

Illinois Business Divorce Report

Information on the dissolution of Illinois corporations, LLCs and partnerships

Individual's Use of Company Funds to Defend Business Divorce Cases

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Unfortunately, corporate officers and directors and LLC managers and members may find themselves involved in business divorce cases. Until these lawsuits reach their ultimate conclusion, these individuals may steadily accrue significant legal fees and, when they do, they will inevitably turn to the corporation or LLC for payment of these fees.

In this context, the term “indemnification” refers to the right of the individual to ultimately be reimbursed for these legal fees. In contrast, the term “advancement” refers to immediate interim relief for ongoing legal expenses, where the funds are advanced on credit while awaiting a final determination on indemnification.



Corporations

Typically, a corporation's bylaws provide that the corporation may indemnify an officer or director for legal fees incurred as a result of actions taken in the individual's role as officer or director. Consequently, individual clients often ask whether the business can pay the legal fees that they are incurring while defending a business divorce case — as those fees are accruing and before a final disposition of the case.

First, corporate officers and directors may be indemnified in situations where they acted in good faith and in a manner they reasonably believed to be in, or not opposed to, the best interests of the company. [805 ILCS 5/8.75\(a\)](#). However, the determination of whether indemnification is proper under this standard must be made by: (a) the majority vote of the directors who are not parties to such suit, even though less than a quorum; (b) by a committee of such directors, even though less than a quorum, designated by a majority vote of such directors; (c) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion; or (d) by the shareholders. [805 ILCS 5/8.75\(d\)](#).

Second, attorneys' fees incurred by an officer or director in defending a civil suit may be paid by the corporation in advance of the final disposition of the case upon receipt of an undertaking — such as a promissory note — by the officer or director to repay the advanced funds if it is ultimately determined that he or she is not entitled to be indemnified by the corporation. [805 ILCS 5/8.75\(e\)](#). The advancement of funds is not preconditioned on a finding of the directors, independent counsel, or shareholders that indemnification is proper. *Johnson v. Gene's Supermarket, Inc.*, 117 Ill. App. 3d 295 (4th Dist. 1983).

LLC's

The Illinois LLC Act provides that an LLC may reimburse a member or manager for liabilities incurred by him or her in the ordinary course of business or for the preservation of the LLC's business or property. [805 ILCS 180/15-7](#). However, in contrast to the Business Corporation Act, the LLC Act does not address: (a) the requisite standard

for determining whether indemnification is proper; or (b) advances prior to a final determination.

It is often said that LLC's are "creatures of contract" because state LLC acts give maximum effect to the principle of freedom of contract and the enforceability of limited liability agreements. Therefore, these issues, which are not expressly covered in the Illinois LLC Act, should be expressly covered in the LLC's operating agreement. *E.g.*, *Fillip v. Centerstone Linen Services, LLC*, 2014 WL 793123 (Del. Ch. Feb. 20, 2014) (applying Delaware law and requiring advances to former manager and officer of LLC).

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