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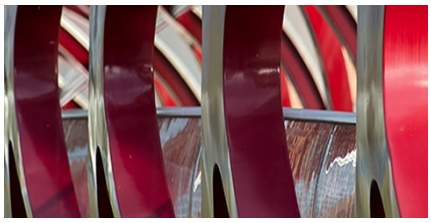

News & Types: Commercial, Competition & Trade Update

No Liability from Void Contract with Union

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By: Stephen M. Proctor

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In May, 2008, Matthew Friedman, a manager of 1550 MP Road LLC ("MP Road"), must have been very pleased. He had just negotiated and signed a lucrative lease and purchase agreement ("LPA") with Teamsters Local Union No. 726 ("Local 726"). The LPA obligated Local 726 to occupy and pay rent on commercial property located at 1550 Mount Prospect Road in Des Plaines, Illinois (thus the name of the LLC). The monthly rent was $12,549 in the first year with gradual increases to $16,559 per month in year 15. Local 726 also had to pay operating expenses and real estate taxes.

It got even better. After five years, Local 726 was obligated to purchase the property for $2,145,371. If Local 726 failed to do so, it was required to pay MP Road 200% of the base rent for the remainder of the lease term (called a "double-rent penalty"). If this occurred, Local 726 would have to pay around $3,583,000 over 10 years without obtaining title to the property.

There was a sordid back story, described in the Illinois Court of Appeals opinion. (*1550 MP Road LLC v. Teamsters Local Union No. 700 et. al*., 2017 IL App (1st) 15330, November 13, 2017). While the LPA was being negotiated, the International Brotherhood of Teamsters ("International") started an investigation into the finances of Local 726. Ironically, two weeks after the LPA was signed, Local 726 assured International (without mentioning the LPA) that it was implementing cost-cutting measures to improve Local 726's financial condition. Eventually, Local 726 was dissolved and Teamsters Local Union No. 700 ("Local 700") received Local 726's membership rolls, assets, and liabilities and occupied the property. Local 700 did not view the LPA as favorable and tried to negotiate modifications. These negotiations were ultimately unsuccessful and Local 700 moved out of the property. Litigation ensued, with MP Road claiming damages against the union defendants for breach of the LPA.

The circuit court, in a bench trial, found a) the LPA was valid and enforceable, b) Local 700 was liable for Local 726's breach of the LPA under exceptions to the theory that a successor is generally not liable, namely the exceptions of merger, mere continuation and fraud, c) Local 700 was liable for Local 726's breach of the LPA because Local 726's transfer of its assets was a fraudulent transfer, and d) a Vice President of International, instrumental in the decision to vacate the property, was personally liable for tortious interference with the LPA. The circuit court awarded nearly $2 million in damages and over $320,000 in fees and costs to MP Road.

However, the circuit court denied MP Road the double rent penalty. Still, overall, it was a bad day for International and Local 700. They appealed.

The Illinois Court of Appeals (cited above) largely affirmed the circuit court. It found that the LPA valid and enforceable and that Local 700 was liable for Local 726's breach of contract. But it reversed the portion of the circuit court's opinion finding the transfer of the property to be fraudulent and holding the Vice President of International personally liable. Still, the money verdict against the union defendants stood.

One of the issues unsuccessfully raised by the union defendants was the enforceability of the LPA. Local 726 did not follow the correct procedures in its bylaws and in Illinois law to have the LPA approved by Local 726's members. Local 726's bylaws required Local 726's members to be notified and to vote to authorize the LPA, which was never done. Moreover, the Illinois Property of Unincorporated Associations Act (765 ILCS 115/0.01) ("Act") provided similar requirements to permit an incorporated association in Illinois (which Local 726 was) to lease and own real estate. The Illinois Court of Appeals analyzed this issue at length. It balanced the public policy under the Act, protecting members of unincorporated associations with the principal of freedom of contract. To the court of appeals, it was telling that the legislature did not explicitly state that agreements not complying with the Act were void *ab initio* (i.e., void from the beginning). So, on balance, the court of appeals found the LPA enforceable.

The union defendants then appealed to the Illinois Supreme Court, which took a completely different approach. (*1550 MP Road LLC v. Teamsters Local Union No. 700*, 2019 IL 123046, March 21, 2019)

To the Supreme Court, no balancing was necessary. The Illinois Supreme Court focused on the Act and provided a legal history lesson in its opinion. Under the common law, voluntary unincorporated associations, such as labor organizations, were not legal entities distinct from their members. As a result, voluntary unincorporated associations had no right to sue or be sued, acquire or hold title to real property, or enter into contracts in their own names.

The Act, providing for an exception to this common law rule, went into effect in 1949. The Act empowers unincorporated associations to lease and own real estate in their own name and to sue and be sued on such real estate. But there were conditions. The execution of these types of contracts required notice to and a vote of the members. All parties to the litigation agreed that Local 726 did not follow these procedures.

The Supreme Court then held that the LPA was void *ab initio* because of the failure to comply with these statutory requirements.

A contract void *ab initio* cannot be ratified – it is treated as if it never existed. Without complying with the statutory requirements, Local 726 had no power to execute the LPA. As noted, the court of appeals highlighted the fact that the Act did not explicitly render such contracts unenforceable. To this, the Supreme Court said:

> "Although the Act does not expressly state that the failure to comply with its provisions renders a contract unenforceable, the statute is in derogation of the common law. (citations omitted) As such, it must be strictly construed 'in order to effect the least – rather than the most – alteration in the common law.'
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> . . . .

> "[The language of the Act] clearly expresses a public policy to protect the individual members of an association from liability arising out of contract entered into by its leadership. An interpretation of the statute that allows an organization to ignore these requirements would render the express statutory language meaningless. This we may not do."

But, MP Road argued, didn't the union defendants admit the validity of the LPA in the litigation? The union defendants admitted, in their pleadings, that they told MP Road that Local 726 could not afford to comply with the LPA and wanted to modify it. Implicitly, the union defendants admitted the LPA was valid. Why modify an agreement that is unenforceable anyway?

But the enforceability of the LPA was a matter of law for the courts to decide and not one that could be admitted in a pleading. So any admission by the union defendants was not valid.

Didn't Local 726 ratify the LPA through its course of conduct? In this regard, MP Road had some favorable facts. For example, the union official who signed the LPA had signed leases on the union's behalf before without complying with the Act. So the union official had apparent authority to sign the LPA. Shortly after the LPA was signed, Local 726's executive board signed a consent resolution approving the LPA. Local 726 began performance by occupying the property and paying rent. Even after Local 726 was dissolved, its successor, Local 700, continued to pay rent and occupy the property. But equitable doctrines such as ratification, apparent authority and equitable estoppel do not apply to a contract that is void *ab initio*.

So the union defendants dodged a major liability through their own errors and unauthorized actions. The result may seem "unfair" to MP Road, which negotiated the LPA in good faith, not realizing the defects in the execution of the LPA. But, to the Supreme Court, the law was clear and MP Road's ignorance (and Local 726's disregard) of the statutory requirements in Illinois law did not change the conclusion that the LPA was void *ab initio*.