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Even law firms can be duped by e-r

STEVEN P. GARMISA
Hoey & Farina

Escrow deal shields seller from penalty

GK Development Inc. v. Iowa Malls Financing Corp.

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The question for the Illinois Appellate Court was whether a contract provision that called for returning the escrowed funds to GK Development was an unenforceable penalty.

When GK Development was negotiating to buy the mall for $38.5 million, Hy-Vee Food Stores was planning on expanding into space

IN THE NEWS

BY CHRISTINE M. PUSATERI

During the Pro Bono & Community Service Initiative's January Donate-A-Day at Our Lady of Charity School in Cicero, third-year DePaul University College of Law students Michelle Cass (left) and Evelyn Galindo update the library from a card catalog system to storing its list of books in a Library of Congress database. The event occurred on Jan. 25. *Ben Speckmann*

IN THE LAW FIRMS

Nixon, Peabody LLP elected **Sorinel Cimpoes** to partner. Cimpoes provides patent

that had been vacated by Wal-Mart. Because of the risk that the anchor tenant might balk, GK Development insisted on escrowing $4.3 million of the purchase price pending (a) execution of a new lease by Hy-Vee; (b) the tenant's acceptance of the remodeled premises; and (c) Hy-Vee's receipt — by Oct. 31, 2005 — of all permits needed to open the new store.

If these conditions were satisfied, the seller was supposed to get the escrowed money (called the Hy-Vee holdback). But if the specified events failed to occur, the contract called for returning $4.3 million to the buyer.

In setting the amount of the Hy-Vee holdback, GK Development's primary negotiator calculated that $4.3 million was the present value of the 20-year lease that was being negotiated as part of the Hy-Vee expansion.

Hy-Vee signed the new lease and moved into the remodeled store. But there was a 91-day delay in obtaining the permits required to open, and GK Development wound up losing around $141,000 in rent plus three months of the tenant's pro rata share of real estate taxes and common area maintenance.

Although Hy-Vee started paying rent under the new lease after the three-month delay, GK Development sued in Cook County, arguing that the $4.3 million Hy-Vee holdback was a valid liquidated-damages provision.

The trial judge ruled against the seller, but the Illinois Appellate Court reversed — concluding that the Hy-Vee holdback was "invalid and unenforceable" because it "1) does not meet the three requirements necessary to validate a liquidated-damages clause, 2) results in a windfall to [the] buyer and 3) functions as a penalty for nonperformance."

On remand, though, the buyer will get "an opportunity to prove its actual damages." *GK Development Inc. v. Iowa Malls Financing Corp.*, 2013 IL App (1st) 112802 (Dec. 19, 2013).

Here are highlights of Justice Nathaniel Howse Jr.'s opinion (with omissions not noted in the text):

When interpreting contract provisions that specify damages, Illinois courts draw a distinction between liquidated damages, which are enforceable, and penalties, which are not. *Checkers Eight Ltd. v. Hawkins*, 241 F.3d 558 (2001).

"The test for determining whether a liquidated-damages clause is valid as such or is void as a penalty is stated in Section 356 of the Restatement (Second) of Contracts: 'Damages for breach by either party may be liquidated in the

NOTEBOOK, *Page 5*

portfolio strategic advice and defense and has experience with mechanical and electromechanical technologies.

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Latimer, LeVay, Fyock LLC added **Susan J. Macaulay** as a partner.

She focuses her practice on general corporate matters, including complex mergers and acquisitions, computer hardware and software purchasing, leasing and licensing and private placements as well as secured and unsecured lending.

She was previously with Macaulay Law Ltd.

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Banner & Witcoff Ltd. elected three shareholders.

Audra C. Eidem Heinze joined the firm in 2009. She handles litigation, opinion work and licensing involving patents, trademarks and copyrights.

Brian Emfinger joined the firm in 2012. He concentrates his practice on preparing and procuring patents in the computer, mechanical and electromechanical fields with particular emphasis in computer- and software-implemented inventions.

Matthew J. May joined the firm as a law clerk in 2007 and became an attorney in 2009. He prepares and prosecutes utility and design patent applications for a variety of technological areas, including athletic equipment, medical devices and food and beverage processing systems.

IN THE BAR GROUPS

The Federal Bar Association's Chicago chapter will host "The Right to Counsel & the Criminal Justice Act 50 Years Later: Where Are We Now?" from 2 to 4 p.m. Thursday at the Dirksen Federal Courthouse ceremonial courtroom, 219 S. Dearborn St.

A panel discussion will be moderated by U.S. District Judge **Matthew F. Kennelly**.

The panelists are:

• **Carol A. Brook**, executive director of the Federal Defender Program for the Northern District of Illinois, where she has worked since 1976.

• **Geoffrey Cheshire**, chair of the FBA Criminal Law Section and an attorney with the federal public defender office in Arizona.

• U.S. District Judge **Joan B. Gottschall**, a founder of Chicago's first federal re-entry program.

• **Jonathan Rapping**, president of Gideon's Promise, an organization dedicated to training and supporting public defenders.

• Professor **Randolph N. Stone**, director of the Criminal & Juvenile Justice Project at the University of Chicago's Mandel Legal Clinic. He previously served as the Cook County public defender and was deputy director for the Public Defender Service in Washington, D.C.

The event is free and attendees will earn two hours of Continuing Legal Education credit.

IN THE NEWS, *Page*

Help wanted: Applicants sou federal defender in Central

BY PATRICIA MANSON
Law Bulletin staff writer

A search is under way for Peoria's next top federal defender.

Jonathan E. Hawley is leaving his job as the chief federal public defender for the Central District of Illinois to take the bench. He will replace U.S. Magistrate Judge John A. Gorman, who is retiring at the end of the month.

The 7th U.S. Circuit Court of Appeals will select Hawley's successor in the federal defender's office.

Attorneys in the office represent indigent defendants facing federal criminal charges. They also help train private lawyers appointed under the Criminal Justice Act to represent such defendants.

Jonathan E. Hawley

Nine defenders and nine support staff members work in offices in Peoria, Springfield and Urbana. The defenders also represent clients in R

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agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.' " *Penske Truck Leasing v. Chemetco*, 311 Ill.App.3d 447 (2000) (quoting Restatement (Second) of Contracts Section 356 (1979)).

"It is a general rule of contract law that, for reasons of public policy, a liquidated damages clause that operates as a penalty for nonperformance or as a threat to secure performance will not be enforced." *Jameson v. Kostiner*, 351 Ill.App.3d 416 (2004).

In doubtful cases, we are inclined to construe the stipulated sum as a penalty. *Stride v. 120 West Madison Building Corp.*, 132 Ill.App.3d 601 (1985). Furthermore, "the purpose of damages is to place the non-breaching party in a position that he or she would have been in had the contract been performed, not to provide the non-breaching party with a windfall recovery." *Jobes v. Hryn Development*, 334 Ill.App.3d 413 (2002).

The Jameson Factors

In Illinois, courts will generally find a liquidated-damages provision to be valid and enforceable when the three factors laid out in *Jameson* are satisfied. As stated in *Jameson*, the three elements that must be met in order to validate a liquidated-damages clause are: 1) The parties intended to agree in advance to the settlement of damages that might arise from the breach; 2) the amount of liquidated damages was reasonable at the time of contracting, bearing some relation to the damages which might be sustained and 3) actual damages would be uncertain in amount and difficult to prove. *Jameson*, 351 Ill.App.3d at 423.

Of note, all three requirements must be met in order to enforce a liquidated-damages clause.

Here, the Hy-Vee holdback does not meet the first two requirements of the *Jameson* requirements. As such, the clause is not a valid and enforceable liquidated-damages clause.

The parties did not agree in advance that the $4.3 million would be damages for a delay in obtaining permits.

There is no evidence to suggest that the parties even considered what appropriate damages would be in the event of a minor delay in obtaining permits. Rather, the evidence shows that the parties considered the damages in light of a complete failure of the Hy-Vee lease to come to fruition and, accordingly, estimated the damages as the present-day value of the entire 20-year lease, or the equivalent of $4.3 million.

Because there is no evidence that the parties contemplated damages for a minor delay in obtaining permits at the time of creating the liquidated damages clause, we cannot say that the parties agreed in advance that $4.3 million would represent the damages for any breach, including a delay of 91 days in obtaining permits.

Therefore, the Hy-Vee holdback did not satisfy the first prong of the *Jameson* test and, as a result, it cannot be enforced as a valid liquidated-damages provision.

The amount of liquidated damages bore no relation to the anticipated damages of a delay in performance.

The second *Jameson* element that must be met in order to enforce a liquidated-damages clause is that the amount of the liquidated damages was reasonable at the time of contracting, bearing some relation to the damages that might be sustained.

The holdback amount of $4.3 million simply does not bear any relation to the damages sustained for a 91-day delay in securing permits and, therefore, was not a reasonable prediction of damages.

The Hy-Vee holdback amounted to a windfall recovery for the buyer.

Our courts have invalidated liquidated-damages clauses where they amount to a windfall for one of the parties. *Jobes*, 334 Ill.App.3d at 418. Our courts have also invalidated liquidated-damages clauses based on public policy concerns where the purpose of the clause is to punish nonperformance rather than estimate damages. *Stride*, 132 Ill.App.3d at 605.

In the case at bar, the Hy-Vee holdback must be invalidated based on public policy concerns for both of these reasons because it amounts to a windfall for the buyer and a penalty for the seller's 91-day "non-performance" delay.

The damages awarded from the Hy-Vee holdback, $4.3 million, are grossly disproportionate to the loss the buyer could have sustained in the event of a delay in obtaining construction permits.

The purpose of the Hy-Vee holdback was to secure performance/punish nonperformance.

It is a general rule of contract law that, for reasons of public policy, a liquidated-damages clause which operates as a penalty for non-performance will not be enforced. *Jameson*, 351 Ill.App.3d at 42.

Given that the Hy-Vee holdback of $4.3 million has no reasonable relation to damages caused by a 91-day delay in obtaining permits, the clause was not intended to measure damages in the event of a delay, but rather intended to be a punishment the event of a delay.

The Hy-Vee holdback does not distinguish between minor delays in performance and a complete failure of the Hy-Vee expansion, and there is certainly no per day damage rate that was contemplated by the parties. "The common element to most liquidated-damages clauses that get struck down as penalty clauses is that they specify the same damages regardless of the severity of the breach." *Xco International. v. Pacific Scientific*, 369 F.3d 998 (7th Cir.2004).

"The damages contained in a liquidated-damages clause must be for a specific amount for a specific breach; the provision may not merely serve as a threat to secure performance or as a means to punish nonperformance." *Jameson*, 351 Ill.App.3d at 424.

It is undisputed that the Hy-Vee holdback provided the same amount of damages regardless of the type or extent of the breach.

"When a contract specifies a single sum in damages for any and all breaches even though it is apparent that all are not of the same gravity, the specification is not a reasonable effort to estimate damages; and when in addition the fixed sum greatly exceeds the actual damages likely to be inflicted by a minor breach, its character as a penalty becomes unmistakable." *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284 (7th Cir.1985).

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Chicago Daily Law Bulletin.

Serving the city's law profession since 1854

February 10, 2014

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By Steven P. Garmisa
Hoey & Farina

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