2014 IL App (3d) 130834-U

Order filed September 9, 2014

IN THE

APPELLATE COURT OF ILLINOIS

THIRD DISTRICT

A.D., 2014

DENIS WILLIAMS, Plaintiff, v. RICHARD FUGETT, MICHAEL KOZIOL, TYSON MICHAEL GARBRECHT, REED KONNERTH and INTELLIGENT SOLUTIONS, INC. a/k/a PREMIER FINANCIAL SOLUTIONS, Defendants.	)	Appeal from the Circuit Court of the 12th Judicial Circuit, Will County, Illinois. Appeal No. 3-13-0834 Circuit No. 12-CH-739 The Honorable Barbara Petrungaro, Judge, presiding.

TYSON MICHAEL GARBRECHT, Counter/Cross-Plaintiff/Appellant, v. DENIS WILLIAMS Counter-Defendant, and RICHARD FUGETT, MICHAEL KOZIOL, REED KONNERTH and INTELLIGENT	)	Appeal from the Circuit Court of the 12th Judicial Circuit, Will County, Illinois. Appeal No. 3-13-0834 Circuit No. 12-CH-739

SOLUTIONS, INC. a/k/a PREMIER FINANCIAL SOLUTIONS,	)	
	)	The Honorable
	)	Barbara Petrungaro,
Cross-Defendants/Appellees.	)	Judge, presiding.

PRESIDING JUSTICE LYTTON delivered the judgment of the court.
Justices McDade and Wright concurred in the judgment.

ORDER

¶ 1 *Held*: The trial court abused its discretion by failing to appoint an interim receiver pursuant to section 12.60 of the Business Corporation Act.

¶ 2 Cross-plaintiff, Tyson Michael Garbrecht, filed a motion to appoint a custodian/interim receiver under the Business Corporation Act of 1983 (Act) (805 ILCS 5/12.56 & 12.60 (West 2012)) against defendants, Intelligent Solutions, Inc. (ISI) and shareholders Richard Fugett, Michael Koziol and Reed Konnerth. The trial court denied the motion, concluding that there was no evidence that company assets would be lost or destroyed before a decision on the merits. Garbrecht filed a notice of interlocutory appeal under Illinois Supreme Court Rule 307(a)(2) (eff. Feb 26, 2010), seeking reversal of the court's order. We reverse and remand for further proceedings.

¶ 3 Evidence presented at the hearing on the motion and exhibits attached to Garbrecht's supplemental brief in support of his motion revealed that in 1990, Richard Fugett and Denis Williams formed Intelligent Solutions, Inc. (ISI), an information technology consulting company. The articles of incorporation signed by Fugett and Williams provided for 10,000 shares. At the time of incorporation, 1,000 shares were issued: 500 to Fugett and 500 to Williams. The articles of incorporation did not include provisions regarding the configuration of the board or quorum requirements for the board to transact business. Article III, section 1 of the

bylaws sets a quorum for the transaction of business as a majority of the directors. Section 10 of the same article provides that the board may act without a meeting if a consent in writing, setting forth the action taken, is signed by all of the directors.

¶ 4 In July of 2006, Fugett and Williams formed another corporation, ESMA Investments, LLC (ESMA). ESMA is a real estate investment company. The properties owned by ESMA consist of business condos used by ISI as office space and adjacent complexes for future expansion.

¶ 5 Currently, ISI has 24 employees, including programmers, technicians and management personnel. Fugett is the chief executive officer and president, Konnerth is the chief operating officer, and Koziol is the chief financial officer. Koziol has an accounting degree and has practiced as an accountant for more than 25 years.

¶ 6 Since its incorporation, ISI has purchased multiple "key" employee life insurance policies to protect the business. In the event such an employee dies, the money is paid to the beneficiary and can be used to purchase ISI stock back from the deceased employee's estate. The policies originally insured Fugett and Williams. Some of the policies named Fugett as the beneficiary, some of them named Williams as the beneficiary, and some named ISI as the beneficiary. The policies naming Williams were transferred to Koziol when Williams left ISI. Fugett is the named beneficiary on Koziol's life insurance policies. Koziol testified that the cash surrender value of the policies is more than $500,000 and is not shown on ISI's tax returns because doing so is not required for a C-corporation.

¶ 7 In 2008, Fugett and Williams discussed issuing ISI shares to Koziol and Michael Garbrecht, the architect of ISI's main software program known as "Capers." The plan involved both Williams and Fugett giving up part of their interest in ISI. Later that year, Fugett again

mentioned issuing stock to Garbrecht as an incentive to keep him in the company. However, discussions ended when Williams became involved in divorce proceedings, and Williams expressed concern that his wife would attempt to gain control of ISI.

¶ 8 In light of Williams' impending divorce, Fugett and Williams discussed reducing Williams' interest in ISI and potentially returning his stock to him after judgment was entered. On April 29, 2009, all four ISI directors, Fugett, Koziol, Konnerth and Garbrecht, signed a unanimous consent authorizing the board to issue additional shares of stock. According to the terms of the consent, Williams' shares were reduced to 500 and Fugett's shares were increased to 5,500. In addition, Garbrecht and Koziol were each issued 2,000 shares in exchange for a $50,000 promissory note. Fugett agreed to hold 2,500 shares of his stock for Williams' benefit and planned to transfer those shares back to Williams after his divorce proceedings concluded. Koziol acknowledged that he also agreed to rescind the share purchase agreement whenever Fugett and Williams asked, returning his shares in ISI for a release of the promissory note. Around the same time the unanimous consent was signed in 2009 reducing Williams' interest in ISI, Williams transferred his 50% interest of ESMA stock to Koziol.

¶ 9 In October 2009, Fugett, Williams and Koziol decided to reduce Williams' share in ISI even further. On October 28, 2009, Koziol drafted a second unanimous consent to authorize the issuance of 90,000 new shares and their distribution. It was signed by three of the four directors: Fugett, Koziol and Konnerth. The consent stated that Fugett owned 56,500 shares, Williams owned 500 shares, and Garbrecht and Koziol both owned 21,500 shares.

¶ 10 On June 17, 2010, a hearing was held in Williams' divorce proceedings. At that hearing, Williams testified that he owned a 0.05% interest in ISI. Two weeks after his divorce judgment was entered, Williams asked for his stock shares to be returned to him. Fugett contacted ISI's

attorney, Mark Belongia, who informed Fugett that returning the stock would be improper. Fugett testified that he did not transfer the stock back to Williams because Belongia informed him that holding stock for Williams during the divorce and transferring the stock back to him after the divorce would be fraudulent.

¶ 11 In the meantime, between January 25, 2010, and December 3, 2012, ISI made several transfers directly to ESMA, totaling $404,000. Koziol testified that the transfers were loans. The transfers included funds used to purchase real estate in ESMA's name, to pay legal fees and inspection fees related to those purchases and to pay real estate taxes. In addition, ISI paid ESMA $30,000 as rent for use of its business property in 2009. In 2012, ISI paid ESMA $54,500 annually for using the property. A written lease agreement between the two companies does not exist.

¶ 12 In 2012, Fugett and Koziol started another company named Capers, LLC (Capers), as a "branch off" of the Capers software product. Fugett testified that the plan was to split the technical side and the software side of ISI into two companies. The software company's name is based on the Capers software program, ISI's "flagship product." Fugett and Koziol are the sole shareholders of the limited liability company. Eventually, Fugett and Koziol thought that they would split ISI's technical and software businesses and move all Capers software customers over to the new company, but that plan has not been implemented. Koziol testified that several customers write checks to "Capers," which ISI's bank refuses to cash. Therefore, Capers has its own bank account. He stated that after the checks are deposited into the Capers bank account, the funds are transferred back to ISI.

¶ 13 In 2012, Fugett and Koziol also created Intelligent Cloud Housing, LLC (ICH), an off-site client data hosting company. ICH is owned by Fugett, Koziol, Konnerth and Sebastian

Abbinanti. Like EMSA, ICH uses ISI funds to purchase computer equipment, which is then transferred to ICH. ICH was set up as an entity separate from ISI to protect ISI from lawsuits related to cloud hosting. Koziol testified that ICH provides cloud hosting services to police departments and none of the shareholders of ICH can have felony convictions. Garbrecht has been convicted of a felony. ISI employees initially prepared ICH's cloud hosting product, and former ISI customers are now customers of ICH.

¶ 14 In the fall of 2011, ISI terminated Williams. On February 14, 2012, Williams filed a five count complaint under section 12.56 of the Business Corporation Act, naming Fugett, Koziol, Garbrecht, Konnerth and ISI as defendants. The complaint sought a declaratory judgment that Williams was still a 50% owner and shareholder of ISI and an order instructing defendants to set aside the issuance of additional shares to Fugett, Koziol and Garbrecht.

¶ 15 ISI retained Belongia, now a member of the firm of Roetzel & Andress, LPA, to represent the company against Williams' suit. When the firm reviewed ISI's business records, it discovered that the October 2009 consent only contained three of the four director's signatures. Garbrecht had not signed it. Belongia then drafted a unanimous consent (November 2012 consent) to rectify the prior acts of increasing the authorized shares of the company. Koziol sent Garbrecht the November 2012 consent and a document requiring him to return his ISI stock in exchange for the release of the $50,000 note he signed in 2009. Garbrecht refused to sign the November 2012 consent.

¶ 16 On January 14, 2013, Garbrecht filed a motion in Williams' case as a counter/cross-plaintiff seeking the appointment of a receiver. The motion was entitled "Defendant Garbrecht's Emergency Motion to Disqualify the Roetzel and Andress Firm from Representing Any Party in

this Case and for Appointment of a Custodian Pursuant to 805 ILCS 5/12/56." ISI terminated Garbrecht's employment shortly thereafter.

¶ 17 In response to Garbrecht's motion, Roetzel & Andress withdrew from representing the defendants. In February 2013, the firm of Rathbun, Cservenyak and Kozol filed its appearance on behalf of Fugett, Koziol and Konnerth, individually. Theresa Berkey appeared on behalf of ISI. After the Rathbun firm entered its appearance, Fugett, Koziol and Konnerth paid the firm $3,300 for legal services using ISI funds.

¶ 18 The trial court held an evidentiary hearing on February 1, 2013, to consider Garbrecht's motion to disqualify. At that hearing, Garbrecht introduced a packet containing 22 exhibits. Koziol testified as to several consent of shareholders forms contained in the packet, as well as ISI corporate bylaws, EMSA mortgage liens and ISI general ledgers. The court then continued the hearing on the issue of the appointment of a receiver to allow the submission of written briefs in support of the parties' positions.

¶ 19 In response, Garbrecht filed a supplemental brief in support of his motion for appointment of a custodian. Attached to the motion were several ISI business records, including (1) corporate tax returns from 2009, 2010 and 2011, (2) balance sheets from January 2009 through February 28, 2013, (3) revenue sales sheets from 2009 through 2012, and (4) general ledger sheets dated December 31, 2009, through March 22, 2013.

¶ 20 On September 13, 2013, the trial court conducted a hearing on Garbrecht's motion to appoint an interim receiver. Koziol and Fugett both testified. The trial court also considered Fugett and Williams' discovery depositions and the exhibits submitted in prior proceedings. Following the hearing, the trial court issued a written order denying Garbrecht's request. The court concluded that, under section 12.60 of the Act, the evidence did not establish that ISI's

assets were being disposed of or that assets would be lost or destroyed before a decision on the merits could be reached.

¶ 21 ANALYSIS

¶ 22 Garbrecht argues that the trial court erred in denying his motion to appoint an interim receiver under section 12.56 of the Act. He claims that a receivership is necessary because directors Fugett and Koziol have jeopardized ISI's continued existence by misapplying and wasting corporate assets and engaging in fraudulent conduct.

¶ 23 I

¶ 24 Section 12.56(a) of the Business Corporation Act allows shareholders of non-public corporations to file remedial actions in cases where directors have committed fraud or corporate assets are being misapplied or wasted. 805 ILCS 5/12.56(a) (West 2012). A shareholder may petition the court for various remedies, including (1) the removal from office of any director or officer, (2) the appointment of any individual as a director, (3) an accounting with respect to any matter in dispute, or (4) the appointment of a custodian to manage the business and affairs of the corporation to serve for the term and under conditions set forth by the court. 805 ILCS 5/12.56(b)(3)-(b)(6) (West 2012).

¶ 25 Section 12.60(d) of the Act provides that in an action under section 12.56, the court may appoint an interim receiver with such powers and duties as the court may direct. 805 ILCS 5/12.60(d) (West 2012). An interim receiver "may take such [ ] action as is necessary or desirable to preserve the corporate assets and carry on the business until a full hearing can be had." 805 ILCS 5/12.60(d) (West 2012). The purpose of a limited receivership under section 12.60(d) is to protect and preserve the business of the corporation, pending a judicial

determination on the merits of the shareholder dispute. *Firebaugh v. McGovern*, 404 Ill. 143, 150 (1949).

¶ 26 An application for the appointment of a receiver is left to the sound discretion of the trial court, but the standards by which the court must exercise its discretion are high. *Poulakidas v. Charalidis*, 68 Ill. App. 3d 610 (1979). The appointment of a receiver is an extraordinary and drastic remedy and is appropriate only in cases of necessity where there is a present danger of waste or dissipation of corporate assets and investors' interests are at risk. *Id*. at 614. Generally, an interim receiver may be appointed if: (1) the directors are managing or disposing of corporate assets in such a manner as to serve their own interests so that the assets will probably be lost or destroyed before a decision on the merits can be made; (2) internal dissensions are deadlocking the corporation and frustrating its purpose; (3) the failure or refusal of directors to meet and transact business is jeopardizing the interests of the shareholders; or (4) other forms of dissension, dispute, fraud or mismanagement exist that make it impossible for the corporation to carry on its business or preserve its assets until the controversy is resolved. *Witters v. Hicks*, 335 Ill. App. 3d 435, 439 (2002); *Firebaugh*, 404 Ill. at 149.

¶ 27 II

¶ 28 Here, Garbrecht argues that the trial court erred in denying his request to appoint an interim receiver because Fugett and Koziol admitted they have engaged in conduct that violates provisions of the Act, including (1) the unauthorized transfer of corporate assets, (2) the use of corporate funds to purchase life insurance policies and pay personal legal fees, and (3) the transfer of ISI assets to other corporate entities.

¶ 29 A. Unauthorized Transfers

¶ 30 First, Garbrecht claims that monies and assets have been inappropriately transferred between ISI and ESMA, Capers and ICH. According to the record, Fugett and Koziol became the controlling shareholders in 2009. From that time through the present, they have repeatedly transferred ISI assets and funds to other entities they control in which the remaining ISI shareholders have no interest. For example, Fugett and Koziol own EMSA as equal shareholders; Garbrecht has no interest in EMSA. However, ISI's balance sheet shows a loan receivable to EMSA in the amount of $664,030.71, which is 82% of ISI's total current assets as of February 28, 2013. In his testimony before the court, Koziol did not dispute that ISI loaned EMSA the funds. In addition, profit and loss sheets admitted as exhibits during the hearing also demonstrate that numerous business expenses for Capers, a business owned solely by Koziol and Fugett, were also paid for by ISI, including freight expenses, advertising and postage, and that such business practices continue to occur. Moreover, according to the evidence, Fugett and Koziol use ISI employees and equipment to sell internet hosting services under the name ICH, another company in which other ISI shareholders own no interest.

¶ 31 All of these transfers were completed without proper shareholder approval or a valid consent. Fugett's and Koziol's unauthorized conduct appears to demonstrate a pattern of misappropriation that necessitates the appointment of a receiver. See *Firebaugh*, 404 Ill. at 151-52.

¶ 32 B. Purchase of Life Insurance Policies and Payment of Legal Fees

¶ 33 The record further shows that since they became the controlling shareholders of ISI in 2009, Koziol and Fugett used ISI funds to purchase life insurance policies and pay legal fees for their own benefit. Fugett testified that the life insurance policies were purchased using ISI funds and are worth more than $500,000. However, the value of these policies is not included in ISI's

financial statements or tax returns because ISI is not the primary beneficiary listed on the policies. While Fugett described these policies as "key man" policies to protect ISI, Fugett is the beneficiary of the policies on Koziol's life, not ISI. In addition, corporate records indicate that at least $3,300 of ISI's assets were used to pay the Rathbun firm after the firm appeared in February of 2013 on behalf of Fugett, Koziol and Konnerth, individually, not ISI. Again, neither the purchase of the life insurance policies or the payment of personal legal fees was approved by the ISI board or its shareholders as required by ISI's bylaws.

¶ 34 By making these payments, Fugett and Koziol improperly transferred ISI assets in derogation of corporate rules and regulations. These acts require the appointment of a receiver under section 12.60 of the Act. See *Witters*, 335 Ill. App. 3d at 441-42.

¶ 35 C. Transfer of Assets to Other Entities

¶ 36 Garbrecht also claims that Fugett and Koziol made numerous unapproved transfers of corporate assets to other corporate entities in which Garbrecht was not a shareholder. He argues that such inappropriate transfers raise questions as to corporate preservation and also require a receivership.

¶ 37 Corporate records indicate that in 2012 Fugett and Koziol began transferring business opportunities and assets from ISI to ICH. Fugett and Koziol testified that in 2012 and 2013, ISI purchased equipment and sold the equipment to ICH for business purposes. However, the ledgers for 2012 and 2013 show no record of the sale of ISI equipment to ICH. Fugett and Koziol also created Capers, LLC, naming themselves as the sole shareholders. In 2012, Fugett and Koziol began taking all Capers software customers, formerly customers of ISI, and moving them into a separate corporate entity. According to Fugett's own testimony, that plan included discussions that Fugett and Koziol would be the sole owners of the entity to which ISI software

business was being transferred. The record does not clearly demonstrate that Garbrecht agreed to these transfers or that he agreed to the creation of a separate corporate entity for Capers software business. Moreover, Koziol testified that all of the money deposited into the Capers checking account was transferred back to ISI. However, it appears that nothing in the corporate balance sheets, ledgers or tax returns supports that claim. These transfers reflect the types of corporate dissipation and waste that warrant the appointment of a receiver. See *Witters*, 335 Ill. App. 3d at 441.

¶ 38 III

¶ 39 Defendants maintain that the trial court's decision should be affirmed because there was no evidence that there was a serious suspension of business or imminent danger of dissipation of ISI's assets. Specifically, they note that for the first six months of 2013, the balance sheets indicate that corporate revenue was already $1,700,000 and that the company is profitable. Gross revenue, however, does not demonstrate that a company is profitable or that there is no danger of asset dissipation. In this case, the cash flow sheets from 2009 through 2013 demonstrate that the company had $453,794.11 in cash as of December 2009 and -$4,288.15 in cash as of February 2013. These numbers suggest that ISI may not be profitable and that a serious suspension of business is perhaps imminent. The appointment of an interim receiver is appropriate to preserve the assets that remain.

¶ 40 In *Witters*, the appellate court concluded that the defendant's misappropriation of assets and corporate opportunities required the appointment of an interim receiver to protect the other shareholders from the controlling owner's alleged misconduct. *Witters*, 335 Ill. App. 3d at 442-44. The misconduct consisted of using corporate employees and equipment for his own personal benefit, creating other entities and having those entities pursue the corporation's business

opportunities, and having the corporation pay rent to another business held in the controlling owner's name. The trial court appointed a receiver, and the appellate court affirmed, stating that "it would have been an abuse of discretion not to do so." *Witters*, 335 Ill. App. 3d at 444. Given the improper conduct and dubious transfers in this case, most of which were testified to by Fugett and Koziol, the trial court's refusal to appoint an interim receiver under section 12.60 was an abuse of the court's discretion.

¶ 41 CONCLUSION

¶ 42 The judgment of the circuit court of Will County is reversed, and the cause is remanded for further proceedings.

¶ 43 Reversed and remanded.