

Loyola University Chicago Law Journal

Volume 19

Issue 2 Winter 1988 1986-1987 Illinois Law Survey

Article 4

1988

Commercial Law

Thomas J. Bamonte

Assoc., Sachnoff, Weaver & Rubenstein, Ltd., Chicago, IL

Molly Mosley

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Thomas J. Bamonte, & Molly Mosley, *Commercial Law*, 19 Loy. U. Chi. L. J. 339 (1988).

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Commercial Law

Thomas J. Bamonte*
and Molly Mosley**

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I. INTRODUCTION

During the *Survey* year, Illinois courts refined established commercial law principles. Cases discussed in this article concern the following topics: business associations,¹ securities regulation,² commercial transactions,³ contracts,⁴ and consumer protection.⁵

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* Associate, Sachnoff, Weaver & Rubenstein, Ltd., Chicago, Illinois; B.A., 1978, University of Chicago; J.D., 1983, Northwestern University.

** B.S., 1986, Northwestern University; J.D. candidate, 1989, Loyola University of Chicago.

1. See *infra* notes 9-47 and accompanying text.

2. See *infra* notes 48-63 and accompanying text.

3. See *infra* notes 64-97 and accompanying text.

4. See *infra* notes 98-218 and accompanying text.

This article will describe also the amendments made by the Illinois Legislature to the Business Corporation Act of 1983,⁶ the Uniform Commercial Code (the "U.C.C."),⁷ and the Illinois Banking Act.⁸

II. BUSINESS ASSOCIATIONS

A. Agency

The Illinois Supreme Court decided one important case in the area of agency law during the *Survey* year. In *Martin v. Heinold Commodities, Inc.*,⁹ the court considered a broker's duty to disclose accurately the sources and amount of brokerage commissions to prospective customers.¹⁰ The court did not treat the issue as a legal question concerning the materiality of the information. Instead, the court held that a broker has, with limited exceptions, no duty to disclose the amount of brokerage fees prior to the actual creation of an agency relationship with the customer.¹¹

In *Martin*, the plaintiff (the "purchaser") purchased securities from defendant Heinold Commodities, Inc. (the "broker"), pursuant to a written customer agreement.¹² The agreement failed to disclose that a significant portion of the brokerage fee constituted additional sales commissions.¹³ In addition, prior to the purchaser's accepting the agreement, the broker misled the purchaser about the purpose of the fee.¹⁴ The purchaser argued that the amount of the brokerage fee was material to his decision whether to invest, and that the broker's failure to disclose this information, therefore, constituted a breach of his fiduciary duty as a matter of law. The broker maintained that it had no duty to fully disclose the amount of its fees prior to the creation of the agency relationship.¹⁵

The court rejected the materiality analysis proffered by the

5. See *infra* notes 219-48 and accompanying text.

6. See *infra* notes 249-50 and accompanying text.

7. See *infra* notes 251-55 and accompanying text.

8. See *infra* notes 256-64 and accompanying text.

9. 117 Ill. 2d 67, 510 N.E.2d 840 (1987).

10. *Id.* at 80, 510 N.E.2d at 845-46.

11. *Id.*

12. *Id.* at 70, 510 N.E.2d at 841. The plaintiff purchaser brought a class action on behalf of similarly situated securities purchasers. *Id.*

13. *Id.* at 75, 510 N.E.2d at 843. According to the agreements, the fee would cover the costs of telephone, telex, bookkeeping, floor brokerage, clearing fees, research costs, and compensating defendant's representatives. *Id.* at 73, 510 N.E.2d at 842.

14. *Id.* at 75, 510 N.E.2d at 843.

15. *Id.* at 76, 510 N.E.2d at 844. Apparently, the broker never disclosed the full amount of its commission after it had created the agency relationship by accepting an executed copy of the customer agreement. *Id.* at 75, 510 N.E.2d at 843.

plaintiff.¹⁶ Instead, it relied upon the rule that an agent has no duty to disclose the terms of its compensation prior to the creation of a fiduciary relationship with a principal.¹⁷ The court recognized two exceptions to this rule.¹⁸ First, a prospective agent may have a duty to disclose the terms of its compensation prior to the formal establishment of an agency relationship if the agent is acting as an agent-in-fact when the compensation issue arose.¹⁹ Second, when the fiduciary relationship is one of special trust and confidence, the prospective agent may have a duty to disclose the terms of his employment.²⁰ Thus, the court remanded the action to allow the buyer to prove that one of the exceptions applied.²¹

A strong argument can be made that *Heinhold* was wrongly decided. As Justice Simon recognized in his dissent, "[t]he fiduciary relationship does not permit a fiduciary to mislead someone, become his agent, and then allow his principal to labor under the misimpression caused by the fiduciary's own previous statements."²² The fiduciary's duty to disclose information should be based on the materiality of the information to the principal, and not on whether the information becomes relevant before or after the agent relationship is created.

The *Heinold* court's reliance on the timing of the agency rela-

16. *Id.* at 78, 510 N.E.2d at 845.

17. *Martin*, 117 Ill. 2d at 78, 510 N.E.2d at 845.

18. *Id.* at 78-79, 510 N.E.2d at 845 (citing RESTATEMENT (SECOND) OF AGENCY § 390 comment e (1958); *Hill v. Bache Halsey Stuart Shields, Inc.*, 790 F.2d 817, 824 (10th Cir. 1986); *Greenwood v. Dittmer*, 776 F.2d 785, 788 (8th Cir. 1985)).

19. *Martin*, 117 Ill. 2d at 78-79, 510 N.E.2d at 845. The court noted, for example, that the broker already may have been acting on the purchaser's behalf prior to the execution of the customer's agreement. *Id.* at 79, 510 N.E.2d at 845.

20. *Id.* at 79, 510 N.E.2d at 845.

21. *Id.* at 80, 510 N.E.2d at 846. The Illinois Supreme Court reversed the appellate court and remanded the case for reconsideration of whether the certification of the class was necessary. *Id.* at 83, 510 N.E.2d at 847. The plaintiff also alleged violations of the Consumer Fraud and Deceptive Business Practices Act. *Id.* at 71, 510 N.E.2d at 841. See ILL. REV. STAT. ch. 121 1/2, para. 261-272 (1985). These claims, however, were not a part of the summary judgment motion and, therefore, were not before the Illinois Supreme Court. For a discussion of the purpose and application of the Act, see the Consumer Protection section of this Article, *infra* notes 219-48 and accompanying text.

22. *Id.* at 86, 510 N.E.2d at 848 (Simon, J. dissenting). In his dissenting opinion, Justice Simon focused on the materiality of the compensation information rather than the timing of the agency relationship. *Id.* at 83, 510 N.E.2d at 847 (Simon, J. dissenting). Justice Simon argued that the commission 'kick-backs' constituted a breach of fiduciary duty. *Id.* at 88, 510 N.E.2d at 849. According to Justice Simon, the purchaser would have been influenced in his investment decision had he known of the concealed commissions. *Id.* at 87, 510 N.E.2d at 849. Thus, Justice Simon concluded that the fee distribution was a material fact requiring disclosure and that the defendant breached its fiduciary duty by failing to disclose that material fact. *Id.* at 88, 510 N.E.2d at 849.

tionship as the touchstone of the broker's duty imposes a major problem of proof on plaintiffs. The court placed on plaintiffs the difficult burden of showing the applicability of one of the exceptions to the rule that there is no duty to disclose material information prior to the creation of the agency relationship. In contrast, materiality can often be determined as a matter of law. Perhaps more disturbing about *Heinhold* is the court's refusal to place on the agent the duty to cure misrepresentations made during the pre-agency period. This suggests that brokers (and other agents) can shield themselves from liability by marshalling their misrepresentations in the pre-agency period. *Heinhold* is inconsistent with the court's solicitude for investors in other contexts.²³ Its reach should be limited by the court or the legislature.

B. Corporations

Appellate courts decided several important corporate issues during the *Survey* year. In *Brown v. Tenney*,²⁴ a case of first impression in Illinois, the Appellate Court for the First District rejected the approach of the Delaware, New York, and California courts, and recognized a "double derivative" cause of action.²⁵

In *Tenney*, the plaintiff Brown was a shareholder of T/B Holding Company, which owned all the stock of Pioneer Commodities, Inc. The defendants Tenney, Jell, and Agricon, Inc. operated Pioneer. The plaintiff alleged that the defendants breached their fiduciary duty by wasting, diverting, and damaging the assets of Pioneer.²⁶

In order to recognize a double derivative action, the appellate court relaxed the contemporaneous ownership requirement that an individual bringing a derivative action against a corporation must be a shareholder of that corporation at the time of the alleged wrong.²⁷ According to the court, states that refused to recognize

23. See, e.g., *Benjamin v. Cablevision Programming Inv.*, 114 Ill. 2d 150, 162-63, 199 N.E.2d 1309, 1315 (1986). See the Securities Regulation section of this article, *infra* notes 48-63 and accompanying text.

24. 155 Ill. App. 3d 605, 608-09, 508 N.E.2d 347, 349-50 (1st Dist. 1987), *cert. granted*, — Ill. 2d —, 515 N.E.2d 102 (1987).

25. A double derivative action is one in which a shareholder of a parent or holding corporation seeks to enforce derivatively the corporation's derivative right to sue on behalf of the subsidiary corporation. *Id.* at 607, 508 N.E.2d at 349 (citing Note, *Suits by a Shareholder in a Parent Corporation to Redress Injuries to the Subsidiary*, 64 HARV. L. REV. 1313 (1951); 19 AM. JUR. 2d *Corporations* § 2253 (1986); *Birch v. McColgan*, 39 F. Supp. 358, 366 (S.D. Cal. 1941)).

26. *Tenney*, 155 Ill. App. 3d at 606, 508 N.E.2d at 348.

27. *Id.* at 608, 508 N.E.2d at 350. Contemporaneous ownership is a requirement of

double derivative actions strictly adhered to the contemporaneous ownership requirement.²⁸ The *Tenney* court, however, adopted the approach of the courts that have relaxed the contemporaneous ownership requirement and allowed double derivative actions.²⁹

The court surveyed, with approval, the theoretical and practical bases relied upon by courts that have recognized double derivative actions.³⁰ For example, some courts have analogized double derivative actions to suits for specific performance of the holding company's duty to use its control of a subsidiary to right any wrong to that subsidiary.³¹ Other courts have treated a double derivative action as a suit by a beneficiary of the fiduciary's duty to protect the subsidiary.³² Some courts have allowed double derivative actions when the same individuals controlled the holding and subsidiary corporations, in effect piercing the corporate veil of the subsidiary.³³ Courts have held also that shareholders of a parent corporation have standing to sue derivatively for wrongs to a subsidiary because harm to the subsidiary will diminish the value of the parent corporation's shares.³⁴

Tenny is a salutary decision. The court was correct that rigid adherence to the contemporaneous ownership requirement is ill-advised, at least in the absence of a contrary legislative intent.³⁵ Double derivative actions will help ensure that shareholders can protect themselves against wrongful actions that directly decrease the value of their investment. One question left unanswered by *Tenny* is whether double derivative actions can be maintained if not all of the stock of the subsidiary is held by the parent corpora-

the majority of states for standing in derivative actions; the requirement in Illinois is statutory. See H. HENN & J. ALEXANDER, *LAW OF CORPORATIONS* 1058 (1983); Business Corporation Act of 1983, ILL. REV. STAT. ch. 32, para. 7.80(a) (1985).

28. *Tenney*, 155 Ill. App. 3d at 608, 508 N.E.2d at 349-50 (citing *Busch v. Mary A. Riddle Co.*, 283 F. 443 (D.C. Del. 1922); *Sabre v. United Traction & Elec. Co.*, 225 F. 601 (D.C.R.I. 1915); *Sheehan v. Municipal Light & Power Co.*, 54 F. Supp. 169 (S.D.N.Y. 1943), *aff'd*, 151 F.2d 65 (2d Cir. 1945); *Gaillard v. Natomas Co.*, 173 Cal. App. 3d 410, 219 Cal. Rptr. 74 (1985); *Schneider v. Greater M. & S. Circuit*, 259 N.Y.S. 319, 144 Misc. 534, 236 App. Div. 582 (1932)).

29. *Id.* at 608, 508 N.E.2d at 350 (citing Note, *Suits By a Shareholder in a Parent Corporation to Redress Injuries to the Subsidiary*, 64 HARV. L. REV. 1313-14 (1951)).

30. *Id.* at 609, 508 N.E.2d at 350.

31. *Id.* (citing 13 FLETCHER, *CYCLOPEDIA OF CORPORATIONS* § 5977 (1984)).

32. *Id.* (citing *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944)).

33. *Id.* (citing *United States Lines, Inc. v. United States Lines Co.*, 96 F.2d 148 (2d Cir. 1938); *Hirshhorn v. Mine Safety Appliances Co.*, 54 F. Supp. 588 (W.D. Penn. 1944)).

34. *Id.* (citing 19 AM. JUR. 2D *Corporations* § 2349 (1986)).

35. *Id.*

tion. In that case, other shareholders of the subsidiary might be expected to protect their own interests, obviating the need for a double derivative action. On the other hand, vigilant shareholders of the parent corporation should not be left without a remedy for wrongdoing by a subsidiary that directly threatens their investment in the parent corporation.

In *Geri's West Inc. v. Ferrall*,³⁶ the Appellate Court for the Second District held that an individual acting on behalf of a corporate franchiser is not shielded by the corporate form of the franchiser, and can be personally liable for violations of the Franchise Disclosure Act (the "Act").³⁷ The plaintiff, Geri's West Incorporated (the "franchisee"), purchased a restaurant franchise from the corporate franchiser, Geri Corporation (the "franchiser"). Defendant Ferrall, the president of the franchiser (the "corporation president"), represented the franchiser and handled the sale negotiations. Neither the corporation president nor any other Geri Corporation representative registered or properly disclosed the franchise sale as required by the Act.³⁸ The franchisee sought damages, or, alternatively, rescission of the franchise agreement for the corporation president's violation of the Act.³⁹

The appellate court held that employees of corporate franchisers can be personally liable for violations of the Act, so long as they acted as a "franchise broker," "salesperson," or "other person" in connection with the sale of a franchise.⁴⁰ According to the court, the legislature's application of the Act to noncorporate parties "evidence[s] a clear, comprehensive strategy of individual liability for all those acting for a franchiser and guilty of some wrongdoing under the Act."⁴¹ The court thus held that the corporation presi-

36. 153 Ill. App. 3d 579, 505 N.E.2d 1348 (2d Dist. 1987).

37. *Id.* at 581-83, 505 N.E.2d at 1350-51. The purpose of the Franchise Disclosure Act is to protect Illinois resident franchisees by requiring disclosure of information necessary to make an intelligent decision regarding a franchise purchase. ILL. REV. STAT. ch. 121 1/2, para. 701-40 (1985).

38. *Ferrall*, 153 Ill. App. 3d at 581, 505 N.E.2d at 1349.

39. *Id.* at 581, 505 N.E.2d at 1349-50. The issue of Ferrall's personal liability was especially important because the corporate franchiser had declared bankruptcy. *Id.* at 581, 505 N.E.2d at 1349.

40. *Id.* at 583, 505 N.E.2d at 1351. The appellate court also reversed the trial court's finding that the franchisee failed to give proper notice of its intention to rescind the agreement. *Id.* at 585, 505 N.E.2d at 1352.

41. *Id.* at 583, 505 N.E.2d at 1350. Section 4 of the Act provides that it is unlawful for any "person" to fail to register or to fail to provide proper disclosure concerning any franchise offer or sale. ILL. REV. STAT. ch. 121 1/2, para. 704 (1985). Section 3(7) of the Act defines "person" as meaning an "individual, a corporation, a partnership, a joint venture, an association, a joint stock company, a trust, or an unincorporated organization." *Id.* at para. 703 (1985).

dent could be personally liable because he acted as a franchise broker or sales person by selling the franchise to the plaintiff.⁴²

The *Ferrall* court's expansive reading of the Act is suspect. Nowhere did the court point to statutory language suggesting that the legislature sought to radically broaden the liability of corporate employees for acts done on behalf of the corporation. That the Act also applies to noncorporate parties suggests no more than a legislative recognition that not all the participants in the sale of a franchise may be corporations.

In *Behrstock v. Ace Hose and Rubber Co.*,⁴³ the Appellate Court for the First District held that a fifty percent co-owner of a corporation did not have the express or implied power to raise the salary of an employee over the repeated objections of the other co-owner.⁴⁴ The case arose when the plaintiff co-owner objected to an employment contract that the defendant co-owner executed on behalf of the company.⁴⁵ The court rejected defendant's contention that a fifty percent co-owner has the implied authority to bind the corporation over the objection of the other co-owner.⁴⁶

Although the *Behrstock* decision is unremarkable as a matter of law, it does illustrate the uncertainty and risks inherent when there is fifty percent co-ownership of a corporation. These problems extend to others who enter into an agreement with only one of the fifty percent co-owners. In *Behrstock*, for example, the employee was forced to return salary and bonuses he received under the employment contract to which one co-owner objected.⁴⁷

III. SECURITIES REGULATION

The Illinois Supreme Court considered the reach of the Illinois securities laws in *Benjamin v. Cablevision Programming Investments*.⁴⁸ The court held that, in certain circumstances, the sale of securities to out-of-state residents could be a "sale in this state" subject to registration under section 5 of the Illinois Securities Law ("the Act").⁴⁹ The court further held, however, that the limited-

42. *Ferrall*, 153 Ill. App. 3d at 583, 505 N.E.2d at 1351.

43. 147 Ill. App. 3d 76, 496 N.E.2d 1024 (1st Dist. 1986).

44. *Id.* at 81, 496 N.E.2d at 1027.

45. *Id.* at 80, 496 N.E.2d at 1026. In an earlier ruling, the appellate court held the contract invalid. *Id.*

46. *Id.* at 81, 496 N.E.2d at 1027.

47. *Id.* at 83-84, 496 N.E.2d at 1028.

48. 114 Ill. 2d 150, 499 N.E.2d 1309 (1986).

49. *Id.* at 163-65, 499 N.E.2d at 1315-16. The purpose of the Illinois Securities Law is to ensure full disclosure of securities information. ILL. ANN. STAT. ch. 121 1/2, para. 137.1 (Smith-Hurd Supp. 1987)(comment). Because the suit was brought concerning ac-

offering exemption in section 4(G) of the Act applies only to sales to persons within Illinois.⁵⁰

The defendant Cablevision (the "seller"), an Illinois corporation, sent an investment letter, circular, and subscription agreement in connection with the sale of limited partnership units to the plaintiff (the "purchaser"). The purchaser lived in California and never came to Illinois at any time during the sale process. The seller also executed the agreement in Illinois.⁵¹ Subsequently, the purchaser sought to rescind the sale under section 13 of the Act because the seller failed to register the securities "prior to sale in this state" pursuant to section 5 of the Act.⁵² The purchaser alternatively contended that the seller violated section 4(G) of the Act which imposes sales information reporting requirements for sales to "persons in this state."⁵³

In considering the buyer's first contention that the sale was voidable for failure to register the sale pursuant to section 5 of the Act, the court rejected the argument that section 5 protected only Illinois residents and in-state purchasers.⁵⁴ The court stated that the purchaser's location was not decisive in determining whether there was a sale of securities in Illinois subject to the section 5 registration requirement.⁵⁵ Rather, the Act's registration requirements applied to any activity in Illinois that fell within the statutory definition of "sale" as defined in section 2-5 of the Act.⁵⁶

tions occurring in 1982, the governing law is the Illinois Securities Law of 1953, as amended, which provides in pertinent part the following: section 2-5 defines "sale" as including the common law definition as well as activities such as contracts to sell, exchanges, attempts or offers to sell and offer solicitations; section 5 requires registration prior to offer or sale in Illinois with the Secretary of State for all securities transactions except those exempt under section 4; section 4 provides that sales to not more than thirty-five persons in this state are exempt from registration and that sales exempt from registration must be reported to the Secretary of State; section 13 provides that transactions not in compliance with the act may be rescinded. ILL. REV. STAT. ch. 121 1/2, paras. 137.2-5, 137.4, 137.5, 137.13 (1979).

50. *Benjamin*, 114 Ill. 2d at 169, 499 N.E.2d at 1318.

51. *Id.* at 154, 499 N.E.2d at 1311.

52. *Id.* at 153-54, 499 N.E.2d at 1311.

53. *Id.* at 154, 499 N.E.2d at 1311.

54. *Id.* at 162, 499 N.E.2d at 1315.

55. *Id.* at 163, 499 N.E.2d at 1316.

56. *Id.* at 162-63, 499 N.E.2d at 1316. Thus, the court stated that:

There must be either a "disposition or an attempt to dispose, of a security for value," a "contract to sell" a security, an "offer" to sell a security, or a "solicitation of an offer" to buy a security Furthermore, these activities must take place within Illinois.

Id. at 164, 499 N.E.2d at 1316 (citing ILL. REV. STAT. ch. 121 1/2 para. 137.2-5 (1979)). The court commented that *Green v. Weis, Voisin, Cannon, Inc.*, 479 F.2d 462 (7th Cir. 1973), relied upon by both parties, required an expansive application of the statutory

The court rejected the buyer's alternative contention that the sale was voidable for failure to report the sale pursuant to the section 4(G) limited offering exemption from registration. It refused to recognize that the section 4(G) registration exemption for limited offerings applied to persons located outside of Illinois.⁵⁷ The court stated that exemption from registration for sales to "not more than 35 persons in this state" applied only to sales to persons physically present in Illinois.⁵⁸ Thus, the sale to an out-of-state resident never present in Illinois was not within the meaning of the exemption.⁵⁹

Additionally, the court relied on the legislative history of the Act,⁶⁰ which included a previous exemption enactment generally applicable to sales to "persons" rather than the instant exemption applicable to sales to "persons in this State."⁶¹ The revision persuaded the court that the legislature did not intend the section 4(G) exemption to have an extraterritorial effect.⁶² Apparently, so long as a seller of securities limits his sales to thirty-five Illinois residents or persons physically within Illinois, the seller can market his securities in other states without fear of triggering Illinois' registration requirement.⁶³

IV. COMMERCIAL TRANSACTIONS

A. Debtors and Creditors

The Illinois Appellate Court for the First District decided a noteworthy debtor-creditor case.⁶⁴ In *Puritan Finance Corp. v.*

definition of sale to achieve the broad, paternalistic purpose of the Act. *Benjamin*, 114 Ill. 2d at 161, 499 N.E.2d at 1314.

57. *Id.* at 169, 499 N.E.2d at 1318.

58. *Id.*

59. *Id.*

60. *Id.* at 168, 499 N.E.2d at 1318.

61. *Id.*

62. *Id.* The court noted that the exemption was amended after the instigation of the action. *Id.* According to the court, this was additional evidence that the legislature intended only sales to persons in Illinois to count against the section 4(G) exemption requirements. *Id.*

63. *Id.* at 169, 499 N.E.2d at 1318. The *Benjamin* court noted that had the exemption applied to the seller, the buyer could have voided the agreement because the seller had not reported the sale as required by section 4(G). *Id.*

64. The Illinois Appellate Court for the Fourth District also decided a noteworthy case in debtor-creditor law. In *McLean County Bank v. Brokaw*, 148 Ill. App. 3d 103, 107, 498 N.E.2d 910, 913 (4th Dist. 1986), the court held that guarantors were not released from liability when the creditor loans the debtor a greater sum of money than the guaranty agreement specifies. The case was reversed by the Illinois Supreme Court after the *Survey* period. 1988 Ill. Lexis 18.

Vest,⁶⁵ the court held that a creditor cannot recover unearned interest from a debtor after a commercial loan default.⁶⁶ In *Puritan*, the defendants, Vests (the "debtors"), entered into a commercial loan agreement with plaintiff, Puritan (the "creditor"), to finance the Vests' purchase of a restaurant.⁶⁷ The debtors defaulted after a few payments, and the creditor accelerated the maturity date.⁶⁸ The trial court granted the creditor's motion for summary judgment and awarded interest for the entire term of the loan.⁶⁹

The appellate court reversed and refused to allow the creditor to collect unearned interest.⁷⁰ The court stated that allowing the creditor to collect unearned interest would be inequitable and would constitute a penalty imposed upon a debtor.⁷¹ The court rejected the creditor's argument that commercial loans should be treated differently than consumer loans and thus exempt from the rule against the collection of unearned interest.⁷²

B. Secured Transactions

The Illinois Supreme Court decided one major case concerning secured transactions during the *Survey* year. The Illinois appellate courts also issued several important decisions in this area.

In *State Bank of Piper City v. A-way, Inc.*,⁷³ the Illinois Supreme Court analyzed a secured creditor's right under section 9-501(1) of the Uniform Commercial Code (the "U.C.C.") to enforce its security interest in property given as collateral after the secured party obtained a judgment on a promissory note. The *Piper City* case involved a secured creditor who obtained judgment against the debtor after the debtor defaulted on promissory notes. The secured creditor served the defendant with a citation to discover assets that the defendant held on the debtor's behalf. The defendant responded that it held 5,141.20 bushels of grain for the debtor. Confusing the number of bushels with their value, the secured creditor then sought and obtained an order requiring the defendant

65. 152 Ill. App. 3d 625, 504 N.E.2d 913 (1st Dist. 1987).

66. *Id.* at 627, 504 N.E.2d at 915 (1st Dist. 1987).

67. *Id.* at 625, 504 N.E.2d at 914.

68. *Id.* at 626, 504 N.E.2d at 914.

69. *Id.* at 625, 504 N.E.2d at 914.

70. *Id.* at 627, 504 N.E.2d at 915. The court relied on *Illinois Steel Co. v. O'Donnell*, 156 Ill. 624, 41 N.E. 185 (1885), which held that unearned interest on promissory notes should be deducted on default and accelerated payment of indebtedness. *Puritan*, 152 Ill. App. 3d at 626-27, 504 N.E.2d at 915.

71. *Puritan*, 152 Ill. App. 3d at 627, 504 N.E.2d at 915.

72. *Id.*

73. 115 Ill. 2d 401, 504 N.E.2d 737 (1987).

to pay \$5,141.20 as partial satisfaction of the judgment against the creditor. The defendant sold the grain and remitted \$5,141.20 to the secured creditor and applied the balance to outstanding charges on the debtor's account.⁷⁴ Upon discovering its error, the secured creditor brought an action under Article 9 of the U.C.C. to enforce its security interest in the proceeds of the grain sale over and above \$5,141.20.⁷⁵

The Illinois Supreme Court held that neither the merger of a second party's rights into a judgment against the debtor nor the doctrine of *res judicata* bars a secured party from enforcing its security interest under section 9-501(1) of the U.C.C.⁷⁶ The court noted that under section 9-501(1), the secured creditor's remedies are "cumulative."⁷⁷ Thus "an interest under a security agreement in personal property is separate and independent of an interest in collateral that was created by the note itself."⁷⁸ Although merger precluded a secured creditor from taking further action on a note after a judgment, merger did not preclude enforcement of a security interest.⁷⁹ The court likewise concluded that because of the cumulative remedies language of section 9-501(1), *res judicata* will not bar a secured creditor from exhausting his U.C.C. remedies, even against a third party.⁸⁰

In *Anna National Bank v. Prater*,⁸¹ the Appellate Court for the Fifth District considered for the first time in Illinois whether a mortgagee's interest in crops under a "rents and profits" clause contained in its mortgage constitutes a security interest subject to the U.C.C.⁸² The plaintiff, Anna National Bank (the "mortgagee"), and the defendants, Praters (the "mortgagors"), entered into a mortgage agreement whereby the mortgagors put up their farm property and its "rents and profits" as collateral in exchange for financing. The Praters leased the property to a tenant farmer. Upon the mortgagors' default, the mortgagee brought a foreclosure action and acquired possession before the tenant farmer harvested a soybean crop.⁸³ The issue before the appellate court was whether the mortgagee's interest in the crops was a security interest subject

74. *Id.* at 404, 504 N.E.2d at 738.

75. *Id.* at 405, 504 N.E.2d at 738.

76. *Id.* at 408-09, 504 N.E.2d at 740.

77. *Id.* at 409, 504 N.E.2d at 739.

78. *Id.* at 408, 504 N.E.2d at 740.

79. *Id.*

80. *Id.* at 409, 504 N.E.2d at 740.

81. 154 Ill. App. 3d 6, 506 N.E.2d 769 (5th Dist. 1987).

82. *Id.* at 15, 506 N.E.2d at 775.

83. *Id.* at 8, 506 N.E.2d at 770.

to the current crop lender's interest.⁸⁴

The court first determined that, under Illinois law, unsevered crops growing upon mortgaged premises are deemed to be a part of the realty.⁸⁵ Accordingly, the court concluded that "a rents and profits' clause in a real estate mortgage conveys no separate right to the crops growing on the land[:] such a clause does not create a security interest in personal property. . . subject to the provisions of the U.C.C."⁸⁶ The court also stated that "section 9-312(2) was neither designed nor intended to give a current year crop lender priority over a real estate mortgagee's right to rents and profits of mortgaged property upon taking possession during foreclosure. . . ."⁸⁷ Thus, a mortgagee who takes possession before crops are severed has a claim to the crops superior to that of a tenant farmer.⁸⁸ The court further noted, however, that the mortgagee's interest in unsevered crops upon taking possession is subject to a valid lease between a debtor and a current year crop lender.⁸⁹ The mortgagee-in-possession may claim only the landlord-mortgagor's share of the crops growing on the mortgaged property.⁹⁰

In another action involving secured interests in property, the Appellate Court for the Second District in *International Harvester Credit Corp. v. Helland*⁹¹ outlined the measure of damages in wrongful replevin actions. In that case, the seller wrongfully repossessed tractors.⁹² The trial court awarded damages measured

84. *Id.* at 15, 506 N.E.2d at 774-75. The mortgagee also sought a temporary restraining order ("TRO") to prevent the mortgagors or the tenant farmer from entering and severing the crop. *Id.* at 9, 506 N.E.2d at 771. Thereafter, the tenant farmer intervened to challenge the TRO but not to defend the main action in which the rights to the crop were to be determined. *Id.* at 10, 506 N.E.2d at 771-72. The tenant farmer's motion to dissolve the TRO was denied. *Id.* at 11, 506 N.E.2d at 772. In the main action, judgment of foreclosure followed, placing the mortgagee as mortgagee-in-possession. *Id.* at 8, 506 N.E.2d at 770. Subsequently, the tenant farmer and the mortgagors severed and sold part of the soybean crop for \$8,474.89. *Id.* at 12, 506 N.E.2d at 773. On several motions concerning the right to those crop proceeds, the trial court entered summary judgment for the mortgagee, finding its rights in the crop superior to those of the mortgagors, the tenant farmer, and the tenant farmer's secured creditor. *Id.* at 13, 506 N.E.2d at 770-73.

85. *Id.* at 17, 506 N.E.2d at 776.

86. *Id.*

87. *Id.* at 19, 506 N.E.2d at 778.

88. *Id.* at 20, 506 N.E.2d at 778.

89. *Id.* at 21, 506 N.E.2d at 779.

90. *Id.*

91. 151 Ill. App. 3d 848, 503 N.E.2d 548 (2d Dist. 1987).

92. *Id.* at 855, 503 N.E.2d at 553. The plaintiff, International Harvester Credit Corporation ("IHCC"), was a wholly owned financing subsidiary of International Harvester Company ("IH"), a farm equipment manufacturer not a party herein. *Id.* at 850, 503 N.E.2d at 550. Leaders Equipment Company ("Leaders"), also not a party in the instant

by the cost to the buyer of "not having" the equipment during the period of wrongful detention.⁹³ According to the trial court, plaintiffs in wrongful replevin actions need not introduce evidence as to the expected use of the wrongfully repossessed equipment.⁹⁴

The appellate court reversed the trial court's damage award.⁹⁵ The court reasoned that the trial court's approach to calculating damages in wrongful replevin actions rested upon the often erroneous assumption that the buyer would have used the property.⁹⁶ The appellate court stated that, henceforth, the injured party would be required "to establish by competent evidence the use to which the property would have been put had it remained in his possession."⁹⁷

Although *Helland* probably was decided correctly, it presents difficult problems of proof for buyers. Buyers, according to *Helland*, must prove a negative: what use would the buyer have made of the property but for the wrongful replevin. Courts should be sensitive to this problem when applying *Helland* in future cases.

V. CONTRACTS

A. Contract Formation

The Illinois Supreme Court decided one case involving contract formation issues during the *Survey* year.⁹⁸ In addition, Illinois ap-

action, operated an IH dealership. *Id.* Under the dealer agreement, Leader was prohibited from selling any new IH equipment prior to paying IH the full purchase price, unless Leaders sold the equipment in the ordinary course of retail business. *Id.* Thereafter, Leaders purchased five new tractors from IH and paid with promissory notes. *Id.* Subsequently, Leaders made an oral agreement with defendant Helland to exchange the new tractors for cash and trade-ins. *Id.* at 851, 503 N.E.2d at 550. Helland later resold some of the tractors at an auction. *Id.* IHCC filed a complaint for replevin for those tractors still in Helland's possession and secured an order for writ of replevin. *Id.* Replevin is an action to recover property wrongfully possessed by another. BLACK'S LAW DICTIONARY 1168 (5th ed. 1983). IHCC took possession of the tractors. *Helland*, 151 Ill. App. 3d at 851, 503 N.E.2d at 550. The trial court entered judgment for Helland on the grounds that the sale from Leaders to Helland was in the ordinary course of business. *Id.* at 851, 503 N.E.2d at 551.

93. *Helland*, 151 Ill. App. 3d at 855-56, 503 N.E.2d at 553.

94. *Id.*

95. *Id.* at 860, 503 N.E.2d at 556.

96. *Id.* at 858-59, 503 N.E.2d at 555. The court cited *National Contract Purchase Corp. v. McCormick*, 264 Ill. App. 63 (1st Dist. 1931), in which the court based its estimate of the fair use of a replevied rental automobile on the reasonable rental value of the car for the reasonable time the wronged party could have been expected to use the car. *Helland*, 151 Ill. App. 3d at 857-58, 503 N.E.2d at 554-55.

97. *Id.* at 859, 503 N.E.2d at 555.

98. The court decided also *Duldulao v. St. Mary of Nazereth Hospital Center*, 115 Ill. 2d 482, 505 N.E.2d 314 (1987), which primarily involved labor law issues. In consid-

pellate courts considered the standing of putative third-party beneficiaries in several cases.

In *Ceres Illinois, Inc. v. Illinois Scrap Processing*,⁹⁹ an extremely fact-dependent decision, the Illinois Supreme Court considered whether the parties intended to enter into a binding fifteen year commercial land lease agreement only after reducing it to writing. The court held that the parties intended to be bound after reducing the agreement to writing, outlining a wide range of factors that a court should consider when determining whether parties to an oral agreement intended to be bound contractually only after an agreement is reduced to writing.¹⁰⁰

The defendant, Illinois Scrap, occupied the western half of a piece of property for use in its scrap business pursuant to an oral agreement with International Great Lakes Shipping Company ("Great Lakes").¹⁰¹ The plaintiff, Ceres Terminals ("Ceres"), occupied the eastern half of the property.¹⁰² Illinois Scrap installed equipment and conducted a full-scale scrap-processing operation with Great Lakes while it negotiated for a written long-term lease.¹⁰³ During lengthy negotiations, the Great Lakes's attorney sent a letter which provided the terms of the temporary arrangements for the defendant's use of the property.¹⁰⁴ Illinois Scrap also

ering whether the defendant hospital was required to follow particular procedures in employee termination, however, the court determined that the employee handbook detailing termination procedure created enforceable contractual rights. *Id.* at 490, 505 N.E.2d at 319. The court stated that for an employee handbook to create contractual obligations, the three traditional requirements for contract formation were required: 1) clear language of an offer; 2) handbook dissemination such that the employee was aware of its contents and reasonably believed it to be an offer; and 3) employee acceptance by commencing or continuing to work after learning of the policy. *Id.* at 490, 505 N.E.2d at 318. For a more detailed discussion of the case, see the *Labor Law* article of this *Survey*.

99. 114 Ill. 2d 133, 500 N.E.2d 1 (1986).

100. *Id.* at 144-45, 500 N.E.2d at 5.

101. *Id.* at 137, 500 N.E.2d at 1.

102. *Id.*

103. *Id.* at 137-38, 500 N.E.2d at 1-2.

104. *Id.* at 138, 500 N.E.2d at 2. The letter provided:

As per our recent discussions and as per agreement, the following will apply to the storage of your material on approximately six acres on the western end of our Iroquois Terminal.

Commencing July 1, 1982, we offer 30 days free storage. Thereafter the fee will be \$2,666.67 per 30 day period or fraction thereof.

It is anticipated that prior to the end of July, the legal arrangements for your use of the above mentioned property will have been worked out among our companies and the Chicago Regional Port District. It is understood that those arrangements and agreements, when mutually approved, will take precedence over this one.

Id.

paid rent.¹⁰⁵ Ceres subsequently purchased all of the Great Lakes stock, informed Illinois Scrap that its use was "detrimental" to Ceres' operation, and requested that Illinois Scrap cease operations.¹⁰⁶ Ceres brought suit to secure compliance.¹⁰⁷ Illinois Scrap argued that the oral agreement was an enforceable contract and evidenced a long-term lease to Illinois Scrap that was enforceable.¹⁰⁸

The Illinois Supreme Court held that a reduction to writing was a condition precedent to a valid contract between Great Lakes and Illinois Scrap.¹⁰⁹ The court stated that the following factors should be considered in determining whether the parties intended a reduction to writing to be a condition precedent to a contract: 1) whether the contract is one usually put in writing; 2) whether extensive detail is involved; 3) whether large sums of money are involved; 4) whether writing is required for full description of covenants contemplated; 5) whether negotiations indicated a written document was intended; and 6) whether subsequent conduct indicated that the parties considered the agreement binding.¹¹⁰ The court found that the great changes in negotiation terms, the entrustment of the dealings to attorneys, Great Lakes' attorney's letter indicating that the oral agreement was not binding, and Illinois Scrap's formal requests to occupy the property indicated that the parties intended a reduction to writing to be a condition precedent to a contract.¹¹¹

Ceres illustrates the wisdom of the axiom that parties should memorialize all agreements in writing. The court has no sympathy for the parties who fail to reach a written agreement. In fact, the high costs incurred by Illinois Scrap played no role in the court's analysis of whether a reduction to writing was a condition precedent to a contract. The court's willingness to search for evidence of a condition precedent further reveals its preference for written agreements.

105. *Id.* at 139, 500 N.E.2d at 2.

106. *Id.* at 140, 500 N.E.2d at 3.

107. *Id.*

108. *Id.* at 141, 500 N.E.2d at 4.

109. *Id.* at 144-45, 500 N.E.2d at 5. The trial court held also that the plaintiff was estopped from asserting the Statute of Frauds. *Id.* at 140, 500 N.E.2d at 3. On appeal, however, the appellate court held that the plaintiff was not estopped from asserting the Statute of Frauds to render unenforceable the fifteen-year oral land lease agreement. *Id.* at 141, 500 N.E.2d at 3. The Illinois Supreme Court held that the appellate court's determination on this issue was not against the manifest weight of the evidence and affirmed its finding. *Id.* at 147-48, 500 N.E.2d at 7.

110. *Id.* at 144, 500 N.E.2d at 5.

111. *Id.* at 146-47, 500 N.E.2d at 6.

Illinois appellate courts refused to recognize third-party beneficiary status in several cases, thus tightening the standing requirements for breach of contract actions. In *Bernstein v. Lind-Waldock & Co.*,¹¹² the Appellate Court for the First District held that a guarantor-of-trades member of the Chicago Mercantile Exchange was not a third-party beneficiary of a membership agreement between the Exchange and an Exchange member when the agreement provided that the member would be bound by the Exchange rules.¹¹³

In Illinois, third-party beneficiary status is determined by whether the agreement between the parties was intended, at the time of execution, to directly benefit the third party.¹¹⁴ The court found that the defendant was not a member of any class which the plaintiff and the Exchange intended to benefit in their membership agreement.¹¹⁵ In addition, the court disagreed with the trade guarantor's contention that the agreement barred Exchange members from suing one another.¹¹⁶

In *Miller v. Sears, Roebuck and Company*,¹¹⁷ the Appellate Court for the First District held that under section 2-318 of the U.C.C. an injured customer was not a third-party beneficiary of a warranty of an air compressor given by a seller to a transmission shop.¹¹⁸ According to the court, the drafters of the U.C.C. pro-

112. 153 Ill. App. 3d 108, 505 N.E.2d 1114 (1st Dist. 1987).

113. *Id.* at 110-11, 505 N.E.2d at 1116. At trial the following facts were established. Plaintiff Bernstein (the "Exchange member"), leased his Exchange membership to a third-party, Caan. *Id.* at 109, 505 N.E.2d at 1115. Defendant Lind-Waldock (the "trade guarantor"), a clearing member of the exchange, guaranteed Caan's trades. *Id.* In 1980, Caan suffered losses, and at the trade guarantor's request, the Exchange sold the membership and applied the proceeds to Caan's indebtedness to the trade guarantor. *Id.* The Exchange member brought an action to recover the proceeds, and the trade guarantor counterclaimed for damages, alleging among other things, that it was a third-party beneficiary of a provision in the plaintiff's membership agreement with the Exchange that Exchange members would not sue one another. *Id.* The trial court dismissed the counterclaim on the grounds the trade guarantor was not a third-party beneficiary of the Exchange member's agreement with the Exchange. *Id.* at 109-10, 505 N.E.2d at 1115.

114. *Id.* at 110, 505 N.E.2d at 1116 (citing *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 178 N.E. 498 (1931); *People ex rel. Resnik v. Curtis & Davis, Architects & Planners, Inc.*, 78 Ill. 2d 381, 400 N.E.2d 918 (1980); *Bates & Rogers Constr. Corp. v. Greeley & Hansen*, 109 Ill. 2d 225, 486 N.E.2d 902 (1985)).

115. *Bernstein*, 153 Ill. App. 3d at 110, 505 N.E.2d at 1116.

116. *Id.* at 111, 505 N.E.2d at 1117.

117. 148 Ill. App. 3d 1022, 500 N.E.2d 557 (1st Dist. 1986).

118. *Id.* at 1025, 500 N.E.2d at 559 (citing ILL. REV. STAT. ch. 26, para. 2-318 (1985)). In *Miller*, plaintiff Miller (the "customer") was on the premises of B & W Transmission, not a party to the action, discussing the repair of his automobile. *Id.* at 1023, 500 N.E.2d at 558. An air compressor purchased by B & W from defendant Sears, Roebuck and Co. (the "seller") exploded, injuring the customer. *Id.* The customer alleged that

vided three alternate definitions of a third-party beneficiary of a seller's warranties.¹¹⁹ The *Miller* court reasoned that the Illinois Legislature's choice of the most restrictive alternative indicated an intent to limit the seller's liability for breach of warranty to only those persons expressly enumerated in section 2-318.¹²⁰

The court also rejected the plaintiff's argument that persons who are the "functional equivalents" of those mentioned in section 2-318 also have standing to sue for breach of warranty.¹²¹ Several other Illinois appellate decisions have interpreted section 2-318 to extend to "functional equivalents".¹²² Federal courts in Illinois have refused to recognize an extension to "functional equivalents" because such recognition would be tantamount to judicial legislation.¹²³ The *Miller* court adopted the position taken by federal courts sitting in Illinois.¹²⁴

Miller gives an unnecessarily restrictive reading to section 2-318. The "functional equivalent" test that it rejects is little more than a common sense recognition that the drafters of the U.C.C. could not enumerate every class of third-party beneficiaries in even the most restrictive version of section 2-318. Moreover, the court reads too much into the Legislature's failure to amend section 2-318 after decisions adopted the functional equivalent approach. The court interprets such inaction as disapproval when legislative inaction may well signify approval. Finally, the court failed to

the seller's breach of warranty resulted in his personal injury. *Id.* at 1022-23, 500 N.E.2d at 557-58. Although other claims were brought, the appeal was limited to the warranty claims. *Id.* at 1023, 500 N.E.2d at 558. The trial court granted the defendant's motion to dismiss the warranty claims stating that plaintiff was not within the class of persons to whom warranty protection extended under the U.C.C. *Id.*

119. *Id.* at 1024-25, 500 N.E.2d at 559. These included: a) the contracting party and family members or guests who reasonably could be expected to use the goods and were injured in person (this was the provision ultimately chosen by the legislature, ILL. REV. STAT. ch. 26, para. 2-318 (1986)); b) any natural person who reasonably could be expected to use the goods and was injured in person; or c) any person who could reasonably be expected to use the goods and is injured. *Miller*, 148 Ill. App. 3d at 1024-25, 500 N.E.2d at 559.

120. *Miller*, 148 Ill. App. 3d at 1024-25, 500 N.E.2d at 558-59. The court agreed with the previous decision of *Knox v. North Am. Car Corp.*, 80 Ill. App. 3d 683, 399 N.E.2d 1355 (1st Dist. 1980), on this point, but refused to extend protection to the "functional equivalent" of a guest as suggested by the *Knox* court. *Miller*, 148 Ill. App. 3d at 1025, 500 N.E.2d at 559.

121. *Miller*, 148 Ill. App. 3d at 1025, 500 N.E.2d at 559.

122. *Id.* at 1024, 500 N.E.2d at 558 (citing *Knox*, 80 Ill. App. 3d at 683, 399 N.E.2d at 1355; *Boddie v. Litton Unit Handling Sys.*, 118 Ill. App. 3d 520, 455 N.E.2d 142 (1st Dist. 1983)).

123. *Id.* (citing *Hemphill v. Sayers*, 552 F. Supp. 685 (S.D. Ill. 1982); *In re Johns-Mansville Asbestosis Cases*, 511 F. Supp. 1235 (N.D. Ill. 1981)).

124. *Id.* at 1025, 500 N.E.2d at 559.

canvas the case law to determine if decisions after the Legislature's adoption of section 2-318 had loosened the standing requirements, as the U.C.C. drafters appeared to contemplate.¹²⁵

The Appellate Court for the First District, in *Wheeling Trust & Savings Bank v. Tremco Inc.*,¹²⁶ held that a reference to a property owner's construction location as the delivery site in a purchase order issued by a subcontractor to a materialman did not give the property owner standing as a third-party beneficiary to sue the materialman.¹²⁷ The appellate court reasoned that the property owner was not a third-party beneficiary of the contracts with the materialmen because the contracts failed to state that "the windows were specifically for the plaintiffs."¹²⁸ The court also noted that the contracts did not require the materialmen to consult with the property owner.¹²⁹ The court thus distinguished the case from *People ex rel. Resnik v. Curtis & Davis, Architects & Planners, Inc.*,¹³⁰ in which the Stat. of Illinois was recognized as a third-party beneficiary of a contract between a contractor and an architectural firm, which expressly provided that the architectural firm was to consult with the State of Illinois concerning revision of specifications.¹³¹

Tremco's analysis exemplifies the wooden approach to third-party beneficiary issues taken by the Illinois courts. The court exalted the form of the contract over the substance of the transaction. Surely a materialman who delivers a product or service to a building site knows that the property owner is the beneficiary of its work. Whether a purchase order mentions the owner by name or requires the materialman to consult with the property owner is

125. ILL. ANN. STAT. ch. 29, para. 2-318 comment 3 (Smith-Hurd 1963) (amended 1966).

126. 153 Ill. App. 3d 136, 505 N.E.2d 1045 (1st Dist. 1987).

127. *Id.* at 140, 505 N.E.2d at 1048. In *Tremco*, Wheeling Trust, the plaintiff property owner, entered into agreements with prime contractors for the construction of an office building. *Id.* at 138, 505 N.E.2d at 1046-47. The prime contractors contracted with subcontractors who subsequently entered into agreements with materialmen to provide the necessary supplies. *Id.* at 138, 505 N.E.2d at 1047. The purchase orders to two of the materialmen referred to the project but not to the property owner directly. *Id.* at 141, 505 N.E.2d at 1048. Irreparable streaks began to develop on the windows over a year after the building's completion. *Id.* at 138, 505 N.E.2d at 1047. The plaintiff brought suit against contractors, subcontractors, and materialmen, alleging breach of contract, and warranties and seeking damages for the economic loss for the streaked windows. *Id.* at 138-39, 505 N.E.2d at 1047. The appeal was limited to the issue of whether the trial court's dismissal of actions against the materialmen was proper. *Id.* at 139, 505 N.E.2d at 1047-48.

128. *Id.* at 141, 505 N.E.2d at 1048.

129. *Id.* at 141, 505 N.E.2d at 1049.

130. 78 Ill. 2d 381, 400 N.E.2d 918 (1980).

131. *Tremco*, 153 Ill. App. 3d at 140-41, 505 N.E.2d at 1048-49.

largely irrelevant. Courts should read contracts in light of industry practices and the actual knowledge of the parties when determining third-party beneficiary status, especially when the court's denial of standing as a third-party beneficiary leaves the property owner without a direct remedy against the materialmen.

The Appellate Court for the Fifth District held that a prime contractor was not a third-party beneficiary of a contract between the co-prime contractor and the property owner in *J.F., Inc. v. S.M. Wilson & Co.*¹³² In this case, the property owner, Illinois Capital Development Board (the "board"), awarded one prime contract to defendant S.M. Wilson as general construction contractor and another to plaintiff J.F., Inc. as heating and electric contractor. Both contracts stipulated the same completion date. Because of various delays, however, the construction was completed a year and a half late. J.F. Inc. brought suit to recover from S.M. Wilson the costs of delays, alleging standing as a third-party beneficiary of the contract between the board and S.M. Wilson.¹³³ S.M. Wilson counterclaimed.¹³⁴ Both parties argued that the court should follow decisions from other jurisdictions that prime contractors are third-party beneficiaries of the contracts among the property owner and the other prime contractors.¹³⁵

The court rejected this approach and found that the contractors lacked standing as third-party beneficiaries.¹³⁶ The court reasoned that only the eventual occupant of the building might be a third-party beneficiary of the contracts among the board and the prime contractors.¹³⁷ It noted that neither contractor was mentioned in

132. 152 Ill. App. 3d 873, 878, 504 N.E.2d 1266, 1269 (5th Dist. 1987).

133. *Id.* at 875, 504 N.E.2d at 1267. The plaintiff also brought an action against the board. The trial court dismissed that action to the court of claims, because the board was a state entity subject only to the jurisdiction of that court. *Id.*

134. *Id.* The trial court entered judgment on the cross breach of contract claims against the defendant for \$37,000 and for \$5,000 against the plaintiff on the defendant's counterclaim. *Id.* at 876, 504 N.E.2d at 1267.

135. *Id.* at 879-81, 504 N.E.2d at 1269-71. According to the court, however, other jurisdictions had so held because either the state was immune from suit or because the contracts at issue explicitly placed responsibility of supervision and coordination of the project on one of the prime contractors. *Id.* (citing *W.H. Stubbings Co. v. Worlds Columbian Exposition Co.*, 110 Ill. App. 210 (1903); *United States Steel Corp. v. Missouri Pacific R.R. Co.*, 668 F.2d 435 (8th Cir. 1982), *cert. denied*, 459 U.S. 836 (1982); *M.T. Reed Constr. Co. v. Virginia Metal Products Corp.*, 213 F.2d 337 (5th Cir. 1954); *Thomas v. Snavely Co. v. Brown Constr. Co.*, 16 Ohio Misc. 50, 239 N.E.2d 759 (1968); *J. Louis Crum Corp. v. Alfred Lindgren, Inc.*, 564 S.W.2d 544 (Mo. App. 1978); *Hanberry Corp. v. State Bldg. Comm'n.*, 390 So. 2d 277 (Miss. 1980); *Broadway Maint. Corp. v. Rutgers*, 180 N.J.Super. 350, 434 A.2d 1125 (1981), *aff'd*, 90 N.J. 253, 447 A.2d 906 (1982)).

136. *Id.*

137. *Id.* at 877, 504 N.E.2d at 1268-69.

the other contractor's agreement with the board.¹³⁸ Perhaps most importantly for the court, the contracts provided self-help remedies in the form of change orders for the delays caused by the other contractor.¹³⁹ Moreover, both contractors could sue the Board for its contribution to the delays.¹⁴⁰

B. Contract Construction

Appellate courts considered several contract construction issues during the *Survey* year. The Appellate Court for the First District, in *Perlman v. Westin Hotel Co.*,¹⁴¹ held that a hotel denied a dining club member, whose membership entitled him to a free meal at his choice of two restaurants, the benefit of his bargain by closing one of its restaurants.¹⁴² In *Perlman*, the defendant, Westin Hotel (the "hotel"), offered dining club memberships that included a free meal at either the Consort Room or the Chelsea Restaurant.¹⁴³ Plaintiff Perlman purchased a membership but was unable to have his free meal at the Consort Room, as he preferred, before the hotel closed the restaurant.¹⁴⁴ Subsequently, the plaintiff brought a class action for breach of contract.¹⁴⁵

The appellate court rejected both the plaintiff's contention that the agreement was an option contract giving the plaintiff the choice of performance and the defendant's contention that the agreement was an alternate methods of performance contract giving the defendant a choice among performances.¹⁴⁶ The court analogized the

138. *Id.* at 878, 504 N.E.2d at 1269.

139. *Id.*

140. *Id.*

141. 154 Ill. App. 3d 346, 506 N.E.2d 1318 (1st Dist. 1987), *cert. denied*, — Ill. 2d —, 515 N.E.2d 125.

142. *Id.* at 351, 506 N.E.2d at 1321.

143. *Id.* at 348, 506 N.E.2d at 1319.

144. *Id.* at 349, 506 N.E.2d at 1319.

145. *Id.* The trial court granted the defendant's motion to dismiss on the grounds that the defendant did not promise to keep both restaurants open or to maintain a restaurant with the ambience of the Consort Room. *Id.* at 349, 506 N.E.2d at 1319-20. Both the trial court and the appellate court agreed that the Consort Room was the more elegant restaurant. *Id.* at 347, 506 N.E.2d at 1319.

146. *Id.* at 349-50, 506 N.E.2d at 1320. The court stated that the membership agreement was not an option contract because the promisee did not keep an offer open in exchange for consideration. *Id.* An alternative methods agreement is one in which the promisor reserves the right to carry out the contract in only one of two or more possible methods. *Id.* at 350, 506 N.E.2d at 1320. The court stated that the defendant did not expressly reserve the right to elect the manner of performance, and the plaintiff was partly induced by the inclusion of the "exclusive" Consort Room to enter the deal. *Id.* at 350-51, 506 N.E.2d at 1320-21. The court stated that the choice of where to dine was with the member, not the defendant, thus the agreement was not the "alternative methods" type. *Id.* at 351, 506 N.E.2d at 1321. The court distinguished *Sperry & Hutchinson*

instant action to *Aldrich v. Bay State Construction Co.*,¹⁴⁷ in which the defendant offered to buy the plaintiff's railway ties with stock in either of two railway companies.¹⁴⁸ In *Aldrich*, the defendants ultimately chose the company stock with which to pay.¹⁴⁹ The Massachusetts court held, however, that the plaintiffs had the right to choose because "it is the person who is to take one of two apples who may 'take either apple.'"¹⁵⁰ Based on the reasoning in *Aldrich*, the court concluded that the plaintiff stated a cause of action for breach of contract and reversed the trial court.¹⁵¹

Justice Quinlan dissented on the grounds that the defendant had not agreed to maintain the Consort Room or provide a restaurant with comparable ambience.¹⁵² Justice Quinlan argued that under Illinois law, when a contract provides for alternate performances, the promisor retains the right to elect which of the alternatives will be performed, unless the contract expressly provides otherwise.¹⁵³

In *Pelz v. Streator National Bank*,¹⁵⁴ the Appellate Court for the Third District considered whether an assignment of a long-term installment contract for the sale of commercial property to a bank could bind the bank to honor the contract. In *Pelz*, Virginia and Merlin Elliott (the "buyers") purchased real estate from the plaintiffs, Peter and Carol Pelz.¹⁵⁵ The buyers assigned their rights under the real estate installment contract to the defendant, Streator Bank (the "bank"), in return for financing.¹⁵⁶ The buyers subsequently defaulted on their obligations.¹⁵⁷ The bank made payments to the plaintiffs for several months thereafter and collected

Co. v. Seigel, Cooper & Co., 309 Ill. 193, 140 N.E. 864 (1923), in which the defendant department store gave a choice of coupon redemption in merchandise or cash, but later sold its business. *Perlman*, 154 Ill. App. 3d at 351-52, 506 N.E.2d at 1321-22. The appellate court in *Perlman* stated that the *Sperry* case was distinguishable because the plaintiff could have redeemed the coupons at the new store in that case and because Seigel merely changed owners, as opposed to *Perlman* in which the choice no longer existed. *Perlman*, 154 Ill. App. 3d at 352, 506 N.E.2d at 1321-22.

147. 186 Mass. 489, 72 N.E. 53 (1904).

148. *Perlman*, 154 Ill. App. 3d at 352-53, 506 N.E.2d at 1322.

149. *Aldrich*, 186 Mass. at 489, 72 N.E.2d at 53.

150. *Id.* at 493, 72 N.E.2d at 54-55.

151. *Perlman*, 154 Ill. App. 3d at 353-54, 506 N.E.2d at 1323.

152. *Id.* at 354, 506 N.E.2d at 1323 (Quinlan, J. dissenting).

153. *Id.* at 355, 506 N.E.2d at 1323-24 (citing *Fidelity Fed. Sav. and Loan Assn. v. Pioneer Nat'l. Title*, 428 F. Supp. 1382 (S.D. Ill. 1977); *Metz v. Albrecht*, 52 Ill. 491 (1869); 129 ILL. L. & PRAC. Contracts § 245; 17 AM. JUR. 2D Contracts § 363 (1964)).

154. 145 Ill. App. 3d 946, 496 N.E.2d 315 (3d Dist. 1986).

155. *Id.* at 947, 496 N.E.2d at 317.

156. *Id.* at 948, 496 N.E.2d at 317.

157. *Id.* at 950, 496 N.E. 2d at 318. The bank caused the trustee in bankruptcy to obtain an order of abandonment of the property as well. *Id.*

rents from tenants.¹⁵⁸ When the bank discontinued payments, the plaintiffs brought an action for breach of the installment contract.¹⁵⁹

The appellate court stated that Illinois courts infer an assumption by the assignee of a land contract of his assignor's contractual duties upon clear and convincing evidence that such an assumption was intended by the parties.¹⁶⁰ The court found that the language in the assignment, that the bank "shall be deemed the vendee" if the bank made payments to the plaintiffs, supported an inference that the bank had assumed the buyer's duties under the installment contract.¹⁶¹ Such an inference was especially appropriate because the bank made payments and took an active role in the management of the property.¹⁶²

In *Verbaere v. Community Bank of Homewood-Flossmoor*,¹⁶³ the Appellate Court for the First District analyzed the rights of a bank upon the sale of property to seize cash collateral that was deposited in exchange for the release of a second mortgage on the property. The plaintiffs, the Verbaeres, secured a loan from defendant, Community Bank (the "bank"), to purchase a motor home. The credit insurance policy provided that if Peter Verbaere was unable to make loan payments because of death or disability, the insurance company would make loan payments on his behalf.¹⁶⁴ The collateral for the loan was the insurance policy, a purchase-money security interest in the motor home, and a second mortgage on the Verbaeres' home. Subsequently, Peter Verbaere sustained permanently disabling injuries, and the insurance company took over the loan payments pursuant to the insurance policy. Several years later, the Verbaeres contracted to sell their residence. The bank agreed to release the second mortgage on the Verbaeres' residence if the Verbaeres deposited, in cash, the remaining balance due on the motor home loan. The bank further agreed to send a monthly check equivalent to the amount the insurance company paid pursu-

158. *Id.* at 950, 496 N.E.2d at 318-19.

159. *Id.* at 947, 496 N.E.2d at 317. The trial court awarded damages to the plaintiffs in the amount of the balance due under the contract and awarded attorney's fees and costs. *Id.*

160. *Id.* at 954, 496 N.E.2d at 321.

161. *Id.* at 954, 496 N.E.2d at 322.

162. *Id.*

163. 148 Ill. App. 3d 249, 498 N.E.2d 843 (1st Dist. 1986), *cert. denied*, — Ill. 2d —, 505 N.E. 2d 363 (1987). For a discussion of the insurance law aspects of this case, see the *Insurance Law* section of this *Survey*.

164. *Id.* at 251, 498 N.E.2d at 845.

ant to the credit insurance policy.¹⁶⁵ Upon the sale of the residence and without the consent of the plaintiffs, the bank seized the cash deposit and paid off the motor home.¹⁶⁶

The appellate court held that the defendant's seizure of the cash without the plaintiffs' consent was a breach of a contract which provided for an exchange of a second mortgage for cash collateral.¹⁶⁷ According to the court, the defendant was not justified in seizing the cash because the cash secured the mobile home, and not the residence that was being sold.¹⁶⁸ Thus, the bank had no contractual right to seize the cash collateral upon the sale of the residence.¹⁶⁹ The court stated that it found no support for the argument that the exchange of collateral permitted the bank to seize substituted collateral and thereby pay off the underlying mortgage.¹⁷⁰ The court also rejected the bank's contention that it had properly relied on "industry custom" of paying off the mortgage upon the sale of mortgaged property.¹⁷¹

C. Contract Remedies

The Illinois Supreme Court decided one noteworthy case involving remedies for breach of contract during the *Survey* year.¹⁷² In *W.E. Erickson Construction, Inc. v. Congress-Kenilworth Corp.*, the Illinois Supreme Court applied the doctrine of substantial performance in a dispute over a waterslide construction contract.¹⁷³ The court held that because the plaintiff substantially performed its contract, it was entitled to the amount bargained for less the difference between the actual value of the construction work and the value of the work had the contract been fully performed.¹⁷⁴

165. *Id.* at 252, 498 N.E.2d at 845.

166. *Id.* at 252, 498 N.E.2d at 846. When the insurance company learned the motor home had been paid off, it discontinued payments. *Id.* at 252-53, 498 N.E.2d at 846. The trial court dismissed the plaintiffs' claims on the ground that the defendant had complied with industry custom. *Id.* at 251, 498 N.E.2d at 845.

167. *Id.* at 253, 498 N.E.2d at 846. The court dismissed allegations of fraud, breach of trust, and breach of fiduciary duty. *Id.* at 255-58, 498 N.E.2d 847-49.

168. *Id.* at 254, 498 N.E.2d at 846-47.

169. *Id.* at 254, 498 N.E.2d at 847.

170. *Id.*

171. *Id.* at 254, 498 N.E.2d at 846-47.

172. *W.E. Erickson Constr., Inc. v. Congress-Kenilworth Corp.*, 115 Ill. 2d 119, 503 N.E.2d 233 (1986).

173. *Erickson*, 115 Ill. 2d at 126-28, 503 N.E.2d at 236-37 (1986). The damages awarded for substantially performed construction contracts is the difference between the contract price and the value of the substantially performed construction with defects. *Id.* at 128, 503 N.E.2d at 237.

174. *Id.* at 128, 503 N.E.2d at 237.

At trial, evidence showed that the defendant, Congress-Kenilworth (the "property owner"), contracted with plaintiff, W.E. Erickson, for the construction of a concrete waterslide for not more than \$535,000. The agreement provided that the contractor would make monthly applications for payment and would receive an interest rate of two percent over the prime rate on the property owner's overdue balances. The property owner paid only \$150,000 on the contract. The contractor brought suit seeking \$550,000 for full performance, but the trial court awarded only \$352,000, less the \$150,000 already paid.¹⁷⁵

The Illinois Supreme Court agreed with the lower court's conclusion that the contractor substantially performed its contract, but remanded the case for a more precise calculation of damages.¹⁷⁶ The court also held that the contractor waived its right to interest on overdue payments by failing to submit timely applications for payment.¹⁷⁷ On the property owner's cross-appeal, the court held that the contractor was liable for the costs of a wrongful appointment of a receiver for the property.¹⁷⁸

The Appellate Courts for the First and Second Districts decided cases during the *Survey* year concerning the statute of limitations for breach of contract actions. *Brown v. Goodman*,¹⁷⁹ involved a written five-year option agreement which allowed the plaintiff-seller, Brown, to repurchase real estate from the purchaser, Kuhny. The option agreement specifically provided that a sale to a third party was subject to Brown's right to repurchase. Kuhny sold the land to the defendant, Goodman.¹⁸⁰ Brown unsuccessfully attempted to exercise his repurchase option but waited almost ten years to sue.¹⁸¹ The issue before the appellate court was whether the option contract was written, in which case the ten-year statute of limitations applied, or whether the five-year statute of limitations applied because the option contract was in effect oral as it did not expressly name Goodman.¹⁸²

The appellate court held that the option contract was oral for

175. *Id.* at 125, 503 N.E.2d at 236. The appellate court remanded for recalculation of damages under the doctrine of substantial performance. *Id.* at 123, 503 N.E.2d at 235.

176. *Id.* at 128, 503 N.E.2d at 237.

177. *Id.* at 129, 503 N.E.2d at 238.

178. *Id.* at 131-32, 503 N.E.2d at 239.

179. 147 Ill. App. 3d 935, 498 N.E.2d 854 (1st Dist. 1986).

180. *Id.* at 937, 498 N.E.2d at 855.

181. *Id.* at 937-38, 498 N.E.2d at 855-56.

182. *Id.* at 939, 498 N.E.2d at 856. The trial court dismissed the action as not being within the five-year statute of limitations for oral agreements. *Id.* at 938, 498 N.E.2d at 856; See ILL. REV. STAT. ch. 110, para. 13-205 (1985). The statute of limitations for

the purposes of the statute of limitations and that Brown's suit was time-barred because Goodman was not named in the option contract.¹⁸³ According to the court, an agreement is considered written only if all essential terms of the contract, including the identities of the parties, are in writing and are readily ascertainable from the instrument.¹⁸⁴ When parol evidence is necessary to make the contract complete, the contract is treated as oral under the statute of limitations.¹⁸⁵

Brown stands for the proposition that a contract that meets the requirements of the Statute of Frauds still may not be written for limitations purposes. As the court recognized, Illinois, unlike many other jurisdictions, requires, in addition to the prerequisites of the Statute of Frauds, that all of the essential terms of the contract be in writing in the contract. The wisdom of this additional requirement is questionable as a general matter in an era when contracting parties by agreement are apt to leave important contractual provisions unspecified and subject to later negotiation. The Illinois approach is especially inappropriate with long-term option contracts for land, when changes in parties often cannot be anticipated.

In *Board of Education v. Hartford Accident and Indemnity Co.*,¹⁸⁶ the Appellate Court for the Second District answered affirmatively the question whether parties can contract for a limitation period shorter than that provided by statute.¹⁸⁷ The performance bond at issue in *Hartford* included a provision requiring the plaintiff, the Board of Education (the "Board"), to bring suit on the bond within two years from the date of the final payment on the contract.¹⁸⁸ The Board brought suit, alleging improper construction of a swimming pool, almost ten years after the last payment fell due, but within the ten-year statute of limitations.¹⁸⁹ The appellate court upheld the lower court's enforcement of the contractual limitations period, observing that two years was not an unreasonable limitations period, that the provision was clear and unambiguous, and that the weight of authority from other

written agreements is ten years. *Brown*, 147 Ill. App. 3d at 939, 498 N.E.2d at 856. See ILL. REV. STAT. ch. 110, para. 13-206 (1985).

183. *Brown*, 147 Ill. App. 3d at 941, 498 N.E.2d at 858.

184. *Id.* at 939, 498 N.E.2d at 856-57.

185. *Id.* at 939, 498 N.E.2d at 857.

186. 152 Ill. App. 3d 745, 504 N.E.2d 1000 (2d Dist. 1987).

187. *Id.* at 752, 504 N.E.2d at 1005.

188. *Id.* at 747, 504 N.E.2d at 1002.

189. *Id.* at 746-48, 504 N.E.2d at 1001-02.

states favored enforcement of such provisions.¹⁹⁰

The Illinois appellate courts also considered the Statute of Frauds as a defense to breach of contract actions.¹⁹¹ The Appellate Court for the Second District in *Nelson v. Estes*¹⁹² considered whether the Statute of Frauds barred a cause of action based on an option contract for land that allegedly was modified orally. In *Nelson*, the plaintiff, Nelson (the "seller"), sold the subject real estate to the defendants, Estes (the "buyers"), pursuant to an option contract.¹⁹³ The seller filed a forcible entry and detainer action after defendants failed to make payments according to the schedule in the contract.¹⁹⁴ The buyers asserted as a defense that the parties orally modified the option contract to allow the buyers more time for payment.¹⁹⁵ The seller used the Statute of Frauds to counterattack against the defense.¹⁹⁶

The appellate court held that the possible applicability of the "waiver exception" to the general rule that under the Statute of Frauds an executory contract cannot be orally modified precluded summary judgment in the plaintiff's favor.¹⁹⁷ The waiver exception is invoked when the party asserting the Statute of Frauds waives performance of written provisions and the other party detri-

190. *Id.* at 750-52, 504 N.E.2d at 1005 (citing *Con-Plex Division of U.S. Indus., Inc. v. Vicon, Inc.*, 448 So. 2d 191 (La. App. 1984) (a provision limiting the time to bring suit under a surety bond to two years was enforceable); *Timberline Elec. Supply Corp. v. Ins. Co. of North America*, 72 A.D.2d 905, 421 N.Y.S.2d 987 (1979), *aff'd*, 52 N.Y.2d 793, 436 N.Y.S.2d 707, 417 N.E.2d 1248 (1980) (parties could shorten the statutory period of limitation in their surety contract); *Quin Blair Enter., Inc. v. Julien Constr. Co.*, 597 P.2d 945 (Wyo. 1979) (reasonable time limitations on building contract bond suits enforceable); *Camelot Excavating Co. v. St. Paul Fire & Marine Ins. Co.*, 89 Mich. App. 219, 280 N.W.2d 491 (1979), *aff'd* 410 Mich. 118, 301 N.W.2d 275 (1981) (bond suit limitation, clearly providing suits must be brought in one year, enforceable when there was no controlling state law that prohibited such a limitation); *Rumsey Elec. Co. v. Univ. of Del.*, 358 A.2d 712 (Del. 1976) (time limitation shorter than that provided by statute enforceable as long as no contractual provision to the contrary); *Sam Finley, Inc. v. Interstate Fire Ins. Co.*, 135 Ga. App. 14, 217 S.E.2d 358 (1975) (bond prohibiting commencement of a lawsuit on the bond after one year following completion of work was not void on grounds of public policy)).

191. The Statute of Frauds provides:

"[N]o action shall be brought to charge any person upon any contract for the sale of lands. . . for a longer term than one year, unless such contract or some memorandum or note thereof shall be in writing, and signed by the party to be charged therewith"

ILL. REV. STAT. ch. 59, para. 2 (1985).

192. 154 Ill. App. 3d 937, 504 N.E.2d 530 (2d Dist. 1987).

193. *Id.* at 938, 507 N.E.2d at 531.

194. *Id.* at 938, 507 N.E.2d at 530-31.

195. *Id.* at 938, 507 N.E.2d at 531.

196. *Id.* at 940, 507 N.E.2d at 532.

197. *Id.* at 941, 507 N.E.2d at 533.

mentally relies on the oral modification.¹⁹⁸ In addition, the court canvassed Illinois law and concluded that the party seeking to assert the Statute of Frauds need not have induced the other party to an oral modification in order for the exception to apply; detrimental reliance is sufficient.¹⁹⁹

In another Statute of Frauds case, *Gibbons v. Stillwell*,²⁰⁰ the Illinois Appellate Court for the Fifth District held that partial performance of an oral contract does not remove the contract from the Statute of Frauds in an action at law rather than equity.²⁰¹ In *Gibbons*, the plaintiff, Gibbons, brought a legal malpractice suit against the defendant, Stillwell, based on advice concerning Gibbons's rights as a prospective borrower against a bank concerning the bank's alleged oral commitment for a twenty-year loan.²⁰² The sufficiency of the defendant's advice against attempting to enforce the agreement depended on whether the bank's partial performance of the loan agreement in the form of loan advances made the oral loan commitment enforceable.²⁰³ The court concluded, without analysis, that the bank's partial performance did not take the agreement outside the Statute of Frauds because Gibbons had an action at law for damages against the bank.²⁰⁴

Illinois appellate courts also decided contractual remedies cases concerning other issues. In *Midland Hotel Corp. v. Reuben H. Donnelley Corp.*,²⁰⁵ the Appellate Court for the First District held that in order for the plaintiff in a breach of contract action to recover lost profits, such lost profits must have been reasonably contemplated by the breaching party at the time the contract was entered.²⁰⁶ At trial, the evidence indicated that the defendant, Donnelley, agreed to list the plaintiff, Midland Hotel, in the defendant's Chicago Visitors Guide and Downtown Directory.²⁰⁷ The plaintiff brought a breach of contract action when the defendant failed to include the plaintiff in the directory. The trial court

198. *Id.* at 940-41, 507 N.E.2d at 532.

199. *Id.* at 941, 507 N.E.2d at 532.

200. 149 Ill. App. 3d 411, 500 N.E.2d 965 (5th Dist. 1986), *aff'd in part, rev'd in part*, 118 Ill. 2d 306, 515 N.E.2d 61 (1987) (affirming the appellate court's holding that lost profits damages were not proven with reasonable certainty and reversing the appellate court's holding that the trial court improperly refused a jury instruction patterned after *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854)).

201. *Id.* at 416-17, 500 N.E.2d at 969.

202. *Id.* at 412, 500 N.E.2d at 966.

203. *Id.* at 415, 500 N.E.2d at 968.

204. *Id.* at 416-17, 500 N.E.2d at 969.

205. 149 Ill. App. 3d 53, 501 N.E.2d 1280 (1st Dist. 1986).

206. *Id.* at 63-65, 501 N.E.2d 1287-88.

207. *Id.* at 56, 501 N.E.2d at 1282.

refused a jury instruction proposed by the defendant that stated that the plaintiff was entitled to only those lost profits that were "reasonably within contemplation of the defaulting party at the time the contract was entered [into]."²⁰⁸ The trial court awarded the plaintiff \$500,000 in actual damages based on lost profits.²⁰⁹

The appellate court reversed and remanded the case to the lower court, stating that Illinois courts follow the common law rule that lost profits must have been within the contemplation of the parties at the time the contract was executed in order to be recoverable in a breach of contract action.²¹⁰ The *Midland* court implied that the trial court erred by equating contract damages with tort damages, which include liability for all injuries proximately caused by the tort.²¹¹ The court explained that exposure to damages in breach of contract actions is less than in tort actions because "a contracting party contemplating damages that flow from special circumstances can prepare itself for any additional risk by charging more, or getting insurance, or even deciding to forego the entire contract."²¹²

In *Biehl v. Atwood*,²¹³ the Appellate Court for the Fifth District considered for the first time in Illinois whether a buyer's contractual obligation to pay the balance of the purchase price set in a contract for deed merges into the deed. The court held that a deed transfer in connection with the execution of a land sale installment contract does not merge the contract into the deed for purposes of installment payments when the circumstances surrounding the transaction indicate that the installment payments are to continue after the deed is delivered.²¹⁴

Pursuant to a written contract, the Biehls sold thirty-seven acres of land to the defendants, Atwoods, for \$85,000, payable in annual installments of two thousand dollars each. The Biehls delivered the deed to the Atwoods the day after the contract was executed.²¹⁵ The defendant Mr. Atwood, then divorced, made payments for six years until Mr. Biehl died. The executor of Mr. Biehl's estate sued to recover the amount due under the installment contract when the defendant ceased making payments.²¹⁶

208. *Id.* at 63, 501 N.E.2d at 1286-87.

209. *Id.* at 55-56, 501 N.E.2d at 1282.

210. *Id.* at 63-65, 501 N.E.2d at 1287-88.

211. *Id.* at 64, 501 N.E.2d at 1287.

212. *Id.*

213. 151 Ill. App. 3d 763, 502 N.E.2d 1234 (5th Dist. 1986).

214. *Id.* at 766, 502 N.E.2d at 1236.

215. *Id.* at 764, 502 N.E.2d at 1235.

216. *Id.* at 765, 502 N.E.2d at 1236.

The appellate court noted the general rule that delivery of a deed in full execution of a contract for sale of land merges the provisions of the contract into the deed.²¹⁷ A buyer's continued payment of installments, however, is strong, if not conclusive, evidence that the parties do not intend the execution and delivery of the deed to cancel the installment contract.²¹⁸

VI. CONSUMER PROTECTION²¹⁹

In the area of consumer protection law, the Illinois Supreme Court decided cases concerning the Consumer Fraud and Deceptive Business Practices Act²²⁰ and the privity requirement under an implied warranty theory. In *Charles Hester Enterprises, Inc. v. Illinois Founders Insurance Co.*, the Illinois Supreme Court rejected several challenges to a "sleep-safe" insurance clause that provided insureds with coverage in excess of the statutory limit on liability in exchange for higher premiums.²²¹

In *Hester*, the defendant, Illinois Founders, insured the plaintiff dramshop owner, Charles Hester, against personal injury claims by his guests.²²² The plaintiff sought the imposition of a constructive trust on the premiums paid for coverage in excess of the statutory cap on liability.²²³ The plaintiff contended that the promise of coverage in excess of statutory liability limits was illusory.²²⁴

Given possible legislative action raising the liability limit, the court concluded that the insurer's promise was conditional, not il-

217. *Id.* at 765, 502 N.E.2d at 1235.

218. *Id.* at 766, 502 N.E.2d at 1236.

219. In *Kindred v. Stuhler*, 155 Ill. App. 3d 194, 507 N.E.2d 1379 (3d Dist. 1987), the Appellate Court for the Third District held that a motel was not a dwelling for the purposes of the Uniform Vendor and Purchaser Risk Act ("the Act"). *Id.* at 196, 507 N.E.2d at 1381. The Act allocates the risk of loss between vendors and purchasers and requires certain disclosures. ILL. REV. STAT. ch. 29, para. 8.1-8.22 (1985). Section 8.22 of the Act provides that any installment contract for the sale of a dwelling structure is voidable at the election of buyers, unless a certificate of compliance or express written warranty of compliance with the applicable dwelling code is provided. See ILL. REV. STAT. ch. 29, paras. 8.21(b), 8.22 (1985).

220. ILL. REV. STAT. ch. 121 1/2, para. 261-272 (1985). The purpose of the act is to protect consumers, borrowers, and businessmen against fraud, unfair methods of competition, and unfair or deceptive acts or practices in the conduct of any trade or commerce and to give the Attorney General certain powers and duties for the enforcement thereof. ILL. ANN. STAT. ch. 121 1/2, para. 261 comment (Smith-Hurd Supp. 1987).

221. 114 Ill. 2d 278, 499 N.E.2d 1319 (1986). According to the court, a sleep-safe clause is a promise by the insurer to insure against possible increases in statutory liability. *Id.* at 286, 499 N.E.2d at 1322.

222. *Id.* at 283-84, 499 N.E.2d at 1321.

223. *Id.* at 282, 499 N.E.2d at 1320.

224. *Id.* at 287, 499 N.E.2d at 1323.

lusory.²²⁵ The court rejected the plaintiff's fraud claim on the grounds that the insurance had some value and that defendants had not been charged with misrepresenting the terms of coverage.²²⁶ The court's conclusion that the insurers did not violate the Consumer Fraud Act followed from this holding.²²⁷ In addition, the court reasoned that the insurer's failure to disclose the liability limit in its insurance policies did not constitute "concealment, suppression or omission of any material fact" in violation of the Consumer Fraud Act because the limits were set out clearly in the Dramshop Act.²²⁸

The Illinois Supreme Court's decision in *Hester* was premature. The court, by affirming the dismissal of the complaint, gave the plaintiff no opportunity to show, for example, that the insurer had vastly superior bargaining power or that the insurer may have owed dramshop owners a duty to disclose the statutory liability limits. Courts should not be too quick to apply *Hester* to dismiss similar actions before the plaintiff has had an opportunity to take discovery.

The Illinois Supreme Court, in *Lanier v. Associates Finance, Inc.*,²²⁹ analyzed another alleged violation of the Consumer Fraud and Deceptive Business Practices Act. The court held that a lender's mere mention, without explanation, of the so-called "Rule of 78's" in a credit agreement did not violate any duty owed to borrowers under the Consumer Fraud and Deceptive Business Practices Act or the common law.²³⁰

In *Lanier*, the plaintiff, Lanier, entered into a loan agreement with the defendant, Associates Finance.²³¹ The agreement provided in relevant part that earned interest on the borrower's accelerated payment would be calculated according to the Rule of

225. *Id.*

226. *Id.* at 290, 499 N.E.2d at 1324.

227. *Id.* at 292, 499 N.E.2d at 1325.

228. *Id.* (citing ILL. REV. STAT. ch. 121 1/2, para. 262 (1983)).

229. 114 Ill. 2d 1, 499 N.E.2d 440 (1986).

230. *Id.* at 9-18, 499 N.E.2d at 443-47. The Rule of 78's is a method of computing interest for a loan, in which the borrower pays more of the interest in the first payments than he does in later payments. *Id.* at 6-7, 499 N.E.2d at 442. For example in a 12-month loan, the borrower will pay 12/78 of the total finance charge in his first monthly payment, and will pay 11/78 of the total finance charge in his second monthly payment. *Id.* at 6, 499 N.E.2d at 442. In each succeeding month of the 12 month period, the amount of the total finance charge is reduced by 1/78 of the total, until only 1/78 remains to be paid in the last payment. *Id.* Thus, the financier recovers most of the finance charge in the first months. For a discussion of the Consumer Fraud and Deceptive Business Practices Act, see *supra* note 220.

231. *Id.* at 5, 499 N.E.2d at 441.

78's;²³² the contract did not define the Rule of 78's.²³³ The plaintiff instituted a class action and sought to recover the difference in recoverable unearned interest as calculated by the actuarial method as compared to the Rule of 78's method.²³⁴ The plaintiff alleged that use of the Rule of 78's, absent explanation, was fraudulent and violative of the Consumer Fraud and Deceptive Business Practices Act.²³⁵

The Illinois Supreme Court first rejected the plaintiff's attempt to modify the loan agreement on the ground that there was no meeting of the minds because of the complexity and obtuseness of the Rule of 78's method.²³⁶ It concluded that the reference to the Rule of 78's method in the credit agreement was not ambiguous and refused to reform the agreement simply because the plaintiff failed to understand how the method operated.²³⁷ The court stated that the Federal Truth in Lending Act required issuers of consumer credit to make certain disclosures in credit agreements, including disclosure of the yearly cost of credit or "annual percentage rate" of interest.²³⁸ The court relied on the Federal Reserve Board's interpretation of the Federal Truth in Lending Act to support its finding that simple reference to use of the Rule of 78's in prepayment interest calculations was sufficient disclosure and to require otherwise would result in information overload.²³⁹ According to the court, mere reference to the use of the Rule of 78's was not violative of the Consumer Fraud and Deceptive Business Practices Act, because the defendant complied with the federal statute.²⁴⁰ Section 10(b)(1) of the Consumer Fraud Act states that the Act does not apply to actions specifically authorized by State or federal regulatory agencies; thus, compliance with the Federal Truth in Lending Act and the Federal Reserve Board's interpretation of its regulations was a complete defense.²⁴¹

232. *Id.* at 5-6, 499 N.E.2d at 441-42. For an explanation of the Rule of 78's, see *supra* note 230.

233. *Id.* at 8, 499 N.E.2d at 443.

234. *Id.* at 4-6, 499 N.E.2d at 443. The actuarial method is another method for computing interest in which the interest attributed to each month bears a direct relation to the amount of money held by the borrower and the time for which that amount is held. *Id.* at 7, 499 N.E.2d at 445.

235. *Id.* at 4-5, 499 N.E.2d at 441.

236. *Id.* at 8-9, 499 N.E.2d at 443 (citing 15 U.S.C. §§ 1601-1700 (1982)). The trial court dismissed the action, and the appellate court affirmed. *Id.* at 5, 499 N.E.2d at 441.

237. *Id.* at 8-9, 499 N.E.2d at 443.

238. *Id.* at 9-11, 499 N.E.2d at 443-44.

239. *Id.* at 14, 499 N.E.2d at 445-46.

240. *Id.* at 17-18, 499 N.E.2d at 447.

241. *Id.*

The Illinois Supreme Court, in *Szajna v. General Motors Corp.*,²⁴² considered whether the privity requirement in an implied warranty breach action should be abolished. The court refused to enlarge the scope of implied warranty actions, holding that the action was properly dismissed because the plaintiff was not in privity with the defendant.²⁴³

In *Szajna*, the plaintiff, Szajna, purchased a 1976 Pontiac Ventura manufactured by the defendant, General Motors. At the time of purchase, Szajna did not know that the car was equipped with a Chevrolet Chevette transmission. He subsequently learned of this fact when he experienced problems with the transmission.²⁴⁴ Szajna brought a class action seeking damages for the economic loss from the allegedly inferior transmission, claiming breach of implied and express warranties under both the U.C.C. and the federal Magnuson-Moss Act, breach of express warranty under the U.C.C., and common law fraud.²⁴⁵

The Illinois Supreme Court affirmed the dismissal of the U.C.C. implied warranty action on the ground that Szajna was not in privity with General Motors.²⁴⁶ The court refused to follow other jurisdictions that had abolished the privity requirement for implied warranty actions.²⁴⁷ The court stated that the legislature's intent to limit economic loss actions to contracting parties was clear by its choice of the most restrictive scope of implied warranty provision suggested by U.C.C. drafters.²⁴⁸

242. 115 Ill. 2d 294, 503 N.E.2d 760 (1986).

243. *Id.* at 311, 503 N.E.2d at 767.

244. *Id.* at 299, 503 N.E.2d at 762.

245. *Id.* at 298, 503 N.E.2d at 761.

246. *Id.* at 311, 503 N.E.2d at 767. The trial court granted General Motors' motion to dismiss; the appellate court affirmed the lower court. *Id.* at 298, 503 N.E.2d at 761. The Illinois Supreme Court affirmed the dismissal of the express warranty claims for lack of privity, in addition to the implied warranty claims. *Id.* at 319-20, 503 N.E.2d at 771. In affirming the dismissal of the common law fraud claim, the court stated that the use of the Ventura name as the description of the vehicle did not constitute an untrue statement capable of supplying an inference of intent to deceive about the transmission. *Id.* at 323, 503 N.E.2d at 773. The court remanded the Magnuson-Moss implied warranty claim for further proceedings. *Id.* at 315, 503 N.E.2d at 769. In its analysis of the Magnuson-Moss Act claim, the court found that sufficient privity for an implied warranty action under the Act existed for implied warranties arising under state law. *Id.* at 315, 503 N.E.2d at 766. The court based this finding on the ground that the written warranty supplied by the buyer was sufficient under the Act to find privity. *Id.* at 315, 503 N.E.2d at 769.

247. *Id.* at 311, 503 N.E.2d at 767.

248. *Id.* at 307, 503 N.E.2d at 766.

VII. RECENT LEGISLATION

A. Corporations Legislation

The Business Corporation Act of 1983 incorporated one minor change during the *Survey* year.²⁴⁹ The provision, section 2.35, provides that boards of directors for residential cooperative corporations of at least twenty-four units in a city of more than one million inhabitants must give notice of meetings and allow residents to attend.²⁵⁰

B. Secured Transactions Legislation

Changes were also made to the U.C.C. during the *Survey* year.²⁵¹ Section 9-307(4) was amended to provide that buyers of farm products take the property subject to a security interest on the following conditions: first, the buyer received written notice from the secured party within one year prior to the sale; or second, if the buyer failed to perform the payment obligations.²⁵² This replaces the previous language of the section which provided that a buyer took free of security interests if he purchased the farm products in the ordinary course of business without notice of the security interest.²⁵³

Additionally, section 9-307.1 of the U.C.C. has been amended to provide that a commission merchant or selling agent who sells a farm product for others is subject to security interests created by the seller of the farm products, if, within one year before the sale, the buyer had written notice from the seller and if the commission merchant or selling agent failed to perform the payment obligations.²⁵⁴ This section replaces the previous one which provided that a commission merchant or selling agent was not liable unless he had notice of the security interest within five years prior to the sale.²⁵⁵

C. Banks and Banking Legislation

Changes were made also to the Illinois Banking Act (the "Act").²⁵⁶ First, section 15(9)(f) has been added and provides that when a change in the ownership of the outstanding stock of a state

249. ILL. REV. STAT. ch. 32, paras. 1.01-17.05 (1985).

250. ILL. REV. STAT. ch. 32, para. 2.35 (Supp. 1986).

251. ILL. REV. STAT. ch. 26, paras. 9-307(4), 9-307.1 (Supp. 1986).

252. ILL. REV. STAT. ch. 26, para. 9-307(4) (Supp. 1986).

253. ILL. REV. STAT. ch. 26, para. 9-307(4) (1985).

254. ILL. REV. STAT. ch. 26, para. 9-307.1 (Supp. 1986).

255. ILL. REV. STAT. ch. 26, para. 9-307.1 (1985).

256. ILL. REV. STAT. ch. 17 paras. 301-394 (1985).

bank results in a change of the control of the bank and the conditions discussed below result, the person that acquired forty-one percent ownership or holding may merge the state bank with another state bank or with a national bank owned or controlled by the same person.²⁵⁷ The controlling conditions are the following: 1) the change occurs after January 1, 1985; 2) the change results in ownership or holding of outstanding stock of at least fifty-one percent by a person; and 3) the Commissioner has made a written finding directed to the Board of Governors of the Federal Reserve System that factual circumstances exist permitting expedited approval of acquisition by the Federal Reserve or the Commissioner has made findings pursuant to section 31(1) or (2) of this Act.²⁵⁸ The changes became effective January 20, 1987.²⁵⁹

Additionally, section 47 of the Act was amended to require quarterly bank statements within thirty days rather than the previous twenty-eight day limitation.²⁶⁰ Also, the previous one hundred dollars per day late fee was abrogated.²⁶¹ Further, a new provision now requires evidence to be submitted to the Commissioner that the quarterly report was published, and noncompliance involves a penalty of one hundred dollars per day.²⁶²

Finally, section 48 of the Act was amended to raise the annual fee required of banks for the administration of the act from four hundred dollars to eight hundred dollars and also to raise the schedule for the variable fee dependant on banks' assets.²⁶³ The amendment included a penalty fee for noncompliance with reporting requirements.²⁶⁴

VIII. CONCLUSION

The changes in Commercial Law during the *Survey* year noted in this Article are important because they reflect various trends in the approach of Illinois courts toward issues that often confront practitioners in this area.

257. *Id.*

258. ILL. REV. STAT. ch. 17, para. 338 (Supp. 1987).

259. *Id.*

260. ILL. ANN. STAT. ch. 17, para. 358 (Smith-Hurd Supp. 1987).

261. *Id.*

262. *Id.*

263. Pub. A. No. 85-10, 1987 Ill. Legis Serv. 21 (West) (to be codified at ILL. REV. STAT. ch. 17, para. 359).

264. *Id.*