

No. 1-10-2917

NOTICE: This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

| | | |
|--|---|--------------------------------|
| FIRST MIDWEST BANK, |) | Appeal from the |
| |) | Circuit Court of |
| Plaintiff-Appellee, |) | Cook County. |
| |) | |
| v. |) | 09 CH 4045 (Consolidated with) |
| |) | 10 MC2 050615 & 10 MC2 050345) |
| AMP OF ILLINOIS, LLC, and ZACH JOSEPH, |) | |
| <i>et al.</i> , |) | |
| |) | The Honorable |
| Defendants-Appellants. |) | Margaret A. Brennan, |
| |) | Judge Presiding. |

JUSTICE PUCINSKI delivered the judgment of the court.
Presiding Justice Lavin and Justice Fitzgerald Smith concurred in the judgment.

ORDER

¶1 HELD: In an action by a bank for foreclosure, a grant of summary judgment in favor of the bank was affirmed where: the defendants failed to present any genuine issue of material fact that the terms of the loan agreement were breached; that the defendants did not make the monthly payments required; that the loan was out of balance; and that the loan was in default. Under the undisputed terms of the construction loan agreement, the plaintiff bank was justified in not funding the loan from an interest reserve account due to the defendants' failure to meet a condition of the agreement regarding pre-leases. The

1-10-2917

failure to then make monthly payments and the loan being out of balance undisputedly constituted events of default under the loan agreement.

¶2 BACKGROUND

¶3 Defendant Zach Joseph formed defendant AMP of Illinois, LLC (AMP) to construct and develop the real estate located at 3355 N. Milwaukee Avenue in Glenview, Illinois. The property was purchased in 2005. It consisted of an operating restaurant and bar at the time. Later, the restaurant and bar were demolished to construct a proposed three-story retail and office building with approximately 29,000 square feet of space. Plaintiff First Midwest Bank (First Midwest) agreed to finance the construction project with a loan of \$5,992,500. On behalf of AMP, Joseph executed a promissory note, mortgage, construction loan and security agreement, along with a personal guarantee. Under the promissory note, AMP was required to make monthly payments of interest up until the maturity date of June 17, 2009, or, if an option was exercised by AMP, the extended maturity date of December 17, 2009. Under the construction loan and security agreement, an interest reserve account in the amount of \$400,000 was created by the bank to fund the monthly payments required by the promissory note. No principal payments were required under the loan until the maturity date. As of December 2008, First Midwest had received \$112,253.61 from the interest reserve account.

¶4 As a condition precedent to closing the loan and funding monthly payments of interest, the construction loan and security agreement required that at least 40% of the tenantable space in the project be pre-leased to tenants in accordance with terms of leases acceptable to First Midwest. To meet the pre-leasing requirements, AMP retained NAI Hiffman to solicit proposed tenants for the project. Under the loan documents, First Midwest had the right to refuse to close

1-10-2917

the loan if the pre-leasing requirements were not met. The leases of prospective tenants provided by First Midwest met the requirement of 40% of the tenantable space. First Midwest reviewed the leases and did not object at that time, and the loan closed on December 9, 2007.

¶5 Section 3.2 of the note defined an event of default as either the failure to make any payment of principal or interest required, or the occurrence of an event of default as that term is defined in the loan agreement.

¶6 Section 2(g) of the construction loan and security agreement regarding the interest reserve provided the following:

"g. **Interest Reserve**. Included within the budget for the Loan is an interest reserve (the "Interest Reserve") in the amount of \$400,000.00, from which Bank shall make disbursements in order to pay accrued interest and loan fees, *subject to the terms and conditions herein.* *** No separate fund or account shall be created for the Interest Reserve. *Bank may refuse to make any further disbursements from the Interest Reserve upon the occurrence of an Event of Default.* In the event the Interest Reserve becomes depleted, Borrower shall be responsible for the payment of interest and fees out of Borrower's own funds." (Emphasis added.)

¶7 Section 1(c) of the construction loan and security agreement defined "events of default," in relevant part, as the following:

"c. 'Event of Default' shall mean the occurrence of any one or more of the following events (subject to applicable cure periods, if any):

i. Failure to make prompt payment when due, of any payment due on any of

the Indebtedness, or failure to promptly perform any covenant, promise or agreement contained herein or in the other Loan Documents, or in any other agreement, document or instrument hereinafter delivered by Borrower to Bank;

- ii. Any representation, warranty or other information made or furnished to Bank shall prove to have been false or incorrect in any material respect [sic];

* * *

- xi. Any material adverse change in Borrower's or Guarantor's financial condition."

¶8 Section 6(k) of the loan agreement provided:

"Borrower shall have made an equity contribution to the Project sufficient to result in a loan-to-value ratio satisfactory to Bank."

¶9 Section 6(p) provided:

"At least 40% of tenantable space in the Project shall have been pre-leased to tenants in accordance with terms acceptable to Bank."

¶10 Section 7(e) provided:

"Bank shall not be obligated to make advances except during the progress of construction on the basis of Bank's estimate of the value of the work and improvements in place, of the cost of completion of construction, and of the amount of reserves required to be retained by Bank for its protection. Bank may retain, in addition to all reserves, an amount

1-10-2917

sufficient, in Bank's sole judgment, to insure that there will be proper retainage from contractors, subcontractors, and materialmen to assure their performance of their contracts and to cover the contingency of insufficiency of cost estimates or of additional expense being incurred in reletting any contracts or subcontracts in case of default or nonperformance of their contracts. In any event, Bank may provide a reserve for contingencies of ten (10%) percent of the estimated cost of construction. *** Advances shall be made only at such intervals as Bank may reasonably specify. ***"

¶11 Section 8(h) also required the following:

"Anything in this Agreement contained to the contrary notwithstanding, it is expressly understood and agreed that the Loan hereunder shall at all times be in balance. The Loan shall be deemed to be in balance only when the undisbursed proceeds of the Loan, after provision for all reserves authorized by this Agreement, shall equal or exceed the amount necessary, based upon Bank's estimates of construction costs and loan expense, to pay for all work done or to be done for completion of the construction of the Improvements including the installation of fixtures and equipments. If, for any reason, the Loan should at any time after commencement of disbursement of the proceeds become out of balance, Borrower will, within five (5) days after written request by Bank, deposit deficiency with Bank, which deposit shall first be exhausted before any further disbursement of the proceeds of the Loan shall be made."

¶12 On October 1, 2008, First Midwest informed Joseph to put the construction project on hold until further notice. At that time, AMP had incurred in excess of \$400,000 in construction

1-10-2917

costs, which was over the amount in the interest reserve account.

¶13 Lawrence Walther of First Midwest testified at his deposition that after reviewing AMP's second draw request of \$136,000, he concluded that there was a significant change in AMP's cost statement because the price of steel had increased substantially. The loan was thus out of balance so he decided the draw would not be funded.

¶14 After Walther made this decision not to fund the loan, he decided to also review the tenant pre-leases which had previously been approved prior to closing the loan. According to Walther, the signature for the dental practice tenant did not seem to match the signature on the tenant financial statement. Joseph offered to have the person who signed the lease and financial statement attest to the accuracy of the signatures. However, it is undisputed that Joseph and AMP never did provide any attestation for the signatures. According to Walther, AMP was in default because the loan was out of balance, meaning that the remaining funds in the loan were not sufficient to cover the costs of the project, and because of the failure to make the monthly payments.

¶15 According to AMP and Joseph, they did not get an answer to their queries regarding why the loan was not being funded by First Midwest from the interest reserve account. There was a meeting between Joseph and Walther and Greg Andrews of First Midwest on November 4, 2008, at which the parties were represented by attorneys. According to AMP and Joseph, there was no explanation that a default existed. AMP and Joseph did not otherwise make monthly payments.

¶16 According to AMP and Joseph, they first received notice of default in a letter dated December 4, 2008. The letter stated that AMP defaulted by "failing to meet the pre-leasing

1-10-2917

requirements set forth in Section (p) of the Loan Agreement."

¶17 On January 30, 2009, First Midwest filed the instant action to foreclose the mortgage. On March 20, 2009, AMP and Joseph filed their answer. In their answer, they did not assert any affirmative defenses. On May 27, 2009, the court entered an order granted First Midwest's motion to be placed as mortgagee-in-possession because AMP and Joseph had left a dangerous condition on the property, a large trench. First Midwest took possession and filled the trench.

¶18 On December 2, 2009, First Midwest filed its motion for default, summary judgment, and judgment of foreclosure and sale. The circuit court granted summary judgment in favor of First Midwest, and AMP and Joseph appealed.

¶19 ANALYSIS

¶20 AMP and Joseph argue that the circuit court erred in granting summary judgment to First Midwest because there are genuine issues of material fact regarding whether First Midwest breached the duty of good faith and fair dealing and whether First Midwest, and not AMP and Joseph, breached the loan agreements. Specifically, AMP and Joseph argue that there is a genuine issue of material fact whether there was actually a default or whether this reason for not funding the loan was pretextual.

¶21 Summary judgment is appropriate only where "the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." 735 ILCS 5/2-1005(c) (West 2008). "In determining the existence of a genuine issue of material fact, courts must consider the pleadings, depositions, admissions, exhibits, and affidavits on file in the case

1-10-2917

and must construe them strictly against the movant and liberally in favor of the opponent."

Purtill v. Hess, 111 Ill. 2d 229, 240 (1986) (citing *Kolakowski v. Voris*, 83 Ill. 2d 388, 398 (1980)).

¶22 We determine there is no genuine issue of material regarding any purported breach of the duty of good faith and fair dealing. The duty of good faith implied in every contract "requires the party vested with contractual discretion to exercise it reasonably, and he may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectation of the parties. *Bank One, Springfield v. Roscetti*, 309 Ill.App.3d 1048, 1059-60 (1999) (citing *Carrico v. Delp*, 141 Ill. App. 3d 684, 690 (1986), *Chemical Bank v. Paul*, 244 Ill.App.3d 772, 783 (1993), and *Northern Trust Co. v. VIII South Michigan Associates*, 276 Ill. App. 3d 355, 368 (1995)).

¶23 However, "Illinois courts have consistently held that the covenant of good faith and fair dealing is not an independent source of duties for the parties to a contract." *Fox v. Heimann*, 375 Ill. App. 3d 35, 42 (2007) (citing *Cramer v. Insurance Exchange Agency*, 174 Ill. 2d 513, 525 (1996), *Beraha v. Baxter Health Care Corp.*, 956 F.2d 1436, 1443 (7th Cir. 1992)). While the implied covenant of good faith and fair dealing exists in every contract in Illinois, it is essentially used as a construction aid in determining parties' intent, and " 'vague notions of fair dealing' do not form the basis for an independent tort." *Anderson v. Burton Associates, Ltd.*, 218 Ill. App. 3d 261, 267 (1991) (quoting *Foster Enterprises, Inc. v. Germania Federal Savings & Loan Association*, 7 Ill. App. 3d 22, 31 (1981)). See also *The Northern Trust Co. v. VIII South Michigan Associates*, 276 Ill. App. 3d 355, 367 (1995) ("Although the covenant of good faith and

1-10-2917

fair dealing is used as an aid in construing a contract, it does not form the basis of an independent tort recognized in Illinois.") (citing *Koehler v. First National Bank*, 232 Ill. App. 3d 679 (1992), *Anderson*, 218 Ill. App. 3d 261).

¶24 In *Koehler*, the court upheld the dismissal of a claim for breach of the implied duty of good faith and fair dealing based on a bank's failure to close on a loan, similar to the instant case. In *Koehler*, count V of the plaintiffs' second amended complaint was directed against the defendant bank and sought both compensatory and punitive damages, alleging that, by the Bank's failure and refusal to close a certain loan with the plaintiffs, the Bank breached its "implied duty of good faith and fair dealing" owed to the plaintiffs. *Koehler*, 232 Ill. App. 3d at 680. The trial court dismissed this count for failure to state a cause of action "recognized by the law of this state." *Koehler*, 232 Ill. App. 3d at 680. In affirming the dismissal, the appellate court repeated the observation that "no Illinois case or statute supports a cause of action for bad-faith dealing outside the areas of insurance and employment law." *Koehler*, 232 Ill. App. 3d at 683 (citing *Chicago College of Osteopathic Medicine v. George A. Fuller Co.*, 719 F.2d 1335 (7th Cir. 1983)). The *Koehler* court specifically cautioned that "[c]are must be taken to prevent the transmutation of every breach of contract into an independent tort action through the bootstrapping of the general contract principle of good faith and fair dealing." *Koehler*, 232 Ill. App. 3d at 683 (citing *Martin v. Federal Life Insurance Co.*, 109 Ill. App. 3d 596 (1982)). The court held that it "decline[d] to extend the cause of action for bad-faith dealing to this area of the law. The trial court properly concluded that count V fails to state a cause of action cognizable in Illinois and rightly described the plaintiffs' cause as a contract action." *Koehler*, 232 Ill. App. 3d

1-10-2917

at 683. Similarly in this case, there is no genuine issue of material fact regarding any independent cause of action for breach of the implied duty of good faith and fair dealing.

¶25 As First Midwest correctly points out, "[d]espite the forgoing good-faith principles, parties to a contract are entitled to enforce its terms to the letter, and an implied covenant of good faith cannot overrule or modify the express terms of a contract." *Bank One*, 309 Ill. App. 3d at 1060 (citing *Northern Trust Co. v. VIII South Michigan Associates*, 276 Ill. App. 3d 355, 367 (1995)). "The covenant of good faith and fair dealing does not allow a party to read an obligation into a contract that does not exist." *Suburban Insurance Services, Inc. v. Virginia Surety Company, Inc.*, 322 Ill. App. 3d 688, 693 (2001) (citing *Northern Trust*, 276 Ill. App. 3d at 368; *Bank One, Springfield v. Roscetti*, 309 Ill. App. 3d 1048 (1999)).

¶26 There is no genuine issue of material fact that the bank also did not breach the loan agreement in failing to fund the loan from the interest reserve account. On our *de novo* review of the record, First Midwest was not obligated to fund the loan from the interest reserve account if the terms and conditions of the loan were not met. Here the construction loan agreement does not obligate First Midwest Bank to use the interest reserve to make the interest payment due on the loan if AMP and Joseph breached the terms and conditions of the agreement. Section 6(p) required that "[a]t least 40% of tenantable space in the Project shall have been pre-leased to tenants in accordance with terms acceptable to Bank." Here, it is undisputed that the terms of the pre-tenant leases were not acceptable to First Midwest and that the loan was out of balance. Although AMP and Joseph argue the reason for not funding the loan was pretextual, it is undisputed that the leases were unacceptable to First Midwest. First Midwest was under no

1-10-2917

obligation to continue funding the loan from the interest reserve account. Thus, there is no genuine issue of material fact that First Midwest did not breach any duty of good faith and fair dealing and also did not breach the loan agreement.

¶27 The circuit court properly granted summary judgment to First Midwest. There was no genuine issue of material fact that AMP and Joseph were in default under the construction loan agreement. In particular, Joseph's affidavit, the only counter-affidavit submitted in response to First Midwest's summary judgment motion, failed to deny that AMP was in default.

¶28 "In determining the existence of a genuine issue of material fact, courts must consider the pleadings, depositions, admissions, exhibits, and affidavits on file in the case and must construe them strictly against the movant and liberally in favor of the opponent." *Purtill v. Hess*, 111 Ill. 2d 229, 240 (1986) (citing *Kolakowski v. Voris*, 83 Ill. 2d 388, 398 (1980)). However, when affidavits presented in support of summary judgment are not contradicted by counter-affidavits, they must be taken as true. 735 ILCS 5/2-1005(c) (West 2008). "[F]acts contained in an affidavit in support of a motion for summary judgment which are not contradicted by counteraffidavit are admitted and must be taken as true for purposes of the motion." *Purtill*, 111 Ill. 2d 229, 241 (1986) (citing *Heidelberger v. Jewel Cos.*, 57 Ill. 2d 87, 92-93 (1974)). An affidavit submitted in the summary judgment context serves as a substitute for testimony at trial. *Robidoux v. Oliphant*, 201 Ill. 2d 324, 335-36 (2002) (citing *Fooden v. Board of Governors of State Colleges & Universities*, 48 Ill. 2d 580, 587 (1971)). Although a plaintiff is not required to prove his case at the summary judgment stage, in order to survive a motion for summary judgment, the nonmoving party must present a factual basis that would arguably entitle the party

1-10-2917

to a judgment. *Robidoux v. Oliphant*, 201 Ill. 2d 324, 335 (2002) (citing *Allegro Services, Ltd. v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 256 (1996)). Thus, the party opposing summary judgment must produce some competent, admissible evidence which, if proved, would warrant entry of judgment for the opposing party. *Davis v. Times Mirror Magazines, Inc.*, 297 Ill. App. 3d 488, 494-95 (1998). We apply a *de novo* standard when reviewing summary judgment rulings. *Outboard Marine Corp. v. Liberty Mutual Insurance Co.*, 154 Ill. 2d 90, 102, 607 N.E.2d 1204, 1209 (1992).

¶29 Under contract law, the party seeking to enforce the contract has the burden of proving that he has substantially complied with all material terms of the contract. *Israel ex rel. Dundee-Landwehr Ltd. Partnership v. National Canada Corporation*, 276 Ill. App. 3d 454, 461 (1995) (citing *Goldstein v. Lustig*, 154 Ill. App. 3d 595 (1987)). Here, AMP and Joseph cannot prove AMP substantially complied with all material terms of the contract, as the fact that they were in default for not making monthly payments is undisputed. First Midwest's materials in support of the summary judgment motion establish that AMP and Joseph breached the loan agreements because First Midwest did not receive the monthly interest payments due on the promissory note. After First Midwest determined the pre-leases were unacceptable and did not continue funding the loan from the interest reserve account, AMP and Joseph did not make the monthly payments. Joseph's affidavit opposing the summary judgment motion does not controvert First Midwest's evidentiary materials stating there was a default. Though Joseph recounts various statements and meetings where First Midwest did not explain how or why AMP was in default, nowhere in his lengthy affidavit does he dispute that he and AMP indeed failed to

1-10-2917

make the interest payments on the loans and thus were in default.

¶30 Under our *de novo* review, we also determine that the fact that AMP was in default due to the loan being out of balance also remains undisputed by AMP and Joseph, thus entitling First Midwest to summary judgment. The issue of whether a material adverse change in a borrower's financial condition occurred is normally a question of fact. See *Israel*, 276 Ill. App. at 461-62 ("The issue of whether a material adverse change in Israel's financial condition occurred is a question of fact and will not be disturbed on review unless the finding is against the manifest weight of the evidence.") (citing *Barrows v. Maco, Inc.*, 94 Ill. App. 3d 959, 968 (1981)). Here, however, the fact that the loan was out of balance has not been disputed by AMP and Joseph. In fact, in his affidavit Joseph admits that the construction costs were over the \$400,000 interest reserve account which was to fund the monthly payments on the loan.

"On October 1, 2008, *after incurring construction costs owed to suppliers and subcontractors in excess of \$400,000*, I was informed by First Midwest to put the construction project on hold until further notice with absolutely no explanation."
(Emphasis added.)

Joseph disputed being informed of the reason First Midwest would not allow any further draws, but he admitted that the costs exceeded the interest reserve account.

¶31 Also, Walther of Midwest Bank testified at his deposition that upon review of a line item for steel that had increased the costs of the project significantly, it was determined that the costs of the construction project would exceed the loan, thus making the loan out of balance, and therefore AMP was in default under the agreement. AMP and Joseph have not disputed the

1-10-2917

increased costs of the project and that the loan was out of balance. Nowhere in Joseph's affidavit does he even address this issue, much less controvert it. AMP and Joseph also put forth no other evidence to controvert this fact. This fact remains undisputed. Thus, there was no factual issue as to default on this basis as well under the construction loan agreement.

¶32 Joseph's affidavit recounts instances where First Midwest ostensibly did not advise him how or why AMP was in default. However, we note that any alleged failure to explain the default to Joseph does not create any issue of material fact, as there is no obligation to explain the basis of the breach to the breaching party. "Under Illinois law, a party may justify an asserted termination, rescission, or repudiation of a contract by proving that there was, at the time, an adequate cause ***." *Israel*, 276 Ill. App. 3d at 462 (citing *IK Corp. v. One Financial Place Partnership*, 200 Ill. App. 3d 802, 815 (1990)).

¶33 AMP and Joseph nevertheless contend there is a genuine issue of material fact as to whether the breaches were material. However, the undisputed terms of the loan agreement clearly set forth that a failure to make the monthly payments and the loan being out of balance constitute default under the agreement. See also *Israel*, 276 Ill. App. 3d at 460-61 (affirming the trial court's finding that a bank's refusal to continue funding disbursements in response to a material adverse change in the plaintiff's financial condition constituted a material breach of the loan agreement).

¶34 Further, under our *de novo* review we review of a grant of summary judgment we review all pleadings as well, and we note that AMP and Joseph did not file any affirmative defenses in their answer to First Midwest's complaint. "Illinois law requires a defendant in a breach of

1-10-2917

contract claim to stand by the first defense raised after the litigation has begun." *Israel*, 276 Ill. App. 3d at 462. Thus, there is no genuine issue of material fact regarding the bank's entitlement to summary judgment based on AMP and Joseph's default.

¶35 AMP and Joseph rely on *First National Bank of Cicero v. Sylvester*, 196 Ill. App. 3d 902, (1990), in which the court reversed a grant of summary judgment in favor of the bank and held that there was a question of fact regarding the plaintiff bank's breach of the covenant of good faith and fair dealing in not extending a construction loan. In *Sylvester*, however, whether the defendant was in default remained a genuine issue of material fact. Therefore, the court reversed the summary judgment and held that the trier of fact had to consider, among other things, "any evidence that [the defendant's corporation] was not in default at the time the credit was refused." *Sylvester*, 196 Ill. App. 3d at 911. Here, in stark contrast, defendants have failed to contradict the fact that they were indeed in default under the loan agreement. This failure to contradict the fact that they were in default under the loan proves fatal to AMP and Joseph's opposition to summary judgment in favor of First Midwest.

¶36 AMP and Joseph also argue that First Midwest waived its right to assert AMP's failure to meet the pre-leasing requirements as a breach because it closed the loan and thus accepted the leases. However, as First Midwest points out, waiver is an affirmative defense. *R&B Kapital Development, LLC v. North Shore Community Bank & Trust Co.*, 358 Ill. App. 3d 912, 921 (2005). AMP and Joseph did not plead the affirmative defense of waiver below. As noted, AMP and Joseph did not answer with any affirmative defenses. If not properly pled as an affirmative defense, any such defense is waived and cannot be asserted on appeal. *Chicago Exhibitors Corp.*

No. 1-11-0557

v. Jeepers! Of Illinois, Inc., 376 Ill. App. 3d 599, 610 (2007).

¶37 Also, even were we to consider waiver, we would be constrained to conclude that the construction loan agreement specifically precludes the application of waiver. Section 12 of the Construction Loan and Security Agreement between First Midwest and AMP provides:

"No delay or failure by [First Midwest] to insist upon the strict performance of any term hereof or of the other Loan Documents or to exercise any rights, power or remedy provide for here or therein as a consequence of an Event of Default hereunder or thereunder *** shall constitute a waiver of any such term, such Event of Default or such right, power or remedy."

Thus, there is no basis to assert waiver in this case.

¶38 CONCLUSION

¶39 AMP and Joseph have failed to present any genuine issue of material fact which would warrant reversal of the grant of summary judgment in favor of First Midwest. The only counter affidavit filed, Joseph's affidavit, does not dispute that the terms of the pre-leases were not acceptable to First Midwest; that AMP and Joseph did not make the monthly payments required; that the loan was out of balance; and that the loan was in default. Under the undisputed terms of the construction loan agreement, First Midwest was justified in not funding the loan from the interest reserve account, and due to the failure to make the monthly payments and the loan being out of balance, AMP and Joseph were in default. We affirm the circuit court's grant of summary judgment in favor of First Midwest Bank.

¶40 Affirmed.