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A Note by Any Other Name, or What Is a "Security"

BY CHRISTOPHER C. KENDALL

THE ILLINOIS SECURITIES LAW allows for a prevailing plaintiff to recover their attorney's fees. 815 ILCS 5/13(A). As such, plaintiffs' lawyers will sometimes seek to fit a square peg into the round hole that is the definition of a "security" under the statute.

In *Stukel v. Rowe*, 2024 IL App (3d) 230272-U, the plaintiff Stukel brought suit against 15 defendants after one of the defendants failed to pay on a promissory note given in exchange for loans Stukel made in connection with two real estate projects. Among the defendants were Scott Rowe ("Rowe"), who had appeared in a video promoting the investment and had participated in helping secure the loan from Stukel, and Nancy Rowe. *Id.*, ¶11. Claims against Rowe included a count for violation of the Illinois Securities Law. Plaintiff alleged that the promissory note was a "security" under the Securities Law and that Rowe had acted as a salesperson in connection with the sale.

The case went to trial, with the jury finding in favor of the plaintiff for $87,000. The Court then awarded the plaintiff $102,704 in attorney's fees and costs. The defendant appealed.

To recover under the Illinois Securities Law, the plaintiff had to prove that the promissory note was a "security" as defined under the Securities Law. Plaintiff's theory

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Recent Amendments to the Illinois Biometric Information Privacy Act

BY NIKHIL A. MEHTA

IN AUGUST 2024, ILLINOIS GOVERNOR J.B. Pritzker signed Senate Bill 2979 (SB 2979) into law, amending the state's Biometric Information Privacy Act (BIPA). BIPA regulates the collection, use, and storage of biometric data like fingerprints and facial recognition, and has long been recognized as one of the more unique and restrictive biometric privacy laws in the U.S. The recent amendments bring significant changes, particularly with respect to liability and consent procedures, which will impact businesses, privacy advocates, and legal professionals alike. The amendments are codified in Illinois Public Act 103-0666 (the "Amendment").

1) Limitation of Liability

One of the more notable changes introduced by the Amendment is a

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was that the promissory note was indeed a security because repayment of the loan was "contingent upon the completion of" a construction project for which the loan was provided.

> The Securities Law defines "security" as: "any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, *** or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."
> 815 ILCS 5/2.1 (West 2012).

Though the statutory definition of "security" expressly references "note," the Illinois Appellate Court has explained that "a security within the meaning of the securities laws is a contract, transaction or scheme whereby one person invests his money in a common enterprise on the theory that he expects to receive profits solely from the efforts of others." *Id.* at ¶29, quoting *Boatmen's Bank of Benton v. Durham*, 203 Ill. App. 3d 921, 927 (1990).

Stukel argued that this standard was met because he was not to be repaid on the promissory note "until project completion" and therefore repayment was contingent "on the efforts of others." *Id.,* ¶30. The court rejected this argument. In doing so, it noted that "this is not the sole factor we must consider." Rather, the court stated that it must also "consider whether the note was an investment and whether that investment entitled Stukel to retain *profits* from the project." *Id.,* ¶30 (emphasis added). The court further explained that it would not put form over substance but would rather examine the substance of the transaction. *Id.*

The substance included looking at Stukel's relationship with the other parties, his expectations in lending the funds for the project, and whether he would receive part of the profits from the project. *Id.*

Examining these factors, the court noted that Stukel was not to receive any profits but rather only repayment of principal plus the agreed upon interest. *Id.,* ¶31. Importantly, the court stated that the "project completion" that triggered repayment "may be reached when it is determined that the project can no longer continue and must be abandoned." In support of this conclusion, the court cited the plaintiff's testimony that he believed he was providing a loan and "expected repayment of that loan even if the project failed." *Id.,* ¶31. In this manner, the legal obligation to repay was not dependent upon either profits or the efforts of others (even if the *ability to pay* was dependent upon the success of the underlying project).

The court concluded that Stukel was a "passive lender" akin to a bank and therefore not a security under Illinois' Securities Law. Since the note was not a security, the individual defendant could not be liable for a Securities Law violation. Accordingly, the appellate court reversed the trial court's denial of the defendant's post-trial motion that had challenged the jury's verdict of a violation of the Securities Law.

With the claim under the Securities Law overturned, the Appellate Court also explained that the plaintiff "is no longer entitled" to attorney's fees. Hence, the result of the appeal was that the promissory note did not live by any other name, or at least not by the name "security," rendering the outcome against the Rowes not as sweet as it otherwise had been.

The fact that the court looked to form over substance, and also considered parol evidence, is another reminder that plaintiff's lawyers looking to bring claims under the Illinois Securities Law in an effort to recover attorneys' fees must look closely at whether a "note" satisfies the statutory definition of a "security." On the other hand, this case also highlights that notwithstanding the fact that the statutory definition of "security" includes reference to a "note," most traditional promissory notes (where the lender does not share in the profits of the underlying enterprise) are not "securities" as defined by the law. ■

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limitation of liability for any violations under BIPA. Under the original law, businesses faced substantial financial penalties for each instance of biometric data collection which were conducted without proper consent. These "per-scan" damages, could result in potentially significant uncapped liability for businesses. The Amendment changes this by limiting liability to only a single violation per individual, regardless of the number of biometric scans collected for that individual. This change reduces the risk of excessive financial penalties for businesses, while still protecting consumers.

2) Electronic Consent

The Amendment also modified the consent requirements for biometric data collection. Previously, BIPA required businesses to obtain a written release from individuals before collecting their biometric data. The Amendment expands the definition of "written release" to include "electronic signature," which allows for individuals to provide digital consent. This change aligns BIPA with current business practices, especially with respect to online transactions or remote interactions, and makes it easier for businesses to comply with the law without needing to rely on traditional paper-based consent forms.

3) Scope of Applicability and Compliance Clarity

The Amendment also provides greater clarity regarding BIPA's scope and the overall compliance obligations for businesses. By more clearly defining when biometric data collection will trigger consent requirements under the act, the Amendment helps businesses better understand the circumstances under which consent must be obtained from individuals. This clarification reduces potential ambiguity and the likelihood of BIPA violations in the future.

4) Enforcement and Penalties

Despite these changes, private individuals and the Illinois Attorney General still have the right to pursue enforcement actions for any violations of BIPA. However, due to the limitation of liability provisions and more convenient consent requirements, the volume of litigation is expected to decrease.

Conclusion

The BIPA Amendment strikes a balance between protecting individual privacy and accommodating the needs of businesses that utilize biometric data. By limiting liability to a single violation per person and allowing for electronic consent, the law reduces potential financial burdens on businesses while maintaining its core mission of safeguarding the biometric information of consumers. ■

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Third Circuit Embraces De Novo Review of Demand Futility Dismissals, Overruling Prior Precedent and Joining Delaware Supreme Court and Other Circuits

BY JAY R. SCHLEPPENBACH

UNDER THE FEDERAL RULES OF Civil Procedure, complaints in derivative lawsuits must "state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort."[1] As the Delaware Supreme Court has explained it, "the demand-futility analysis provides an important doctrinal check that ensures the board is not improperly deprived of its decision-making authority."[2] Because derivative suits, by their very nature, are attempts by corporate stakeholders other than the board to bring claims held by the corporation, they "encroach[] on the managerial freedom of directors by seeking to deprive the board of control over a corporation's litigation asset."[3] For decades, courts have therefore dismissed derivative suits for failure to properly allege demand futility.[4] But for almost as long, the standard of review appellate courts should apply to such dismissals has been in flux, with courts seeming to gradually move from an abuse of discretion standard to de novo review.[5] Recently, in *In re Cognizant,* the United States Court of Appeals for the Third Circuit became the latest court to adopt de novo review, overruling its prior precedents.[6]

The underlying complaint in *Cognizant* was filed in the United States District Court for the District of New Jersey, alleging that various directors and officers breached their fiduciary duties by ignoring red flags indicating that employees in India were potentially engaged in bribery and violations of the Foreign Corrupt Practices Act.[7] The plaintiff stockholders had not made a pre-suit demand on Cognizant's board, and the defendants moved to dismiss, pointing out the lack of a demand as well as plaintiffs' failure to state with particularity why demand would have been futile.[8] The district court agreed and dismissed the case.[9]

On appeal, the Third Circuit, sitting *en banc*, considered the proper standard of review before proceeding to the merits of the demand futility dismissal.[10] More than 30 years earlier, in 1992, the court had held that such determinations should be reviewed for abuse of discretion, though the "choice of legal precepts" to be applied would be reviewed de novo.[11] But in the intervening years, the court acknowledged, the Delaware Supreme Court and many sister circuits had all adopted a de novo standard of review for demand futility dismissals.[12] And, the court reasoned, "when other courts largely disapprove of our reasoning in more recent decisions, those contrary views may impel us to consider whether the reasoning applied by our colleagues elsewhere is persuasive."[13] The court found this to be one of those cases.[14]

Considering the appropriate standard of review anew, the court applied several "significant relevant factors" the Supreme Court has identified as relevant to whether deferential or de novo review should be employed:

> (1) whether, as a matter of the sound administration of justice, one judicial actor is better positioned than another to decide the issue in question; (2) the nonamenability of the problem to rule, because of the diffuseness of circumstances, novelty, vagueness, or similar reasons that argue for allowing experience to develop; (3) the language and structure of the governing statute or rule; and (4) whether the decision under review ordinarily has such substantial consequences that one might expect it to be reviewed more intensively.[15]

The court concluded that each of these factors favored a de novo standard of review.[16] District courts were in no better position to assess demand futility than appellate courts, as "an appellate court performs exactly the same task as when reviewing the dismissal of any other action: the court reads the facts alleged in the complaint, assumes the truth of those facts, and decides whether those facts state a claim under the applicable legal standard."[17] As to the second factor, "doctrines of demand futility are reasonably uniform and amenable to general rules that cover a wide range of circumstances."[18] Third, nothing in the language or structure of Rule 23.1 or applicable state law suggested a preference for abuse of discretion review.[19] Finally, demand futility review could have substantial consequences, namely the outright dismissal of a derivative action, that warranted more intensive review.[20] Thus, the court found that de novo review was the appropriate standard.[21]

Thus, the Third Circuit has aligned itself with the consensus approach favored by the Delaware Supreme Court and other circuit courts, adopting a more searching standard of review for demand futility decisions. It remains to be seen whether this change will result in more reversals in cases dismissed on the basis of demand futility, but at a minimum, directors and officers within the Third Circuit (and those who advise them) should be aware of the new standard and plan accordingly. ■

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1. Federal Rule of Civil Procedure 23.1.
2. *United Food & Commercial Workers Union v. Zuckerberg*, 262 A.2d 1034, 1049 (Del. 2021).
3. *Id.* at 1047.
4. Andrew S. Hirsch, *Dismissing Derivative Actions in the Federal Courts for Failure to Allege Demand Futility: Choosing a Standard of Appellate Review--Abuse of Discretion or De Novo?*, 64 Emory L. J. 201 (2014).
5. *Id.*
6. *In re Cognizant Technology Solutions Corporation Derivative Litigation*, 101 F.4th 250 (3d Cir. 2024) (en banc).
7. *Id.* at 254.
8. *Id.* at 255-56.
9. *Id.*
10. *Id.* at 256.
11. *Blasband v. Rales*, 971 F.2d 1034 (3d Cir. 1992).
12. *In re Cognizant*, 101 F.4th at 258-59 (citing *Brehm v. Eisner,* 746 A.2d 244 (Del. 2000); *Espinoza ex rel. JPMorgan Chase & Co. v. Dimon*, 797 F.3d 229, 235–36 (2d Cir. 2015); *Unión de Empleados de Muelles de P.R. PRSSA Welfare Plan v. UBS Fin. Servs. Inc. of P.R.*, 704 F.3d 155, 162–63 (1st Cir. 2013); *In re Ferro Corp. Derivative Litig.,* 511 F.3d 611, 617 (6th Cir. 2008); *Westmoreland Cnty. Emp. Ret. Sys. v. Parkinson*, 727 F.3d 719, 724–25 (7th Cir. 2013); *Gomes v. Am. Century Cos., Inc.*, 710 F.3d 811, 815 (8th Cir. 2013); *City of Cambridge Ret. Sys. v. Ersek*, 921 F.3d 912, 917–18 (10th Cir. 2019)).
13. *Id.* at 258 (cleaned up).
14. *Id.* at 258-59.
15. *Id.* at 259-60 (citing *Pierce v. Underwood*, 487 U.S. 552, 559, 563 (1988) (internal quotations omitted)).
16. *Id.* at 260-61.
17. *Id.* at 260.
18. *Id.*
19. *Id.* at 261.
20. *Id.*
21. *Id.*

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