

Insights

Recent Illinois Case Encourages Use of Liquidated Damages Rather than Rent Acceleration Clauses in Commercial Leases

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Most Illinois commercial leases accelerate rent when a tenant defaults, but also require the landlord to mitigate damages by reletting, with the defaulting tenant getting credit for rents from the replacement tenant. This creates logistical challenges for the landlord filing a joint action for eviction and damages under Illinois' Forcible Entry and Detainer Act (735 ILCS 5/9-101). With the defaulting tenant in possession, the landlord can only guess as to the possible rent credits from a replacement tenant. Some leases address this by creating formulas that allow landlord to recover current lease rent less current market rent, plus other damages. Others may require a landlord to choose between (a) immediately terminating the lease and the right to future rents from the defaulting tenant; (b) waiting until the replacement tenant is found so that damages and offsets can be calculated; or (c) bringing periodic suits for damages as the defaulting tenant's rent comes due. None is ideal.

A recent decision of the Illinois Court of Appeals offers a solution: label future rents as a form of liquidated damages in the lease and specify that these liquidated damages — without offsets for reletting — are recoverable in either case, whether the landlord immediately terminates the lease upon default or just the right of possession. *2460-68 Clark, LLC v. Chopo Chicken, LLC*, 2022 IL App (1st) 210119 (January 18, 2022) 2d Div. / Cook Co.

The Lease in the *Chopo Chicken* case gave the landlord the option to terminate just the right of possession or to terminate both the Lease and the right of possession. In either case, the Lease allowed the landlord to recover “all damages incurred by reason of Tenant's default” and itemized various types of damages, including among others: a sum equal to the amount of unpaid rent and other charges and adjustments called for under the Lease for the remaining balance of the term of the Lease, which sum shall be due to Landlord as damages by reason of Tenant's default hereunder.

Id. at 3. The Lease did not call these “liquidated damages,” but the court nonetheless described this as a “liquidated damages provision” and dispensed with any requirement of mitigation, citing the “general rule that, in the case of an enforceable liquidated damages provision, mitigation is irrelevant and should not be considered in assessing damages.” *Id.* at 33. This meant that the landlord was entitled to full rent for the remaining Lease term, without any offset for amounts received from reletting the property.

Because the lease had a “liquidated damages” provision rather than a provision for “post-default *rental payments* ...for the duration of the lease term” the court found no statutory duty to mitigate damages under 735 ILCS 5/9-213.1. *Id.* at 30-32 (emphasis in original).

Note that the tenant in the *Chopo Chicken* case remained in possession when the damage award was entered, which was another reason the court found no duty to mitigate — a landlord cannot relet occupied space. If the damage hearing is conducted as part of the joint action while the tenant remains in possession, the issue of mitigation should not arise. *Id.* at 34. A landlord can essentially eliminate any obligation to mitigate damages defense by conducting the possession hearing and the damages hearing at the same time (depending on the terms of the lease, of course)

A few words of caution...

The tenant's possession of the premises at the time of the hearing in *Chopo Chicken* likely made it more palatable for the court of appeals to dispense with the landlord's obligation to mitigate. Fair-minded trial court judges may try in some way to distinguish or limit *Chopo Chicken* and impose a duty to mitigate. Allowing property to sit idle is not commercially reasonable. A tenant might argue that any liquidated damages clause that does not somehow credit the tenant for subsequent rents is not valid because it doesn't attempt to forecast the landlord's actual damages from default. Rent from a replacement tenant will likely net more than any collection efforts from the financially distressed defaulting tenant. So, intentionally allowing property to sit vacant while invoking *Chopo Chicken* to seek full recovery of “liquidated damages” is an ill-advised gamble.

Additionally, drafting a valid and enforceable liquidated damages clause is somewhat of an art. A liquidated damages clause must aim to reasonably forecast damages that would result from default and will be valid only if the damages are uncertain in amount and difficult to prove *Med+Plus Neck & Back Pain Ctr., S.C. v. Noffsinger*, 311 Ill. App. 3d 853, 860, 726 N.E.2d 687, 693 (2d Dist. 2000). The liquidated damages must be a specific amount for specific breaches and cannot seek to penalize nonperformance. *Id.* at 693. The liquidated damages clause also cannot give an “option” to choose between actual or liquidated damages. See *H&M Driver Leasing v. Champion*, 181 Ill.App.3d 28 (1st Dist. 1989) (liquidated damages clause in real estate contract struck down because it allowed plaintiff option of (a) liquidated damages (keep the earnest money) or (b) exercise other remedies).

KEY TAKEAWAYS: Careful and knowledgeable lease drafting can create critical advantages when landlords take those leases to court for enforcement. With a valid liquidated damages clause to replace current acceleration provisions, landlords might avoid an obligation to mitigate and also streamline litigation over damages. Liquidated damages also facilitate an early and simultaneous hearing of both the eviction and damages portions of the joint action under Illinois' Forcible Entry and Detainer Act (735 ILCS 5/9-101), which will avert most mitigation issues. Regardless of whether a duty to mitigate exists, landlords are advised always to act in a commercially reasonable manner and maximize productivity of the leased property.

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