BY WILLIAM J. ANAYA

Old Wine in New Cases

A primer on settled law associated with modern real estate transactions.

IN *SMART OIL LLC v. DW MAZEL, LLC*,[1] THE U.S. COURT OF APPEALS for the Seventh Circuit confirmed that lawyers are essential in real estate transactions. The Seventh Circuit recognized its role in interpreting contracts and giving effect "to the intention of the parties as expressed in the agreed terms."[2] Lawyers are the client's advocate, charged with articulating the client's precise intentions in the agreement, and then guiding the transaction with careful attention to detail through closing. The court noted that "[t]he first and most reliable indication of the parties' intent is what the parties wrote."[3] In *Smart Oil*, the court rolled up its sleeves, analyzed current facts, and applied well-settled law commonly relied upon by real estate lawyers. The case offers insights to environmental and real estate lawyers and a cautionary tale for those who seek to cleverly avoid or circumvent settled law in modern real estate transactions. Lawyers representing sellers and buyers in transactions and litigation are well served in reading this Seventh Circuit's primer on settled law in Illinois.

Facts

In *Smart Oil LLC*, the seller agreed to sell and the buyer agreed to buy 30 gasoline stations and convenience stores in Illinois. The sales price was roughly $67 million. The parties entered into a written agreement that provided an earnest money deposit of approximately 1 percent of the

1. *Smart Oil LLC v. DW Mazel, LLC*, 970 F.3d 856 (7th Cir. 2020).
2. *Id*. at 860.
3. *Id*.

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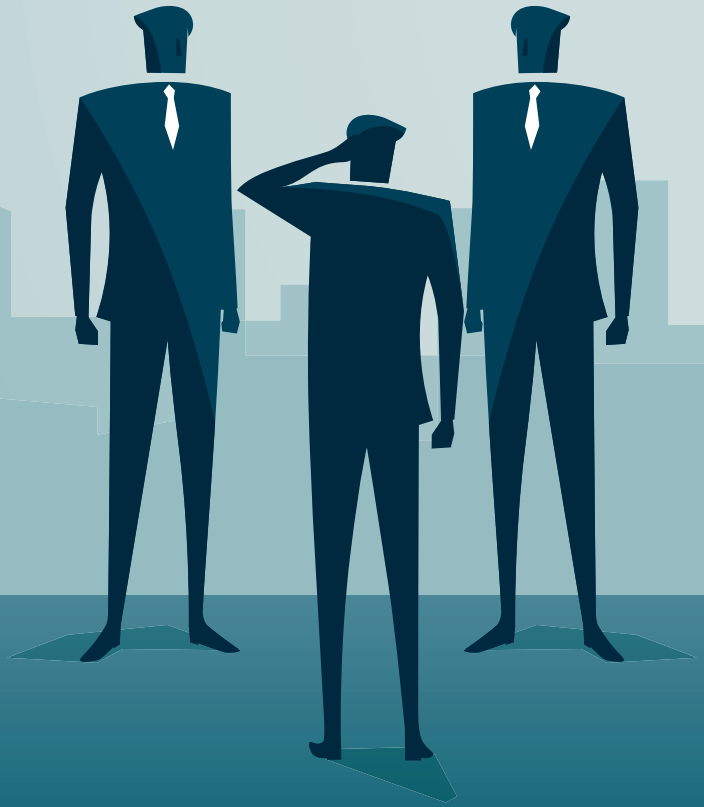

TAKEAWAYS >>

- Illinois law should be used in agreements that involve Illinois property or clients in Illinois.

- If you are relying on the absence of evidence, document why evidence is not available and present it with a motion to dismiss. Without documenting it, evidence of no evidence is no evidence at summary judgment or trial.

- Absent a clear intention, courts will only review the precise language provided in an agreement.

EVIDENCE OF NO EVIDENCE IS RARELY, IF EVER, PROBATIVE EVIDENCE OF ANYTHING—CERTAINLY NOT AFTER A MOTION TO DISMISS.

sales price, plus a due-diligence period during which the buyer had the option of terminating the transaction if the buyer was unsatisfied with what it learned. The agreement also provided that its terms were to be interpreted by Illinois law, with a liquidated-damages clause that provided: "If Buyer defaults in its performance … under this Agreement, including the obligation of Buyer to purchase the Property if all conditions precedent to such obligations has [sic] been satisfied, Seller shall receive the entire Earnest Money Deposit and all accrued interest thereon as complete liquidated damages." To make the point clear, the parties provided in all capital letters: "IT BEING UNDERSTOOD THAT THE DAMAGE TO SELLER CAUSED BY ANY SUCH DEFAULT OF BUYER WOULD BE EXTREMELY DIFFICULT TO OR IMPOSSIBLE TO ASCERTAIN."[4]

There were two wrinkles in the facts to consider: 1) The seller did not own the 30 parcels at the time of the agreement but reportedly had written agreements with the owners of those 30 parcels and the authority to obtain those parcels to perform under the agreement; and 2) the buyer never provided the earnest money of approximately $750,000.

Litigation

As lawyers understand, there would be no litigation to discuss had the transaction closed without incident. But here, the buyer refused to close and the seller sued, seeking the earnest money as its liquidated damages. The buyer argued that the seller had not performed all of the requirements under the agreement and that the seller had not provided all of the required due-diligence documents. The buyer also counterclaimed that the seller had breached the agreement and had intentionally and fraudulently induced the buyer to sign the agreement.

The district court found for the seller and against the buyer, and the Seventh Circuit affirmed.

Choice-of-law provision

The Seventh Circuit first confirmed that the parties' choice of Illinois law described in the agreement was proper, holding that federal court's sitting in diversity should honor an agreement's choice-of-law provision in the absence of a contrary public policy.[5]

***Practice pointer**: Illinois law is well-developed, good law and should be used in agreements that involve Illinois property or clients in Illinois.*

Breach of contract

The Seventh Circuit then analyzed the seller's claim of breach of contract pursuant to Illinois law and found that plaintiffs are required to prove: 1) the existence of a contract; 2) that plaintiff performed the conditions precedent required by the contract; 3) the defendant breached the contract; and 4) damages.[6]

After confirming that an agreement existed, the issue for the Seventh Circuit was whether the seller had performed the conditions precedent—conditions "that must be met before a contract becomes effective or that is to be performed by one party to an existing contract before the other party is obligated to perform."[7] In this instance, the court found the agreement described four conditions precedent: 1) delivery of due-diligence materials; 2) delivery of title evidence; 3) completion of an inventory; and 4) a requirement that the seller's representations remain accurate at closing.[8] The buyer alleged that the seller was unable to perform the conditions precedent because the seller was not the owner of the properties that were the subject of the sale and because the seller had not delivered the documents required for due diligence.

In response to the buyer's claim that the seller was unable to convey the properties to the buyer at closing, the court cited affidavits in the record from 21 of the 30 property owners that supported the seller's claim of authority. Even so, the buyer insisted that affidavits from 21 property owners did not support the seller's authority to sell all 30 of the properties that were the subject of the agreement. The court acknowledged that 21 is not 30, but held that the seller was only required to prove its authority by a preponderance of the evidence—*i.e.*, that it was more likely than not that the seller had the requisite authority. According to the court, "[s]ubmitting declarations from the remaining two-thirds of the property owners—with no evidence to the contrary for the remaining properties and no evidence that [the seller] deceived [the

4. *Id.*
5. *Id* at 861.
6. *Id.*
7. *Id.*
8. *Id.* 861-62.

ISBA RESOURCES >>

- Michael J. Rooney, *Swing and a Miss: Seventh Circuit Ends Hitting Streak*, Real Property (June 2020), law.isba.org/3m0Ry2h.
- ISBA Free On-Demand CLE, *Solutions to Basic Real Estate Issues for New and Non-Real Estate Attorneys* (recorded Feb. 20, 2020), law.isba.org/2ySRrHX.
- William J. Anaya, *What Color Is Your Contract*, Environmental Law (Mar. 2018), law.isba.org/2J0tL4c.

buyer]—satisfied that standard."[9]

Evidence of no evidence is rarely, if ever, probative evidence of anything—certainly not after a motion to dismiss. Note that the court focused on the evidence that had been admitted and in the trial court's record, but ignored evidence of no evidence apparently relied on by the buyer. Evidence of no evidence may be probative and relevant according to the court, but not without evidence explaining why. In this instance, why was it relevant that the seller did not provide affidavits from the other nine property owners? Was it because those other nine were fictitious or fraudulent? In the absence of any evidence explaining the lack of evidence, the court reviewed only the admitted evidence and required that the buyer should have provided evidence that the lack of evidence supporting of the seller's claim was relevant. The buyer did not.

It is curious that the seller was unable to provide the additional affidavits in support of its claim, and that the buyer had no evidence that the remaining nine had not provided the seller with the requisite authority. What happened in discovery? Lawyers are forewarned by the *Smart Oil* case not to rely solely on the lack of evidence as a failure of a plaintiff's case when there is other evidence to the contrary and are admonished to pursue evidence necessary to support the defense. While a plaintiff's wholesale failure to provide any evidence may support a motion to dismiss under Federal Rule of Civil Procedure (FRCP) 12, relying on partial evidence of no evidence at summary judgment pursuant to FRCP 56 is a risky—and likely losing—gambit.

Practice pointer: *If you are relying on the absence of evidence, document why evidence is not available and present it with a motion to dismiss. Without documenting it, evidence of no evidence is no evidence at summary judgment or trial.*

Due diligence

In this agreement, the parties also provided that "[o]n or before the expiration of the Due Diligence Period, Buyer shall deliver to Seller; Buyer's written notice of its disapproval of its due diligence investigations for the Property. Buyer's failure to timely deliver such notice shall be deemed Buyer's approval of such investigations."[10] The buyer argued that the seller had failed to deliver necessary due-diligence documents and that the parties had agreed to an extension of the due-diligence period; therefore, the buyer should be excused from the required notice of disapproval necessary to terminate the agreement. The court did not agree that the seller had failed to deliver the necessary documents to the buyer. And even so, the court held that the purported failure to deliver the documents, as well as the purported extension, were not tantamount to a notice of disapproval and termination of the agreement, and held the buyer to the strict language in the agreement.

Practice pointer*: Lawyers are well advised to document extensions timely, and to specifically refer to the continuing term of the agreement with a specific reference to the operation of a continuing right to terminate the agreement—or, if necessary, to formally terminate the agreement. Informal agreements are meaningless in court. In the absence of a clear intention otherwise, courts will only—and correctly—review the precise language provided in the agreement. Informal agreements or understandings that are not fully and properly documented are meaningless in court.*

It is difficult to understand how the parties could ignore such formalities in a $67 million agreement. The buyer's claims to the contrary seem to be mere *ad hoc* explanations. Regardless, the court found that the seller had performed its obligations and the buyer had breached the agreement and held that the seller was entitled to damages (in this case, liquidated damages).[11]

Liquidated damages

Recall that the agreement provided for liquidated damages in the event of the buyer's default. Remember, too, that the liquidated damages were described in the agreement as the earnest money provided according to the agreement. Also remember that the buyer never delivered any earnest money (described in the agreement as two installments totaling approximately $750,000). Again, the failure to pay attention to this detail in a $67 million transaction is remarkable and provided the buyer with the argument that because the buyer had never deposited the earnest money, there were no damages available to satisfy the seller for the buyer's breach of contract.

THE COURT'S ANALYSIS IS SIMILAR TO THE MAXIM IN EQUITY THAT BARS RELIEF TO A PARTY WITH UNCLEAN HANDS DUE TO FRAUD, DECEIT, UNCONSCIONABILITY, OR BAD FAITH, AND THE COURT ADDRESSED THE PURPORTED DEFENSE BY REFERRING TO A STRICT READING OF THE AGREEMENT. BUT NOT ALL COURTS ARE AS MINDFUL OF ITS ROLE.

The court took great pains to analyze the liquidated-damages clause at issue in the agreement. First, the court defined liquidated damages in Illinois and found that "[a] liquidated damages clause provides a predetermined remedy in the event a party breaches."[12] The court cited authority that the predetermined amount may or may not exceed the actual damages "and both parties agree to accept this inherent risk."[13] Moreover, the court found that "[a]n unreasonably large liquidated damages clause is unenforceable under Illinois law on grounds of public policy."[14] Citing settled law in Illinois, the court

9. *Id*. at 862.
10. *Id*.
11. *Id*. at 863.
12. *Id*. (internal citations omitted).
13. *Id*. (internal citations omitted).
14. *Id*. (internal citations omitted).

also found that "[w]hether a liquidated damages clause in a contract is a penalty or a valid provision is a question of law" according to *Grossinger Motor Corp, Inc. v. American National Bank & Trust Co.*[15] In addition, the burden of proof "rests on the party resisting enforcement of a liquidated damages clause to show that the agreed-upon damages are clearly disproportionate to a reasonable estimate of the actual damages likely to be caused by a breach."[16]

Citing more settled law in Illinois, the court found that liquidated-damages clauses are valid and enforceable if: "(1) the parties intended to agree in advance to the settlement of damages that might arise from the breach; (2) the amount of damages was reasonable at the time of contracting; [and] (3) actual damages would be uncertain in amount and difficult to prove."[17] While the court commented that Illinois' analysis of reasonableness in interpreting liquidated damages clauses is "mysterious," especially when interpreting such clauses negotiated by sophisticated parties, the court noted that "the rule against contractual penalties 'hangs on' but is chastened by an emerging presumption against interpreting liquidated damages clauses as penalty clauses."[18] The court noted that federal courts are not at liberty to change state law and may only apply it even if other states consider the policy differently.

***Practice pointer**: The court's analysis is an excellent summary of Illinois law in 2020. Every lawyer in Illinois should be aware of it when preparing or litigating a contract.*

When the court analyzed the precise terms of the liquidated-damages clause at issue (described above), it found that "the plain language of the Agreement satisfies two of the three elements of liquidated damages under Illinois law."[19] That is, the court found that both parties consented to the clause and agreed that damages for breach would be difficult to ascertain. The open question for the court to determine, as a matter of law, was whether the damages were reasonable.

The court noted that the liquidated-damages clause in this case amounted to approximately 1 percent of the sale price and cited Illinois cases where state courts had approved liquidated-damages clauses up to 20 percent of the sales price. Accordingly, the court had little trouble finding that the liquidated-damages clause in the case under review was reasonable.

***Practice pointer**: Liquidated-damages clauses have been misunderstood for years, especially following* Grossinger. *Keep in mind the Seventh Circuit's reference to a presumption, especially in cases involving sophisticated parties.*

Next, the buyer argued that the seller had not suffered any actual damages and therefore should not be awarded any liquidated damages. But the court held that "actual damages are not required under Illinois law before liquidated damages can be assessed."[20]

***Practice pointer**: Know this rule.*

The buyer also argued that the seller was not entitled to liquidated damages described in the agreement as the earnest money because the buyer had never deposited any earnest money. According to the buyer, there was nothing for the seller to recover. Undeterred, the court cited the unambiguous terms of the agreement: The "[s]eller shall receive the entire Earnest Money Deposit and all accrued interest thereon as complete liquidated damages."[21]

The court noted that the "Earnest Money Deposit" was defined in the agreement as "the Deposit and the Additional Deposit" of $300,000 at the time of the contract and $450,000 at the close of the due-diligence period.[22] After reinforcing that "shall" means "mandatory" in Illinois, the court noted that "[a]lthough the agreement describes the earnest money due as a 'Deposit,' it does not limit the liquidated damages to funds actually deposited."[23] The court admonished the buyer and stated: The buyer not having "to pay the earnest money deposit because it never paid it in the first instance would result in the absurd outcome of wrongdoers being absolved of their debts simply by not paying them."[24]

The court's analysis is similar to the maxim in equity that bars relief to a party with unclean hands due to fraud, deceit, unconscionability, or bad faith, and the court addressed the purported defense by referring to a strict reading of the agreement. But not all courts are as mindful of its role.

***Practice pointer**: Be precise in preparing the agreement, diary the dates, and insist on strict performance of the terms. Do not rely on a court to strictly review the terms of the agreement, even if that is its charge.*

Fraudulent inducement

As its final argument, the buyer insisted that the seller "knowingly made false statements concerning its ability to complete a sale under the Agreement" to falsely induce the buyer to sign the agreement.[25] Citing more settled law in Illinois, the court found that to prove fraudulent inducement, a party must show: "(1) a false statement of a material fact; (2) knowledge or belief by [the seller] that the statement was false; (3) an intention to induce [the buyer] to act; (4) reasonable reliance upon the truth of the statement by [the buyer]; and (5) damages."[26] Citing the record on appeal adduced by the district court, the Seventh Circuit found no such evidence in the record to support the buyer's claim.

Attorney fees

Finally, the court acknowledged that the agreement under review provided for an award of attorney fees to the prevailing party and ordered the seller to submit an application for fees to the court to be

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15. *Grossinger Motor Corp, Inc. v. American National Bank & Trust Co.*, 240 Ill. App. 3d 737 (1st Dist. 1992).
16. *Smart Oil*, 970 F.3d at 856 (internal citations omitted).
17. *Id.* (internal citations omitted).
18. *Id.* (internal citations omitted).
19. *Id.* at 864.
20. *Id.* (internal citations omitted).
21. *Id.* at 865.
22. *Id.*
23. *Id.*
24. *Id.* (citing *Summers v. Hedenberg*, 198 Ill. App. 460, 467 (holding that Buyer "cannot insist on abandoning [its] contract and yet [not pay] the deposit because that would enable [it] to take advantage of [its] wrong.")).
25. *Smart Oil*, 970 F.3d at 865.
26. *Id.* at 866 (internal citations omitted).

included in the final judgment in favor of the seller.[27]

Practice pointer: *Attorneys are well advised to include an attorney-fees clause in every agreement that provides the court with authority to award the substantially prevailing party attorney fees and costs that may be included in the judgment.*

Conclusion

Illinois courts tend to be dismissive of current cases that involve settled law. But federal courts are willing to review current contract disputes that involved settled law and strictly interpret "a contract to give effect to the intention of the parties as expressed in the agreed terms" citing two recent federal decisions in *Life Plans, Inc.*[28] and *Ocean Atlantic Development Corp. v. Aurora Christian Schools, Inc.*[29] With the recent amendment of Illinois Supreme Court Rule 23, perhaps we can expect better analysis from the Illinois Appellate Court, similar to the attention provided by the Seventh Circuit.

Old wine in new bottles—settled law applicable to new cases—continues to deserve judicial attention. *Smart Oil, LLC* provides an excellent primer for all commercial real estate lawyers involved in transactions and litigation. IBJ

27. *Id*.
28. *Life Plans, Inc. v. Security Life of Denver Insurance Co.*, 800 F.3d 343, 349 (7th Cir 2015).
29. *Ocean Atlantic Development Corp. v. Aurora Christian Schools*, 322 F.3d 963, 1006 (7th Cir. 2003).