAUL E. REINHART, PER ALPHA INVESTMENTS, LLC, RB-1 INVESTMENT PARTNERS, WILLIAM “WILL” BUNKER, WB INVESTMENT PARTNERS, SALEM INVESTMENT PARTNERS, GREG STRINGER, HENRY RERPESS, CHESTER PARTNERS, WILLARD HILL, and WKH	)	Appeal from the Circuit Court of Cook County.
	)	No. 2015 L 001879
	)	Honorable Margaret A. Brennan, Judge, presiding.

INVESTMENT PARTNERS,	)
Plaintiffs-Appellants,	)
	)
v.	)
	)
DAVID PARSE, DEUTSCHE BANK, AG,	)
DEUTSCHE BANK SECURITIES, INC.	)
d/b/a Deutsche Bank Alex. Brown, and DB	)
ALEX BROWN, LLC,	)
Defendants-Appellees.	)

PRESIDING JUSTICE COBBS delivered the judgment of the court.
Justices Fitzgerald Smith and Howse concurred in the judgment.

O R D E R

¶ 1 *Held*: Trial court did not err in dismissing second amended complaint based on lack of standing; trial court did not abuse its discretion in denying leave to amend.

¶ 2 Plaintiffs appeal from orders of the circuit court of Cook County: (I) dismissing their second amended complaint pursuant to section 2-619(a)(9) of the Code of Civil Procedure (735 ILCS 5/2-619(a)(9) (West 2016)) based on lack of standing and, alternatively, (II) denying their motion to file a third amended complaint. We affirm.

¶ 3 BACKGROUND

¶ 4 When ruling on a motion to dismiss pursuant to section 2-619 of the Code, a court must accept as true all well-pled facts in the complaint and all reasonable inferences that may arise from them. *Chicago Teachers Union, Local 1 v. Board of Education of the City of Chicago*, 189 Ill. 2d 200, 206 (2000). The court may also consider all facts presented in the pleadings, affidavits, and depositions contained in the record. *John Doe A. v. Diocese of Dallas*, 234 Ill. 2d 393, 396 (2009); *People v. Philip Morris, Inc.*, 198 Ill. 2d 87, 90 (2001).

¶ 5 The record reflects the following pertinent facts. The instant second amended complaint named as defendants Deutsche Bank AG; Deutsche Bank Securities, Inc. d/b/a Deutsche Bank Alex Brown; and DB Alex Brown, JJC (collectively Deutsche Bank) and David Parse, a former Deutsche Bank broker. The complaint alleged that defendants conspired with the now-defunct law firm of Jenkins & Gilchrist, P.C. ("J&G"), to design a tax avoidance scheme, which they marketed and sold to "thousands of Deutsche Bank customers." Typically, this scheme was aimed at someone who had sold a business or a share thereof, thereby realizing a substantial capital gain on the sale. Defendants and J&G purported to have developed, and advised their clients of, an "investment strategy" that would probably generate profit, but if not, any losses incurred could be used to offset taxable gains. The scheme required the taxpayer to buy and sell options, and then transfer the option positions to a partnership. The taxpayer would claim that the basis of the taxpayer's partnership interest was increased by the cost of the purchased options, but was not reduced by the taxpayer's "liability" with regard to the options sold.

¶ 6 Defendants and J&G induced Irwin Plowden, Michael DeSimoni, Daniel DeSimoni, Massimo DeSimoni, Hammond Hunt, William H. Hunt, Jr., Charles Byrd, Dennis Owens, J. Turner Hunt, Maxine Kelley, J. Douglas Reinhart, Paul Reinhart, William Bunker, Gregory Stringer, Henry Respess, and Willard Hill (the individual plaintiffs) to participate in the tax avoidance scheme. In accordance with the scheme, the individual plaintiffs formed the following named limited liability companies: MJD Wild Horse Investments, LLC, the sole member being Michael DeSimoni; DJD Wild Horse Investments, LLC, the sole member being Daniel DeSimoni; WH Abington Place Investments, LLC, the sole member being William H. Hunt, Jr.; COB Tanglewood Investments, LLC, the sole member being Charles

Byrd; TH West Investments, LLC, the sole member being Turner Hunt; JDR Rolling Hills Investments, LLC, the sole member being Douglas Reinhart; and Per Alpha Investments, LLC, the sole member being Paul Reinhart (LLC plaintiffs).

¶ 7 In furtherance of the tax avoidance scheme, the individual plaintiffs also formed the following partnerships: Eakle Partners, Caballo Salvaje Partners, Wild Horse Partners, Overbrook Partners, WRK Investment Partners, RB-1 Investment Partners, WB Investment Partners, Salem Investment Partners, Southern Crescent Investments[1], Chester Partners, and WKH Investment Partners (partnership plaintiffs), and two corporations: Channel Lumber Company and Adobe Lumber Company.

¶ 8 Between 1999 and 2001, each LLC plaintiff, and Channel Lumber, executed a written trade contract ("Trade Confirms") with Deutsche Bank. Each LLC plaintiff then entered into options transactions with Deutsche Bank serving as the counterparty. In the options transactions, LLC plaintiffs bought and sold off-setting foreign currency options, and then assigned their option rights under the Trade Confirms to the partnership plaintiffs. Deutsche Bank then undertook contractual obligations to the partnership plaintiffs as if they had been parties to the original transactions. Deutsche Bank collected in excess of $1,700,000 in fees from the individual plaintiffs to enter into and implement the scheme.

¶ 9 In August 2000, the IRS published a notice entitled "Tax Avoidance Using Artificially High Basis," (I.R.S. Notice 2000-44), in which the IRS informed tax shelter promoters across the country that options strategies such as defendants' scheme were illegal tax shelters. This IRS Notice was issued before most of the individual plaintiffs claimed losses on their tax returns, and within the time those individual plaintiffs who did claim losses could have

[1] Although Southern Crescent is named in the body of the instant complaint, it is not listed in the caption.

amended their returns. However, J&G represented to the individual plaintiffs that the Notice "did not apply to their transactions."

¶ 10 After completing the options transactions, the individual plaintiffs claimed losses on their tax returns. The Internal Revenue Service rejected these claimed losses and imposed "substantial" penalties and interest against the individual plaintiffs. Additionally, the individual plaintiffs incurred "significant clean-up costs" "to extricate themselves" from the scheme. In December 2010, Deutsche Bank entered into a Non-Prosecution Agreement with the federal government.

¶ 11 In February 2015, the individual and entity plaintiffs (collectively "plaintiffs") filed their initial complaint. Defendants moved to dismiss. In response, plaintiffs filed a first amended complaint. Discovery ensued. Defendants then filed motions to dismiss, which the trial court granted in part and denied in part.

¶ 12 In January 2017, plaintiffs filed the instant second amended complaint. Alleging the above-recited facts, the instant complaint asserted claims for: breach of contract (count I), civil conspiracy against all defendants (count II), breach of fiduciary duty (counts III, V), common law fraud (count IV), and negligent misrepresentation (count VI). Defendants filed motions to dismiss pursuant to sections 2-615 and 2-619 of the Code of Civil Procedure (735 ILCS 5/2-615, 2-619 (West 2016)).

¶ 13 On May 17, 2017, the trial court dismissed the second amended complaint, ruling as follows. Pursuant to section 2-619(a)(9), the court dismissed all plaintiffs but one for lack of standing. The individual plaintiffs lacked standing because they are merely derivative shareholders of the LLC plaintiffs. In turn, the LLC plaintiffs and Channel Lumber lacked standing because they assigned whatever claims they had to the partnership plaintiffs. The

complaint alleged that the partnership plaintiffs "[had] not liquidated all of their assets, dissolved, wound up, or terminated." However, the partnership plaintiffs' own documents stated that each partnership plaintiff was liquidated and terminated between 1999 and 2001, and the trial court so found. Since the partnership plaintiffs no longer existed, the trial court dismissed them for lack of standing. Also, pursuant to section 2-615, the trial court dismissed the remaining plaintiff, Adobe Lumber, for failure to allege a distinct injury.

¶ 14 Plaintiffs filed a motion to reconsider, or alternatively, for leave to file a third amended complaint. The trial court denied the motion, in its entirety, with prejudice. Plaintiffs appeal. Additional pertinent background will be discussed in the context of our analysis of the issues.

¶ 15 ANALYSIS

¶ 16 Plaintiffs assign error to the trial court's dismissal of the second amended complaint based on lack of standing and, alternatively, to the court's denial of leave to file a third amended complaint.

¶ 17 I. Standing

¶ 18 Plaintiffs contend that the trial court erred in dismissing the claims of the individual plaintiffs, the LLC plaintiffs, and the partnership plaintiffs, all based on lack of standing.[2] Section 2-619 of the Code of Civil Procedure provides for the involuntary dismissal of a cause of action based on certain defects or defenses. 735 ILCS 5/2-619 (West 2016). One of the enumerated grounds for a section 2-619 dismissal is that the claim is barred by affirmative matter which avoids the legal effect of or defeats the claim *Id*. 2-619(a)(9). Affirmative matter refers to something in the nature of a defense that negates the cause of

[2] Plaintiffs' appellants' opening brief is completely devoid of any discussion or argument relating to the trial court's section 2-615 dismissal of Adobe Lumber. Accordingly, plaintiffs have forfeited review of this dismissal. Ill. S. Ct. R. 341(h)(7) (eff. July 1, 2008); see, *e.g.*, *Stevens v. Village of Oak Brook*, 2013 IL App (2d) 120456, ¶ 30.

action completely, or refutes crucial conclusions of law or conclusions of material fact contained in or inferred from the complaint. Lack of standing is an "affirmative matter" that is properly raised under section 2-619(a)(9). *International Union of Operating Engineers, Local 148, AFL-CIO v. Illinois Department of Employment Security*, 215 Ill. 2d 37, 45 (2005); *Glisson v. City of Marion*, 188 Ill. 2d 211, 220 (1999). The doctrine of standing is intended to assure that issues are raised only by those parties with a real interest in the outcome of the controversy. A plaintiff need not allege facts establishing standing. Rather, it is the defendant's burden to plead and prove lack of standing. *Chicago Teachers Union*, 189 Ill. 2d at 206; *Alpha School Bus Company, Inc. v. Wagner*, 391 Ill. App. 3d 722, 745 (2009). A court's disposition of a section 2-619 motion to dismiss is reviewed *de novo*. *International Union of Operating Engineers*, 215 Ill. 2d at 45; *Alpha School Bus*, 391 Ill. App. 3d at 745.

¶ 19 A. Individual Plaintiffs

¶ 20 Plaintiffs contend that the individual plaintiffs had standing to file the second amended complaint. One well-settled aspect of the general doctrine of standing is the shareholder standing rule, which prohibits a shareholder from bringing a lawsuit to enforce the rights of the corporation. *Franchise Tax Board v. Alcan Aluminum Ltd.*, 493 U.S. 331, 336 (1990); *Cashman v. Coopers & Lybrand*, 251 Ill. App. 3d 730, 733 (1993). Pursuant to the shareholder standing rule, when the alleged injury is inflicted upon the corporation and the only injury to the shareholder is the indirect harm consisting of the diminished value of his corporate shares, the primary wrong is to the corporate body. Accordingly, the shareholder, experiencing no direct harm, has no standing to sue in his or her own right as a shareholder. *Mann v. Kemper Financial Companies, Inc.*, 247 Ill. App. 3d 966, 975-76 (1992) (quoting *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727, 732 (3d Cir. 1970)); *Twohy v. First National*

Bank of Chicago, 758 F.2d 1185, 1194 (7th Cir. 1985) (applying Illinois law). "It is settled that if an injury is incurred by the corporation, then the shareholders can only sue upon a derivative basis and not as individuals." *Bio-Scientific Clinical Laboratory, Inc. v. Todd*, 149 Ill. App. 3d 845, 850 (1986). "Illinois follows the widespread rule that an action for harm to the corporation must be brought in the corporate name. When investors have been injured in common, they must continue to act through their collective—the corporation." *Frank v. Hadesman and Frank, Inc.*, 83 F.3d 158, 160 (7th Cir. 1996) (collecting cases; applying Illinois law); *Alpha School Bus*, 391 Ill. App. 3d at 746 (citing *Small v. Sussman*, 306 Ill. App. 3d 639, 643 (1999)).

¶ 21 However, it is equally established that a shareholder with a direct, personal interest in a cause of action may bring a lawsuit against a defendant even if the corporation's rights are also implicated. *Franchise Tax Board*, 493 U.S. at 336; *Alpha School Bus*, 391 Ill. App. 3d at 746; see *Frank*, 83 F.3d at 160 ("Injury to the corporation does not, however, prevent suit by an investor who suffers a distinct personal injury"); *Twohy*, 758 F.2d at 1194) (recognizing exception "where the shareholder suffers an injury separate and distinct from that suffered by other shareholders"). Determining whether a cause of action is derivative or direct requires a strict focus on the nature of the alleged injury, that is, whether the injury is to the corporation or the individual shareholder. *Alpha School Bus*, 391 Ill. App. 3d at 746; *Small*, 306 Ill. App. 3d at 644; *Bio-Scientific*, 149 Ill. App. 3d at 850.

¶ 22 In the case at bar, the trial court found that the individual plaintiffs lacked standing because they were actually derivative shareholders of the LLC plaintiffs, and because they failed to allege a distinct duty owed to them or a distinct injury. Before this court, plaintiffs contend that the individual plaintiffs were defrauded into investing in the tax fraud scheme

"as individuals—each of whom suffered direct, personal harm as a result of his participation in those transactions."

¶ 23 The record belies this contention. The individual plaintiffs have not—and cannot—allege any facts establishing a basis for direct claims against defendants. Initially, the individual plaintiffs never entered into any option transaction. Rather, the LLC's were created so that they—and not the individual plaintiffs—would commit the fraudulent transactions. Further, the individual plaintiffs have not—and cannot—allege that they suffered harm separate and distinct from that suffered by the LLCs. Rather, the only damages that the individual plaintiffs allege are the losses incurred by the LLCs that passed through to them individually. Further, the tax penalties assessed to the individual plaintiffs on their tax returns were the result of pass-through taxation from their LLCs. We uphold the trial court's finding that the individual plaintiffs lacked standing.

¶ 24 B. LLC Plaintiffs

¶ 25 Plaintiffs next contend that the LLC plaintiffs had standing to file the second amended complaint. The trial court found that the LLC plaintiffs lacked standing because they assigned all of their claims to the partnership plaintiffs. Before this court, plaintiffs contend that "the assignment agreements at issue involved only a partial assignment of rights, and did not assign the LLC Plaintiffs' claims based on breaches of contract that preceded the assignment." In their briefs, the parties agree that the instant assignment agreements are governed by New York law. Generally, an assignment is the transfer of some identifiable property, claim, or right from the assignor to the assignee. An assignment puts the assignee into the shoes of the assignor, and the assignor no longer has any rights in the thing assigned. *Hassebrock v. Ceja Corp.*, 2015 IL App (5th) 140037, ¶ 55. These general principles are

reflected in New York law. See, *e.g.*, *In re Stralem*, 758 N.Y.S.2d 345, 347 (App. Div. 2003). Further, under New York law, "the assignment of the right to assert contract claims does not automatically entail the right to assert tort claims arising from that contract." *Banque Arabe et Internationale D'Investissement v. Maryland National Bank*, 57 F.3d 146, 151 (2nd Cir. 1995) (applying New York law). To determine whether a party assigned tort claims with contract claims, New York courts look to the language of the assignment agreement. When the assignment agreement addresses rights in a transaction, rather than a specific contract, New York law recognizes that the assigning party has assigned tort claims as well as contract claims. *Id*. at 152-53.

¶ 26 Plaintiffs misread the record. In each assignment agreement, "Whereas Clause B" expressly states that each partnership plaintiff "shall assume the rights *** equivalent to those of the [LLC plaintiff] under the Original Transactions." Each LLC plaintiff agreed, without limitation, that it "assigns *** to the [partnership plaintiff] the financial positions described as the Original Transactions." By assigning their transaction rights to the partnership plaintiffs, the LLC plaintiffs lost their rights to bring future contract and tort claims relating to the option transactions. Accordingly, they lack standing to pursue contract and tort claims in this lawsuit. See *Banque Arabe*, 57 F.3d at 153.

¶ 27 In any event, the LLC plaintiffs lacked standing pursuant to the Limited Liability Company Act (LLC Act) (805 ILCS 180/1-1 *et seq*. (West 2016)). Each of the LLC plaintiffs was organized under laws other than the laws of Illinois. Accordingly, under the terms of LLC Act, each LLC plaintiff is a "foreign limited liability company". 805 ILCS 180/45-1 (West 2016). Section 45-45(a) of the LLC Act expressly provides: "A foreign limited liability company transacting business in this State may not maintain a civil action in any

court of this State until the limited liability company is admitted to transact business in this State." *Id*. 45-45(a). Since none of the LLC plaintiffs were admitted to transact business in Illinois, they lacked standing to bring the instant action. We uphold the trial court's finding that the LLC plaintiffs lacked standing.

¶ 28 C. Partnership Plaintiffs

¶ 29 Plaintiffs next contend that the partnership plaintiffs had standing to file the second amended complaint. The trial court found that the partnership plaintiffs lacked standing because they were liquidated or terminated between 1999 and 2001, and thus no longer existed. Before this court, plaintiffs argue that none of the documents that defendants relied upon to show partnership termination actually establish that any partnership plaintiff "completed a windup." Plaintiffs further argue that none of those documents dispose of, or even mention, the partnership plaintiffs' unknown causes of action.

¶ 30 Plaintiffs refer to settled partnership law. Termination of a partnership occurs when the assets are sold, the debts are paid, and the accounts among members are settled. A partnership no longer exists when the last partnership right has been transferred and the last partnership duty has been discharged. *Classic Hotels, Ltd. v. Lewis*, 259 Ill. App. 3d 55, 60 (1994). " 'The order of events is: (1) dissolution; (2) winding up; and (3) termination. Termination extinguishes their authority. It is the ultimate result of the winding up and occurs at the conclusion of the wind up.'" *Horton, Davis & McCaleb v. Howe*, 85 Ill. App. 3d 970, 972 (1980); *Estate of McKay v. Moses*, 35 Ill. App. 3d 458, 465 (1976) (both quoting *Englestein v. Mackie*, 35 Ill. App. 2d 276, 288-89 (1962)).

¶ 31 The record does not support plaintiffs' argument. Although it is the defendant's burden to plead and prove lack of standing, where the defense is raised as an affirmative matter and is

supported by evidence, the burden shifts to the plaintiff to submit evidence that establishes standing. *Village of Willow Springs v. Village of Lemont*, 2016 IL App (1st) 152670, ¶ 29 (citing *Epstein v. Chicago Board of Education*, 178 Ill. 2d 370, 383 (1997)). The documents submitted with defendants' 2-619 motion to dismiss establish that each partnership plaintiff completed its wind up and terminated by 2001, more than 15 years prior to the filing of the instant complaint. None of the documents cited by plaintiffs establish that the partnership plaintiffs continued operating after 2001.

¶ 32 Plaintiffs cited pleadings indicating that in 2004 and 2005 four partnership plaintiffs were named as plaintiffs in tax lawsuits against the IRS. However, these pleadings do not refute plaintiffs' own documents that each of the partnership plaintiffs had been terminated years before the IRS lawsuits were filed. Rather, they merely show that plaintiffs have filed other lawsuits on behalf of defunct partnership entities. In any event, these IRS lawsuit pleadings fail to show that any partnership plaintiff was an operating entity when plaintiffs filed the instant complaint. We uphold the trial court's finding that the partnership plaintiffs lacked standing.

¶ 33 We acknowledge defendants' alternative argument that plaintiffs' claims are time-barred pursuant to section 2-619(a)(5) of the Code of Civil Procedure (735 ILCS 5/2-619(a)(5) (West 2016)). However, plaintiffs' lack of standing renders any discussion of this argument unnecessary. See *Standard Mutual Insurance Co. v. Lay*, 2013 IL 114617, ¶ 35; *In re K.E.F.*, 235 Ill. 2d 530, 541 (2009). We uphold the trial court's section 2-619 dismissal of plaintiffs' second amended complaint based on lack of standing.

¶ 34 II. Leave to Amend

¶ 35 Alternatively, plaintiffs contend that the trial court abused its discretion in denying them leave to file a third amended complaint. Plaintiffs argue that their proposed third amended complaint "makes even more clear that the Individual Plaintiffs are not bringing claims merely as shareholders of the LLC Plaintiffs."

¶ 36 Section 2-616(a) of the Code of Civil Procedure provides that a trial court may allow amendments to pleadings on just and reasonable terms at any time prior to final judgment. 735 ILCS 5/2-616(a) (West 2016). The Code further provides that it "shall be liberally construed, to the end that controversies may be speedily and finally determined according to the substantive rights of the parties." *Id*. 1-106.

¶ 37 Despite this liberal policy, a plaintiff does not have an absolute and unlimited right to amend a complaint. *Keefe-Shea Joint Venture v. City of Evanston,* 364 Ill. App. 3d 48, 62 (2005); *Hayes Mechanical, Inc. v. First Industrial, L.P.*, 351 Ill. App. 3d 1, 6 (2004); *Wilk v. 1951 W. Dickens, Ltd.*, 297 Ill. App. 3d 258, 265 (1998). The decision to grant leave to amend a complaint rests within the sound discretion of the trial court, and we will not reverse such a decision absent a manifest abuse of discretion. *Loyola Academy v. S&S Roof Maintenance, Inc.*, 146 Ill. 2d 263, 273-74 (1992); *Wilk*, 297 Ill. App. 3d at 265. In determining whether a trial court has abused its discretion, the relevant factors are: "(1) whether the proposed amendment would cure the defective pleading; (2) whether other parties would sustain prejudice or surprise by virtue of the proposed amendment; (3) whether the proposed amendment is timely; and (4) whether previous opportunities to amend the pleading could be identified." *Loyola Academy*, 146 Ill. 2d at 273. The plaintiff must satisfy all four factors. *Id.* at 276. Accordingly, if the proposed amendment would not have cured a defect in the pleading, the other *Loyola Academy* factors are rendered superfluous and further

analysis is unnecessary. *Maschek v. City of Chicago*, 2015 IL App (1st) 150520, ¶ 80; *Cooney v. Magnabosco*, 407 Ill. App. 3d 264, 270 (2011); *Keefe-Shea*, 364 Ill. App. 3d at 62.

¶ 38 In the case at bar, the documents attached to the second amended complaint clearly establish that the individual plaintiffs did not participate in the options transactions in their individual capacities. Rather, they chose to form the LLC plaintiffs, which entered into the options transactions. Plaintiffs' new allegations in their proposed third amended complaint do not—and cannot—change these dispositive facts. Accordingly, we hold that the trial court did not abuse its discretion by denying plaintiffs leave to file a third amended complaint.

¶ 39 CONCLUSION

¶ 40 In this appeal, the individual plaintiffs are asking us to disregard the corporate form of their LLCs and partnerships. They want us to view their LLCs and partnerships not as distinct entities, but rather as complex contractual arrangements among investors and other venturers. Even so, these contracts have legal effects, one of which is respect for the corporate form. The individual plaintiffs seek the best of both worlds: corporate recognition for engaging in transactions they do not want to do personally, yet corporate disavowal and direct compensation for damages arising from those corporate transactions. "Investors who created the corporate form cannot rend the veil they wove." *Kagan*, 907 F.2d at 693.

¶ 41 For the foregoing reasons, the orders of the circuit court of Cook County are affirmed.

¶ 42 Affirmed.