2014 IL App (1st) 122723-U

SECOND DIVISION
June 17, 2014

No. 1-12-2723

IN THE
APPELLATE COURT OF ILLINOIS
FIRST DISTRICT

LAGRANGE PARK PUBLIC LIBRARY DISTRICT, *ex rel.*, JOHN J. CRONIN, on behalf of itself and all other municipal and governmental entities similarly situated, Plaintiff-Appellant, v. J.P. MORGAN SECURITIES, INC., FLATLAND, THOMAS & COMPANY, and JERRY L. LACY, Defendants-Appellees.	)	Appeal from the Circuit Court of Cook County No. 01 CH 6831 Honorable Rita M. Novak, Judge Presiding.

JUSTICE SIMON delivered the judgment of the court.
Presiding Justice Harris and Justice Pierce concurred in the judgment.

O R D E R

¶ 1 *Held*: Denial of motion for class certification of claims brought pursuant to Sections 102 and 103 of the Illinois Recovery of Fraudulently Obtained Public Funds Act, Article XX of the Code of Civil Procedure (735 ILCS 5/20-102 & 103 *et seq.* (West 2000)), was proper because relator's action was derivative and not individual. Trial court did not abuse its discretion in striking relator's expert and report and denying relator's motion to strike defendants' expert. Summary judgment was proper where relator failed to present evidence of material fact of whether defendants' sale price and markup were reasonable.

¶ 2 On April 23, 2001, plaintiff-relator John J. Cronin filed an eight-count complaint against defendants Banc One Capital Markets, Inc. (now J.P. Morgan Securities, Inc. and hereafter referred to as J.P. Morgan), Flatland, Thomas & Company (Flatland), and Jerry L. Lacy. Following the statutory prerequisite of contacting the director of plaintiff LaGrange Park Public Library District (District), relator filed this taxpayer derivative action as a putative class action pursuant to section 104 of the Illinois Recovery of Fraudulently Obtained Public Funds Act (Act) Article XX of the Code of Civil Procedure (Code) (735 ILCS 5/20-104(b) (West 2000). Relator sought to recover alleged overcharges fraudulently charged by defendants in their "yield-burning" scheme in advance-defeasance refinancing of municipal debt held by the District. Relator argued that defendants conducted this same yield-burning scheme against other municipalities and similarly excessively marked up the Treasuries sold.

¶ 3 The trial court dismissed all claims but the two claims brought pursuant to sections 102 and 103 of the Act. The court subsequently denied relator's motion for class certification, reasoning that the Code did not permit such an action and that common questions of fact and law would not predominate over questions affecting individual members. The matter progressed and the parties each moved to bar the other's expert. The trial court granted defendants' motion to bar, but denied relator's motion. The court then granted defendants' motion for summary judgment.

¶ 4 Relator appeals from the court's denial of class certification and summary judgment as to defendant J.P. Morgan. On appeal, relator argues the trial court in finding that a claim pursuant to Article XX of the Code may not be asserted on a class basis and that no common questions of fact and law supported certification. Relator also asserts that the trial court abused its discretion

in ruling on the motions to bar expert testimony. Lastly, relator argues that the trial court erred in entering summary judgment. For the following reasons, the judgment of the circuit court is affirmed.

¶ 5 I. BACKGROUND

¶ 6 Relator, a resident taxpayer of the Village of LaGrange Park, Illinois, since January 30, 1992, filed the underlying eight-count complaint against defendants as a putative class action related to an alleged "yield-burning" scheme undertaken by defendants in 1992. Filing on behalf of the District pursuant to the Act, relator alleged that defendants defrauded the District. Relator alleged that defendants approached the District and developed a bond refinancing, or advance defeasance, scheme. Relator brought eight claims sounding in: violations of sections 102 and 103 of Article XX of the Code; common law fraud; breach of fiduciary duty; breach of contract against each defendant; and malpractice against Lacy.

¶ 7 Under an advance defeasance transaction, a municipality may take advantage of lowered interest rates to refinance its debt and reduce its obligations. If the municipality has outstanding bonds that have not reached the "call date," the date when the municipality can call the bonds for redemption, the municipality may issue bonds at the new, lower interest rate. The proceeds of the bond issuance then can be used to purchase U.S. Treasury Bonds, which are then placed in an escrow account. The treasury bonds are set to mature on the same dates as the original municipal bonds and are utilized to pay off those old bonds as they mature.

¶ 8 These transactions allow the municipality to save money by paying a lower rate on its bonds. These advance defeasance bonds are considered an attractive investment because, as long as the escrowed bonds do not generate revenue greater than that owed on the bonds, they are tax

exempt under the federal policy created to assist local governments. However, if the Internal Revenue Service determines the revenue generated from the escrowed bonds exceeds the payoff amount, the excess funds must be returned to the Treasury, or the interest is declared taxable.

¶ 9 Therefore, under the advance defeasance mechanism, the broker or investment bank has an opening to undertake "yield burning." This means that excess yield from the escrowed bonds is reduced by the broker's raising the price of the escrowed bonds, thereby increasing the broker's profit. This practice of inflating the price is typically not an issue to the municipality because it would not realize the difference as those funds would have to be returned to the Treasury if the broker did not "burn" the excess yield.

¶ 10 On August 27, 1999, pursuant to Article XX of the Code, relator sent the chief executive officer of the District a certified letter, return receipt requested, demanding action against defendants. Relator stated his intent to file a cause of action against defendants if the District did not act in response to defendants' alleged fraudulent actions of yield burning in completing the advance refunding transactions for the District. The statutory 60-day period lapsed without legal action by the District. In fact, the District announced its intent not to sue, and on April 23, 2001, relator filed the instant taxpayer derivative action as a putative class action.

¶ 11 Relator advanced eight claims against defendants. Relator alleged that, as in a typical advance defeasance, J.P. Morgan identified the District as a candidate for advance refunding and contacted Flatland. In turn, Flatland contacted the District about the opportunity. J.P. Morgan acted as the lead underwriter, provided financial advisory services, and handled all aspects of the refinancing including selecting the new treasuries to be escrowed. Flatland was engaged to provide advisory services and Lacy was engaged as accountant for the transactions.

¶ 12 The District had a December 1, 1987, debt issue outstanding of $1,495,000 for its general obligation library bonds with corresponding annual interest obligations of $113,810. Flatland recommended J.P. Morgan to underwrite the refunding bonds and to be the dealer for the new treasuries for the defeasance escrow. J.P. Morgan completed underwriting for the refunding bonds at the current, lower interest rate and set up a defeasance escrow portfolio with treasuries set to mature on or near the interest, principal, and call dates of the original bonds. The price set by J.P. Morgan included a mark-up to compensate for the issuance and underwriting for the sale of the treasuries.

¶ 13 On August 12, 1992, the District's Board approved the bond ordinance at a special meeting where Flatland presented information on the transaction. On August 26, 1992, the District utilized the proceeds from the refunding bonds to pay for the treasuries. Relator alleged that J.P. Morgan failed to disclose that the price set for $1,658,893.21, was well above the "ask" price set for those securities in the Wall Street Journal on the date of sale, August 5, 1992.

¶ 14 The instant matter was delayed until the conclusion of relevant litigation on similar causes of action under way in the circuit court. On August 23, 2003, the trial court dismissed relator's common law claims, leaving the claims under sections 102 and 103 of Article XX. Relator moved for class certification on these two remaining claims for all Illinois governmental entities that were similarly charged above-market rates in their advance defeasance refinancing transactions. Following briefing and oral argument, the trial court concluded that class certification was not appropriate.

¶ 15 Specifically, the court found that Article XX contained certain restrictions on who could be an appropriate plaintiff and what was an appropriate action. The court stated that the

legislature essentially set up a derivative action, specifically requiring the derivative party to reside in the municipal unit. Accordingly, it concluded that the statute did not provide for class actions and did not create a suitable class representative. In addition, the court found that common issues of fact and law did not predominate because for the different municipalities, there were different transactions over different times involving different bonds and calculations. The court added that the determination of what markup is impermissible or excessive is different for each individual transaction and would not be a common issue, but a disputed matter.

¶ 16 Following discovery, the parties each moved to strike each other's proffered expert. On August 15, 2011, the trial court upheld defendants' expert Gerald Guild, but the court struck relator's expert Michael Claytor and his report that was prepared for the litigation. The court explained that its analysis of this issue was first defined by the scope of Article XX and whether funds were fraudulently received or improperly concealed by an improper markup by defendants. This required understanding the requirements of the statute, industry practice, and what is reasonable for the transactions involved in the case.

¶ 17 With respect to Guild, the trial court first stated that Guild was not personally involved in advance refunding transactions, but he had extensive experience in the industry and knowledge concerning how the underlying types of transactions work. In addition, Guild testified as an expert in related cases before the circuit court. More important to the court, Guild's report defined the overall operation of the market involved and explained the normal course of events, transactions, customs, and practice. Accordingly, despite some of the limitations of Guild's direct experience, his report and testimony provided specialized knowledge central to the resolution of the case and the court denied relator's motion to strike Guild's testimony.

¶ 18 The trial court also found Claytor to have extensive experience in the financial sector. The court found this included specific experience in governmental transactions stating that Claytor "has worked in state government specifically with transactions involving municipal bonds and these kinds of defeasance transactions." However, the court expressed issues with Claytor's methodology and the reliability of his opinion because "he relies on a standard without any footing." In particular, the court took issue with Claytor's reliance on the "Dodd document."

¶ 19 Claytor testified that he found the Dodd document on the Internet by conducting a search on the IRS website utilizing the search term "yield burning." The Dodd document was created by Allyson Dodd and was available in a section on tax exempt bonds on the IRS's website. From this document, Claytor determined the "IRS methodology" for calculating whether an excess markup was charged in the sale of securities. Claytor testified in his deposition that he relied on the Dodd document to determine an acceptable mark-up rate because he did not have a baseline number to utilize from his own experience.

¶ 20 However, Claytor also testified that the numbers utilized by Dodd for determining basis points in calculating potential yield burning cases came as "part of the global settlement among the IRS, the SEC, and the underwriting firms for the yield burning global settlement." Claytor testified that the Dodd document used the Wall Street Journal bid price and set an acceptable markup level of within 40 basis points of that number. Claytor then testified that he utilized a number somewhere in between these two prices as his marker. Claytor also corrected his calculations several times based on feedback and presentation of new information to him.

¶ 21 The trial court determined that the Dodd document was "not the type of document that one would expect an expert to rely on for purposes of reaching an expert conclusion." The court

found that this was not a helpful tool in understanding the industry or in determining the illegality in industry actions. The court also pointed to Claytor's repeatedly corrected determination of end prices for transactions that were determined in what the court found to be somewhat arbitrary fashion. Therefore, the court struck Claytor's testimony and report as unhelpful in determining the answer to difficult and highly technical questions in the instant case.

¶ 22 On November 10, 2011, defendants moved for summary judgment on the remaining counts. Following briefing and oral argument, the trial court granted defendants summary judgment on August 23, 2012. Defendants argued that relator failed to present any evidence concerning whether the transaction was not reasonable. Defendants cited to the testimony and report by Guild as well as testimony from the deposition of Todd Krzyskowski, an employee in the finance department for First Chicago.

¶ 23 Krzyskowski testified that he structured the defeasance escrow portfolio for the transaction, including pricing the treasuries involved. Krzyskowski testified that it was industry custom and practice to include a mark-up in the pricing to compensate the dealer for the sale and that this was typically not disclosed. He testified that he did not recall if he disclosed the markup in this transaction but stated that he would if he had been questioned on that issue. Relator argued that because there was an undisclosed markup, sufficient evidence was presented to present the issue to the trier of fact to determine whether the markup was reasonable and proper.

¶ 24 The court concluded that there was no issue of material fact. The court stated that, after Claytor and his report were stricken, relator failed to present any material evidence to support his claims. Accordingly, relator could not satisfy the burden of proof that there was a fraudulent act

or concealment of a material fact to demonstrate that the markups on the transactions were not reasonable. The only evidence on that issue was presented by Guild who opined that the markups were reasonable and well within standard industry practice. This appeal followed.

¶ 25 II. ANALYSIS

¶ 26 A. Class Certification

¶ 27 Relator argues that the trial court erred in denying the motion for class certification. He contends that the court erred in determining that he failed to meet the criteria for a class action to support certification. Relator also asserts that Article XX and the class action statute (735 ILCS 5/2-801 (West 2002)) permit a municipality to bring a class action suit and relator to do so derivatively on behalf of the municipality and other municipalities. Relator claims that the legislative history of Article XX further supports relator's ability to file a class action on behalf of the municipality. As such, relator asserts that this issue is a matter of statutory construction and our standard of review is *de novo*. *Jarvis v. South Oak Dodge, Inc.*, 201 Ill. 2d 81, 86 (2002). Defendant contends that the issue before this court is whether the trial court's decision regarding the elements for class certification was proper, which is reviewed under an abuse of discretion standard. *Avery v. State Farm Mutual Automobile Insurance Co.*, 216 Ill. 2d 100, 125-26 (2005).

¶ 28 This action is a derivative action and we agree with the trial court that relator's class action certification is not authorized under Article XX or case law. As a derivative action, the District is the only real party in interest and relator has no standing to bring a class action. *Barbara's Sales, Inc. v. Intel Corp.*, 227 Ill. 2d 45, 72 (2007). Resolution of this issue is a matter of statutory construction and relator correctly argues that our review is *de novo*.

¶ 29 Under Article XX, if notice is sent to the government official stating an intent to file suit and the government fails to institute an action within 60 days of receipt of notice , "any private citizen residing within the boundaries of the governmental unit affected may bring an action to recover the damages authorized in this Article on behalf of such governmental unit." 735 ILCS 5/20-104(b) (West 2002). With respect to standing for a class action claim, Article XX is silent as to any right to file or maintain a class action. Our supreme court has noted that Article XX claims "are not '*qui tam*' actions because the purported statutory grant of standing does not make the private citizen a real party in interest, nor does it provide that the private citizen share in the recovery." *Scachitti v. UBS Financial Services*, 215 Ill. 2d 484, 503 (2005). Accordingly, Article XX claims are derivative claims brought on behalf of the municipal government entity. *Id.*; see also *Rifkin v. Bear Stearns & Co.,* 215 Ill. 2d 466, 474-75 (2005) The Seventh Circuit of the United States Court of Appeals has stated that these claims are limited in scope as "[n]othing in Article XX purports to allow county citizens or taxpayers to speak for the government on claims outside its scope, and we do not have the authority so to expand it." *Rifkin v. Bear Stearns & Co., Inc.*, 247 F.3d 628, 633 (2001).

¶ 30 In *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727 (1970), a shareholder of four mutual funds brought an action as a shareholder and as a class representative for shareholders against 65 mutual funds, investment advisers, and directors, alleging violations of various antitrust and security laws. *Id.* at 731-32. Because the alleged injury was the reduction in value of corporate shares, the court found the harm was "indirect" and the plaintiff could not succeed in his own right, as a shareholder. Since the primary wrong was to the corporate body and not to the

plaintiff individually, having "experiencing no harm, [the plaintiff] possesses no primary right to sue." *Id.* at 732-34.

¶ 31 The *Kaufmann* court explained the underlying support for the rule in the context of derivative shareholder suits:

> "The timber of sound reason forms the conceptual underpinning of the rule requiring stock ownership in a corporation as the prerequisite for bringing a derivative action in its behalf. Only by virtue of the shareholder's interest, which has been described as 'a proprietary interest in the corporate enterprise which is subject to injury through breaches of trust or duty on the part of the directors,' [Citation.], does equity permit him 'to step into the corporation shoes and seek in its right the restitution he could not demand on his own.' Standing is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal plaintiff may acquire qua stockholder of the corporation which is the real party in interest. Without this relationship, there can be no standing, 'no right in himself to prosecute this suit.' [Citation.]" *Id.* at 735-36.

¶ 32 The *Hammond* court rejected the plaintiff's 'champion of industry' approach in trying to equate the corporation's primary right of action with the shareholder's secondary right of a derivative action. This right defines the plaintiff's standing, as well as its possible recovery, and is by definition limited; therefore, "[t]he very limitation that inheres conceptually in a derivative action is the bar which defeats appellee's attempt to qualify as the class representative for the other funds." *Id.* at 737. In Illinois, this court has followed this line of reasoning in *Hammond* in

similarly rejecting class representation based on derivative claims. In *Mann v. Kemper Financial Companies, Inc.*, 247 Ill. App. 3d 966, 975-76 (1992), this court examined the standing issue in a class action brought by shareholders both individually and derivatively. The shareholders alleged fraud in the management of mutual fund investments and the court affirmed the dismissal of the derivative class claims while allowing the individual, direct claims to stand. *Id.*

¶ 33 There is no dispute that Article XX claims such as the instant matter are derivative suits on behalf of the municipality as announced in *Scachitti* and *Rifkin*. The Act does not provide for a class action mechanism or grant a relator authority to act outside the scope of the Code. The same "timber of sound reason" supporting the decision in *Hammond* and adopted in *Mann* applies in Article XX cases. Like a shareholder derivative suit, a relator bringing a derivative action cannot qualify as a class representative for other municipalities because he does not have a primary right of action. Accordingly, the circuit court correctly denied relator's motion for class certification.

¶ 34 B. Expert Testimony

¶ 35 Relator argues that the trial court erred in barring expert testimony by Claytor and his report while admitting the testimony of defendants' expert Guild. The decision whether to admit expert testimony is within the sound discretion of the trial court and we will not reverse that decision absent an abuse of discretion. *Snelson v. Kamm*, 204 Ill. 2d 1, 24 (2003). Expert testimony may be admissible if the proffered expert is qualified, a foundation is laid establishing a basis for the expert's opinions, and the testimony would assist the trier of fact in understanding the evidence. *Todd W. Musburger, Ltd. v. Meier*, 394 Ill. App. 3d 781, 800 (2009).

¶ 36 According to Guild's testimony and curriculum vitae, he has worked in the financial services industry for over 40 years. The trial court noted that Guild was not personally involved in advance refunding transactions, but found that he had experience in similar defeasance transactions and extensive experience in the industry and knowledge concerning how the underlying types of transactions work. In addition, Guild had testified as an expert in related cases before the Circuit Court of Cook County.

¶ 37 More importantly, the court cited to the specifics of Guild's report. Guild defined the overall operation of the market involved and explained the normal course of events, transactions, customs, and practice. Guild cited to applicable standards for the date of the transaction, 1992, and why they applied, or did not apply, in the situation. Accordingly, despite some of the limitations of Guild's direct experience, his report and testimony provided specialized knowledge central to the resolution of the case and the court denied relator's motion to strike Guild's testimony. Based on Guild's experience, his deposition testimony, and his report, the trial court's refusal to strike his testimony was not an abuse of discretion.

¶ 38 Relator's arguments with respect to Guild's qualifications and opinions are largely unsupported and unavailing. Relator cites to portions of Guild's deposition as an "exercise in existentialism" because he speculated that defendant's personnel had expertise because they were in business and stayed in business. However, this was only a portion of his deposition and Guild provided sufficient explanation and support for his opinion. Likewise, relator's argument that Guild's use of a 5% markup guideline is evidence his testimony was pure speculation fails. As defendant notes, and the trial court specifically highlighted, this was a general guideline supported at the time of the transaction and Guild provided testimony about when it would and

would not be a proper markup and explained the reasoning for his conclusion. Furthermore, the subsequent guidelines and policies cited to by relator were not in effect until years after the transaction and do not go to the reasonableness of the transaction at issue.

¶ 39 The trial court also found that relator's expert, Claytor, had extensive experience in the financial sector, including specific experience in governmental transactions and defeasance transactions. However, the court expressed issues with Claytor's methodology and the reliability of his opinion because "he relies on a standard without any footing" in contrast to Guild's report which was "much more nuanced, much more specific" concerning the conclusions reached. In particular, the court took issue with Claytor's reliance on the "Dodd document."

¶ 40 Claytor testified that he had never calculated a markup as in the instant case and that he utilized the Dodd document that he found on the Internet by conducting a search on the IRS website utilizing the search term "yield burning" as the basis for his calculation. Claytor also testified that the numbers utilized by Dodd for determining basis points in calculating potential yield burning cases came as "part of the global settlement among the IRS, the SEC, and the underwriting firms for the yield burning global settlement." Claytor testified that the Dodd document used the Wall Street Journal bid price and set an acceptable markup level of within 40 basis points of that number. Claytor then testified that he utilized a number somewhere in between these two prices as his marker. Claytor also corrected his calculations several times based on feedback and presentation of new information to him.

¶ 41 Based on Claytor's testimony and seemingly arbitrary, and repeatedly corrected, determination of end prices for transactions, the trial court struck Claytor's testimony and report. The court found that the Dodd document did not provide a proper standard. In any event, in his

revised reports, Claytor fluxuated between using the methodology of the Dodd document and other prices in determining what markup was used and what was improper. The trial court did not abuse its discretion in determining that Claytor's reliance on improper standards and resulting opinions were unhelpful in determining the answer to difficult and highly technical questions in the instant case.

¶ 42 C. Summary Judgment

¶ 43 Summary judgment is proper where the pleadings, depositions, affidavits, admissions, and exhibits on file, when viewed in the light most favorable to the nonmoving party, show that there is no genuine issue of material fact and that the moving party is thus entitled to judgment as a matter of law. *Kajima Construction Services, Inc. v. St. Paul Fire & Marine Insurance Co.*, 227 Ill. 2d 102, 106 (2007). A triable issue of fact exists where there is a dispute as to one of the material facts, or where a reasonable trier of fact might differ in drawing inferences from facts that are not in dispute. *Bagent v. Blessing Care Corp.*, 224 Ill. 2d 154, 162-63 (2007). A defendant may nevertheless succeed on its motion for summary judgment by disproving the plaintiff's case with uncontradicted evidence that would entitle it to judgment as a matter of law or by establishing that the plaintiff lacks sufficient evidence to prove an essential element of its cause of action. *Argueta v. Krivickas*, 2011 IL App. (1st) 102166, ¶ 6. Therefore, when facing a motion for summary judgment, a plaintiff cannot simply rest on conclusory or unsupported allegations, but must present a factual basis that would arguably support a judgment. *Robinson v. Village of Oak Park*, 2013 IL App. (1st) 121220, ¶¶ 21-22. For appeals such as this, on the circuit court's grant of defendant’s motion for summary judgment, this court will review the motion *de novo*. *Abrams v. City of Chicago*, 211 Ill. 2d 251, 258 (2004).

¶ 44 Relator's surviving claims were brought under sections 102 and 103 of Article XX. Section 102 of Article XX provides for a refund of compensation, benefits, or remuneration received by means of a false or fraudulent record, statement, claim or device, or other willful misrepresentation. 735 ILCS 5/20-102 (West 2002). Section 103 provides for repayment of compensation, benefits, or remuneration to which a person is not entitled, or in a greater amount than to which he is entitled, that were received by means of a false record, statement or representation, by false concealment of a material fact, or by other fraudulent scheme or device. 735 ILCS 5/20-103 (West 2002).

¶ 45 Relator argues that the trial court erred in granting summary judgment because the resolution of this case entails the question of reasonableness. Relator asserts that this is a question of fact for the trier of fact, not a question of law subject to summary judgment. Relator asserts that any markup in the price would be illegal as a violation of IRS and Treasury rules. He contends that because the markup is illegal *per se*, summary judgment was improperly granted to defendants and should have been granted for relator.

¶ 46 However, as the trial court found, relator did not present any evidence that would assist the trier of fact in coming to that conclusion or what the industry standard was on this issue. Contrariwise, defendants presented the testimony and report of Guild concerning industry practice and the proper markup rates in the underlying types of transactions. Furthermore, relator alleged in the complaint that a markup was acceptable, but contended that defendant's markup exceeded reasonable standards. Accordingly, the trial court found there was no disputed issue of fact on the critical issue of whether there was a fraudulent or willful concealment of a material fact or misrepresentation that led to an improper charge. Relator cannot rest on his

conclusory or unsupported allegations. The trial court properly found he failed to present a factual basis that would arguably support a judgment and granted summary judgment.

¶ 47 III. CONCLUSION

¶ 48 For the reasons stated, we affirm the judgment of the circuit court.

¶ 49 Affirmed.