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Court Holds Sales Representative Act Only Applies to Agreements for Sale of Goods

by Cecil E. Porter
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In *Johnson v. Safeguard Construction Co.*, 2013 IL App (1st) 123616, a dispute arose between a sales representative and his employer over commissions due the representative. The defendant was a corporation that facilitated the repair of damaged homes by sending sales representatives to storm damaged areas to enter into contracts with homeowners for the restoration of their homes. The defendant then entered into subcontracts with trade contractors for the repair work.

The plaintiff was one of the defendant's sales representatives. The sales representative agreement provided in part that the defendant would pay the plaintiff a percentage of its net profits. A dispute arose between the plaintiff and the defendant over commissions resulting in the plaintiff suing the defendant under theories of breach of contract and violations of the Sales Representative Act. 820 ILCS 120/0.01 et. Seq.

The definition of "principal" under the Act requires in part a purveyor of tangible goods. Here, the plaintiff argued the defendant provided both tangible goods and services pointing to the products and services shown on the defendant's web site.

The defendant was granted summary judgment by the trial court as to the count for violations of the Act. The trial court found the Act did not apply because the defendant was not the purveyor of tangible goods and therefore not a principal under the Act. The plaintiff appealed arguing that the defendant provided both goods and services and should be liable under the Act.

The definition of "principal" under the Act requires in part a purveyor of tangible goods. Here, the plaintiff argued the defendant provided both tangible goods and services pointing to the products and services shown on the defendant's web site. In response, the defendant argued that it only described goods and services on its web site. It did not have agreements with any of the product manufacturers and it did not engage in actual repair work. The defendant subcontracted the repair work to third parties to have done.

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The appellate court rejected the plaintiff's argument that any repair work must involve tangible goods, because any tangible goods were incidental to the services contracted by the defendant. The appellate court also found, that even if the home repair services provided by the defendant were products within the meaning of the Act, that the defendant still would not be liable under the Act since it was only within the chain of distribution of the products. The defendant would have to be the original source of the products to be liable under the Act.



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Sometimes People Go Too Far; Court Hammers Business Co-Owner

by John O'Malley
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Kovac v. Barron, 2014 IL App (2nd) 121100 is a dispute between two 50% shareholders of several companies. It is not a pretty story of how one 50% partner treated another 50% partner.

The companies were involved in the design, manufacturing and sale of manufacturing safety devices such as safety light curtains. Plaintiff was responsible for sales and spent most of his time in Pennsylvania. Defendant was responsible for manufacturing and spent most of his time at the manufacturing facilities in Illinois. Plaintiff alleged that plaintiff and defendant had agreed that each would take the same salaries and bonuses.

Defendant's primary responsibility consisted of data processing. He acknowledged that he typed orders into a computer "like a data processing clerk would do." The defendant allegedly had not worked a full day since the 1980s and admitted during his deposition that he left work each day around noon.

Eventually, defendant formed a separate company, KES, to administer and pay payroll taxes and employment benefits for individuals in Illinois who provided labor and services to the companies. Defendant's wife was employed by KES since its inception. Defendant's wife had taken a single accounting class in high school. She worked for the companies part time, around 6-8 hours a week. Her responsibilities included bookkeeping, check writing and some purchasing. She also handled payroll for KES which involved calculating the Illinois employees' hours and submitting both the Illinois and Pennsylvania payrolls to ADP. Sandra also recorded payments and moved funds from the companies to KES to cover payroll. She testified that she probably handled the bookkeeping of Repair Services, one of the companies. Between 1998 and 2007, defendant unilaterally set his wife's annual salary for her part-time work. During those years, her annual salary ranged from \$172,000 – \$272,000.

Around 2007, plaintiff's relationship with defendant began to deteriorate. Defendant began telling the company's customers to pay Repair Services, a company he personally owned and set up, rather than paying the companies for repair work. Defendant ordered invoices for repairs performed by the Operating Companies to be sent out under the Repair Services name. Defendant directed that all payments for repairs were to be funneled to Repair Services. Eventually, defendant ordered a letter be sent to all customers stating that all repair payments should be sent to Repair Services, not the companies.

Defendant eventually refused to talk to plaintiff. At first, defendant instructed that plaintiff be told that he was not in the office when he called. Defendant instructed all employees not to communicate with plaintiff. At about the

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same time, defendant cut off plaintiff's salary. When plaintiff attempted to continue to reach defendant, defendant threatened to call the police if plaintiff continued to call his home phone.

Plaintiff eventually sued defendant and sought a preliminary injunction because defendant had locked him out of the business and was transferring payments from the companies repair business to Repair Services. He requested that the court prevent defendant from denying him access to the business's office and records and from destroying records and wasting corporate assets. The court granted the preliminary injunction on October 1, 2007.

On October 9, defendant had approximately 40 – 50 boxes of records destroyed. Defendant admitted to instructing an employee to put 15 years of business records, including invoices, bills, checks, bank statements, and other bank records into the trash. Defendant continued to divert repair business from the companies to Repair Services. Defendant caused thousands of dollars in personal expenses to be paid by the companies, including chartering an airplane. Defendant told employees not to talk to plaintiff or they would be fired. Defendant eventually changed the locks on the company offices.

Defendant's expert testified that defendant and his wife were collectively paid \$4.9 million more than plaintiff in total compensation from 1999 through 2007. The defendant and his wife were paid \$10.4 million in gross wages compared to plaintiff's \$5.6 million.

Defendant had large sums transferred from the companies to KES and then distributed to defendant and his wife. Plaintiff did not receive similar payments from KES.

Plaintiff's expert testified that defendant's wife's salary of \$172,000 – \$270,000 per year was an "outrageously unreasonable" amount for 6 – 8 hours of bookkeeping per week and given the defendant's wife's lack of credentials. He assumed that the wife's salary should have been \$25,000 per year.

The trial court ruled that defendant had intentionally diverted repair business income to Repair Services and awarded plaintiff \$327,000 in damages. The trial court also found that defendant had "grossly overcompensated" his wife and himself. He awarded plaintiff \$3.2M. Finally, the court awarded plaintiff \$450,000 in punitive damages.

On appeal, defendant challenged the trial court's ruling in plaintiff's favor on the fraud count. Defendant argued that plaintiff's proof of the purported oral agreement that the two shareholders would receive equal compensation consisted solely of defendant's "admission" during his deposition testimony which was not an unequivocal admission sufficient to support the trial court's award of damages.

The second district reviews the trial court's decision on judicial admissions under the abuse-of-discretion standard. Other districts apply a *de novo* standard of review.

During his deposition, defendant was asked about one of the companies' 401(k) savings plan which showed the same amounts paid to plaintiff and defendant. Plaintiff's attorney asked:

Isn't that because you guys agreed that you would be paid the same amount in salary?

Defendant answered:

Apparently, yes.

Following several more questions, the following colloquy ensued:

- Q. For as long as you guys have been partners, for the longest time—
A. Yes.
Q. You always pulled the same salary out, didn't you?
A. Yes.
Q. And if there was a bonus at the end of the year, you paid yourselves an equal bonus, didn't you?
A. Yes.
Q. Until when?
A. I don't recall.

The court found that testimony did not relate solely to the 401(k) savings plan, but concerned the historic practice of the parties being compensated equally. The court found no abuse of discretion in the trial court's decision to hold that defendant's testimony was a judicial admission.

Defendant next argued that the trial court erred in concluding that plaintiff and defendant were "statutorily mandated" to receive equal salaries. The appellate court noted that the statement was inaccurate and that in a subchapter S corporation, the 50% shareholders are entitled to share equally in the **profits** of the companies. However, the appellate court concluded that by drawing excessive compensation for himself and his wife, the defendant did not share the profits equally. While the trial court may have misspoken, its ultimate decision was amply supported by the evidence.

The court agreed that the breach of fiduciary duty court for diverting business income should have been brought by the companies or by plaintiff in a derivative action.

Defendant next argued that the breach of fiduciary duty for diverting business income from the companies to Repair Services and the fraud count should have been brought as derivative claims on behalf of the companies. With regard to the challenge to the fraud count, the court noted that plaintiff, as a 50% shareholder, sustained an individual injury and could bring a claim on his own behalf for those damages.

The court agreed that the breach of fiduciary duty court for diverting business income should have been brought by the companies or by plaintiff in a derivative action. The court noted that a party does not acquire standing to maintain an action in his own right, as a shareholder, when the alleged injury is inflicted upon the corporation and the only injury to the shareholder is the indirect harm of the diminution in value of his corporate shares resulting from the impairment of corporate assets. It turns out that the companies had made the claim in Count III of their cross-complaint, but that the court had granted defendant's motion to dismiss that count. The appellate court noted that it had the power to enter any order that should have been entered by the trial court. Accordingly, it reversed the judgment of the trial court in favor of plaintiff on Count II, but also reversed the judgment of the trial court granting defendant's motion to dismiss Count III of the Operating Companies' cross-complaint. The court then entered judgment in favor of the Operating Companies on Count III of their cross-complaint in order that the funds that Barron received from Repair Services for repair work be awarded to the companies on remand.


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Defendant also challenged the award of punitive damages to plaintiff because defendant had died before trial. The majority of jurisdictions do not allow for punitive damages after the tortfeasor's death. There is one Illinois Appellate Court case, *Penberthy v. Price*, 281 Ill. App. 3d 16 (1996) to the contrary. That is the only case in Illinois where a claim for punitive damages survived the defendant's death.

The court noted that punitive damages serve as punishment for the defendant and are designed to promote three rationales: (1) to act as retribution against the defendant; (2) to deter the defendant to committing similar wrongs in the future; and (3) to deter others from similar conduct. The majority of cases from other jurisdictions focus on the first two rationales in holding the punitive damages are not recoverable upon a tortfeasor's death. *Penberthy* and the other jurisdictions that have allowed punitive damages even when the wrongdoer has died tend to focus on the third rationale.

In *Penberthy*, a motorist and a passenger sued an intoxicated driver's estate for injuries from a collision that killed the intoxicated driver. The plaintiffs were awarded compensatory damages as well as punitive damages. The court found that driving under the influence of alcohol violated a strong and clearly articulated public policy and because the underlying conduct was a crime, the court concluded that strong equitable considerations weighed in favor of survival of the claims of punitive damages. In the instant case, the court noted that defendant deliberately violated multiple, specific court orders, including diverting the Companies' business income, destroying business records and denying plaintiff full access to the business. Defendant misappropriated millions of dollars from plaintiff through fraud, deception and the manipulation of his various businesses which, as the trial court found, "shocked the conscience."

Defendant secretly used KES to funnel funds away from the companies and to pay blatantly outrageous amounts to himself and his wife for their part-time work. He diverted business income from the Operating Companies to Repair Services. Furthermore, defendant took steps to conceal his fraudulent conduct when he destroyed business records and prevented employees from talking to plaintiff. Though the court was not disposed to promulgate a sweeping rule of law that would permit punitive damages against deceased tortfeasor defendants in all circumstances, given the cumulative effect of defendant's conduct, it agreed with the trial court that a judgment for punitive damages against the defendant's estate powerfully serves as a deterrent to others. The award of punitive damages was affirmed.

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Court Finds Status of Debt Misrepresented

by Patrick Cella
Kopon Airdo, LLC

On March 11, 2014, the United States Appellate Court for the Seventh Circuit issued its ruling in two (2) consolidated cases involving the collection practices of two different debt collectors under the Fair Debt Collection Practices Act ("Act"). *McMahon v. LVNV Funding, LLC*, No. 12-3504 (7th Cir. March 11, 2014) Consolidated on Appeal with *Juanita Delgado v. Capital Management Services, LP*, No. 13-2030, 7th Cir. March 11, 2014. The primary issue on appeal in both matters related to the circumstances in which a dunning letter for a time-barred

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debt could mislead an unsophisticated consumer to believe that the debt was enforceable and thereby violate the Act. However, as an initial matter, in the *McMahon* case, the appellate court addressed the circumstances in which a class action may become moot, if a defendant offers to settle with the class representative for full value.

McMahon v. LVNV Funding, LLC

In 1997, Scott McMahon received a bill from Nicor Gas. McMahon did not pay the bill, and fourteen years later in September 2011, the defendant, LVNV Funding, LLC, (“LVNV”), purchased the debt. At this point, the defendant initiated collection proceedings against McMahon by sending a letter to him on December 19, 2011. Within the letter, the defendant noted,

we’re pleased to extend to you an offer to settle your accounts in full for \$233.99. This represents a savings of 6% off your balance.

The letter said nothing about when the debt was incurred or that the four-year statute of limitations applicable to Illinois had expired. McMahon responded to the letter asking for verification of the debt. The defendant responded with more details, but did not indicate the age of the debt, a detail the court believed would have alerted McMahon or his lawyers to the fact that the claim was barred by the statute of limitations.

Soon thereafter, McMahon filed suit under the Act on behalf of himself and a class. The district court dismissed McMahon’s class allegations, but denied LVNV’s motion to dismiss the individual claims. McMahon filed a motion to reconsider, but the court stood on its dismissal; however, it granted McMahon leave to amend his class action complaint. Within hours of the order, LVNV’s attorney sent a fax to McMahon’s attorney offering to settle his case. Specifically, LVNV offered to pay McMahon statutory damages in the amount of \$1,000.00, costs incurred in his individual claim, a reasonable attorney’s fee, and any other reasonable relief in the event the Court concluded that “more was necessary.” Instead of responding to the offer, McMahon amended his class action complaint along with an amended motion for class certification.

LVNV moved for dismissal, taking the position that its settlement offer rendered McMahon’s individual claim moot, thereby rendering McMahon an inadequate representative of the proposed class. The court found that the settlement offer constituted a complete recovery for McMahon’s individual claim. Because the offer was made prior to class certification, the court held that the offer had the effect of depriving McMahon of a personal stake in litigation. The court granted LVNV’s motion to dismiss. In his appeal, McMahon contested both the finding that defendant’s settlement offer mooted his case, and the dismissal of the class claims under the Act.

Delgado v. Capital Managements Services, LP

On February 7, 2012, defendant, Capital Management Services, LP, (“Capital”) sent a debt collection letter to the plaintiff, Delgado. The relevant portion of this letter reads that Capital had been engaged to resolve Delgado’s delinquent debt of \$2,404.13. The letter specifically stated:

Please submit your payment and make your check or money order payable to Capital Management Services, LP, to the above address...Capital Management Services, LP, is authorized to accept less than the full balance due as settlement of the above account. The settlement amount of \$721.24, which represents 30% of the amount presently owed, is due in our office no later than forty-five (45) days after receiving this notice. We are not obligated to renew this offer.

The letter did not say that the claim was time-barred nor did it disclose when the debt was incurred. In fact, the debt was eight years old. Therefore, Delgado filed a complaint under the Fair Debt Collection Practices Act charging that the Defendant violated the Act by sending a dunning letter on a time-barred debt and included an offer of settlement, implying that the debtor was legally obligated to pay the debt. When, in fact, it was time-barred, and if Delgado had made a partial payment, she could have revived the entire claim.

The defendant filed a motion to dismiss for failure to state a claim. The district court denied the defendant's motion. The court noted that the Federal Trade Commission and other federal agencies have found that when collecting on a time-barred claim, a debt collector must inform the consumer that (1) the collector cannot sue to collect the debt and (2) if a partial payment is made, it could revive the collector's ability to sue to collect the entire balance. The district court also found that the reference in Delgado's letter of a possible settlement of the debt to be deceptive because it implied that a legally enforceable obligation to pay the debt existed. Capital appealed the district court's decision.

The appellate court noted that pursuant to its own rules, a defendant can render moot a possible class action by offering to settle with the class representative for the full amount of his demands *before* a plaintiff files a motion for class certification. However, the settlement offer must be for everything that the plaintiff has requested.

The issue of mootness only implicates the *McMahon* case. The appellate court noted that pursuant to its own rules, a defendant can render moot a possible class action by offering to settle with the class representative for the full amount of his demands *before* a plaintiff files a motion for class certification. However, the settlement offer must be for everything that the plaintiff has requested.

Applying these principles to the *McMahon* case, the court found that the offer made by the defendant was not for the full value of plaintiff's case. Specifically, the offer promised to provide *any other reasonable relief that the court thought necessary*. The Seventh Circuit believed that this last part of the offer indicated that the defendant was reserving the right to object to any additional relief that it deemed unreasonable. McMahon did not accept this offer; instead, he filed an amended complaint and an amended motion for class certification. Because the Seventh Circuit determined that the offer made by the defendant was qualified, and did not unequivocally provide for the full value of McMahon's claim, and McMahon then filed for class certification, the defendant missed its opportunity to settle the claim with the individual Plaintiff; therefore, McMahon's claim was not moot.

The Fair Debt Collection Practices Act prohibits the use of any false, deceptive, or misleading representation or means in connection with the collection of any debt. 15 U.S.C. § 1692e. This section provides a non-exclusive list of prohibited practices, including, false representation of the character, amount, or *legal status* of any debt; threat to take any action that cannot legally be taken; and use of any false representation or deceptive means to collect or attempt to collect any debt.

The appellate court specifically noted that the Third and Eighth Circuits have found that sending dunning letters for time-barred debts does violate the Fair Debt Collection Practices Act, unless the letter is accompanied by a threat of litigation. However, the court acknowledged that several federal agencies have disagreed with the Third and Eighth Circuits' limited interpretation of the Act. For example, the Federal Trade Commission has

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found that a debt collector's failure to disclose the fact that the debt is time-barred might deceive a consumer in at least two (2) ways:

1. Because most consumers do not know or understand their legal rights with respect to the collection of a time-barred debt, attempts to collect on such a debt may create a misleading impression that the consumer has no defense to a lawsuit; and
2. Consumers often do not know that in many states the making of a partial payment on a stale debt actually revives the entire debt, even if it was otherwise time-barred.

Because of this potential for confusion, the Federal Trade Commission has recommended that if a collector knows, or should know, that it is collecting on a time-barred debt, it must inform the consumer that (1) the collector cannot sue to collect the debt, and (2) if the consumer provides a partial payment, it could revive the collector's ability to sue to collect the remaining balance.

The Seventh Circuit noted that when considering whether the representations made in a dunning letter are misleading, the court must ask whether a person of "modest education" and "limited commercial savvy" would likely be deceived. The court views each letter through the perspective of an "unsophisticated consumer." Whether a dunning letter is confusing is a question of fact. Dismissal of a complaint is appropriate only when it is apparent from a reading of the letter that not even a significant fraction of the population would be misled by it.

Pursuant to the standard, the appellate court held that the district court in *Delgado* was correct in denying the defendant's motion to dismiss. The court also held that the *McMahon* court will need to take a fresh look at the class allegations in that case, even if it concludes that McMahon, himself, cannot go forward.

The Seventh Circuit noted that it was not creating a rule that it is automatically improper for a debt collector to seek repayment of a time-barred debt. The court indicated that some people may consider full debt repayment a moral obligation, even though a legal remedy for the debt has been extinguished. However, if the debt collector uses language in its dunning letter that would mislead an "unsophisticated consumer" into believing that the debt is legally enforceable, regardless of whether the letter actually threatens litigation, the collector has violated the Fair Debt Collection Practices Act. Significantly, this ruling is contrary to the standard applied in the Third and Eighth Circuit Courts. According to the Third and Eighth Circuits, a dunning letter only violates the Fair Debt Collection Practices Act, if it threatens litigation.

The Seventh Circuit explained that the Act, itself, specifically prohibits the false representation of the character or *legal status* of any debt. This may be accomplished even if litigation is not threatened. The plain language of the Act prohibits not only representations threatening to take any action that the collector cannot take, but also the use of any false, deceptive, or misleading representation, including those about the character or *legal status* of any debt. If a debt collector stated that it could sue on a time-barred debt, but was promising to forbear, that statement would be a false representation about the legal status of the debt.

In both *Delgado* and *McMahon*, the letters misrepresented the legal status of the debt. In both letters, an "unsophisticated consumer" could have reasonably believed that his debt was legally enforceable. Moreover, because both letters contained offers to settle, a gullible consumer who made a partial payment would have inadvertently reset the limitations period and made himself vulnerable to an action for the full amount of the debt. A settlement offer for a time-barred debt implies that the creditor could successfully sue on the debt. The court held that this is misleading. Therefore, the letters violated the Fair Debt Collection Practices Act.



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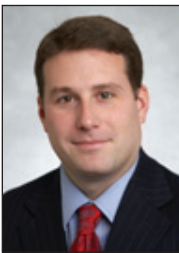
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