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## Navigating Residential Attorney Approvals: Finding a Better Judicial North Star, 39 J. Marshall L. Rev. 171 (2006)

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# NAVIGATING RESIDENTIAL ATTORNEY APPROVALS: FINDING A BETTER JUDICIAL NORTH STAR

DEBRA POGRUND STARK\*

## INTRODUCTION

Although attorneys have largely been excluded from the residential real estate table in most states,<sup>1</sup> in several jurisdictions, attorneys are still in the practice of representing a home buyer or seller through the use of an "attorney approval" clause.<sup>2</sup> By including an attorney approval clause in a form

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1. See Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn From Residential Real Estate Conveyancing*, 62 MO. L. REV. 241, 260-61 (1997) (stating that in thirty-five of the forty states responding to the 1992 survey conducted of the executive directors and the general counsel of the Board of Realtors of all fifty states, the real estate agent typically negotiates and drafts the contract of purchase and sale without the aid or assistance of an attorney). "In these states, attorney involvement is often limited to transactions in which no realtor is involved or transactions that are unusually complicated, such as those involving contract for deed or seller financing." *Id.* at 261-62.

2. Attorney approval clauses are used or discussed in the following eleven states: California, *see, e.g.*, *Converse v. Fong*, 205 Cal. Rptr. 242 (Cal. Ct. App. 1984); Colorado, *see, e.g.*, *Hein Enters., Ltd. v. San Francisco Real Estate Investors*, 720 P.2d 975 (Colo. Ct. App. 1985); Connecticut, *see, e.g.*, *Tavarozzi v. Emmanuel*, 2001 Conn. Super. LEXIS 402 (Conn. Super. Ct. Feb. 13, 2001) (unreported opinion); Illinois, *see, e.g.*, *Chicago Bar Ass'n v. Quinlan & Tyson, Inc.*, 214 N.E.2d 771 (Ill. 1966); Louisiana, *see, e.g.*, *Stassi v. Gureasko*, 120 So.2d 489 (La. 1960); Massachusetts, *see, e.g.*, *Smith v. Allmon*, 461 N.E.2d 1237 (Mass. App. Ct. 1984); Minnesota, *see, e.g.*, *Nelson v. Nelson*, 415 N.W.2d 694 (Minn. Ct. App. 1987); New York, *see, e.g.*, *Duncan & Hill Realty, Inc. v. Dep't of State*, 405 N.Y.S.2d 339 (N.Y. App. Div. 1978); New Jersey, *see, e.g.*, *New Jersey State Bar Ass'n v. New Jersey Ass'n of Realtor Bds.*, 461 A.2d

contract that the broker fills in, brokers are able to have the buyer and seller sign these contracts without any delays, and, in theory, the parties are still able to have an attorney review the contract and make sure that the contract and the deal the broker arranged will in fact meet the client's expectations, goals, and needs.<sup>3</sup> Unfortunately, this latter goal is not being met, partly due to the problematic wording in some attorney approval clauses,<sup>4</sup> but mainly due to the way courts have interpreted the clauses.<sup>5</sup> This Article contends that courts have misinterpreted contract principles as applied to attorney approval clauses and that these interpretations, on the one hand, encourage bad faith terminations<sup>6</sup> and, on the other hand, prevent attorneys from competently representing a buyer or seller.<sup>7</sup> In addition, by failing to better articulate what constitutes "good faith" in this context, these court rulings make it nearly impossible for an attorney to know how to zealously represent her client while, at the same time, complying with ethical requirements.<sup>8</sup>

In Part I, the Article traces the development of attorney approval clauses and describes the court rulings on the unauthorized practice of law that led to the development of these clauses.

Part II describes how a well-trained attorney can protect home buyers and sellers at the contract formation stage and

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1112 (N.J. 1983); North Dakota, *see, e.g.*, *Davis v. Satrom*, 383 N.W.2d 831 (N.D. 1986); and Ohio, *see, e.g.* *Stevens v. Manchester*, 714 N.E.2d 956 (Ohio Ct. App. 1998).

3. *See New Jersey Ass'n of Realtor Bds.*, 461 A.2d at 1114 (concluding that the attorney review provisions and the courts' continuing supervisory control will safeguard the public's interest from any overlap between the realty and legal professions when a party signs a contract that a broker has filled).

4. *See infra* Part III.A. (discussing how many typical attorney approval clauses contain problematic wording that defeats the purpose for which those clauses were inserted in the contract in the first place).

5. *See infra* Part III.B. (discussing in general how several courts have ruled on issues relating to attorney approval clauses in a way that has only made matters worse).

6. *See infra* Part III.B.1. (discussing the negative consequences of mischaracterizing attorney approval clauses as conditional acceptances rather than conditional contracts); Part III.B.2. (discussing how the courts' failure to adequately define "good faith" and require an attorney to specify the reasons for disapproval also encourage bad faith disapprovals).

7. *See infra* Part III.B.1.e. (arguing that the case law in Illinois on the nature of attorney approval clauses is clearly divided and that attorneys lack the predictability they need in order to work with these clauses). Most troubling, the majority of the reported decisions contain dicta that do not accurately reflect the law, that create incentives for bad faith disapprovals, and that prevent attorneys from competently and ethically doing their job. *Id.*

8. *See infra* Part III.B.3.a-e (analyzing five scenarios that attorneys have or may in the future face and discussing on a compare-and-contrast basis what the attorney would do under the current law, and what the attorney should actually be doing, as a prelude to recommendations found in Part IV).

thereafter far better than a broker, a title company, or a lender. Understanding what a well-trained attorney would ordinarily do when representing a party contemplating entering into a purchase and sales contract is fundamental to analyzing whether attorney approval clauses are serving their intended function.

In Part III, the Article argues that, to the extent that attorney approval clauses were intended to provide buyers and sellers with the means to be competently and legitimately represented by an attorney, the typical wording of many attorney approval clauses and certain court interpretations of the clauses have greatly impeded this goal. After critiquing the different wording contained in attorney approval clauses, the Article identifies instances of judicial misapplication of contract principles when interpreting attorney approval clauses (mischaracterizing the clauses as conditional acceptances and any proposed modifications to the contract as counteroffers). The Article argues that such mischaracterizations have opened the door to bad faith rejections of a contract, and have impeded an attorney's ability to competently and legitimately represent their client.

In addition, the Article contends that, although courts require that attorneys act in good faith when exercising the attorney approval clause, courts' failure to require that attorneys state the reason(s) for their disapproval of the contract or to provide proposed changes to the contract weakens the effectiveness of such requirement and forces attorneys into real dilemmas when their clients pressure them to improperly disapprove a contract. The Article asserts that courts' failure to adequately define the "good faith-bad faith" dichotomy forces many attorneys to make shot-in-the-dark type judgments on how to zealously represent their client while properly exercising the attorney approval clause.

Finally, Part IV recommends that courts interpret these attorney approval clauses in a fashion that better comports with the public interest. It also recommends to associations of brokers and bar associations of lawyers how to draft attorney approval clauses in form residential purchase agreements to better serve the purpose of such clauses. This section also advises attorneys on how to fulfill their duty of zealous representation and, at the same time, satisfy the good faith requirement when exercising an attorney approval clause under current case law.

#### I. THE DEVELOPMENT OF ATTORNEY APPROVAL CLAUSES

Notwithstanding the fact that a home typically represents the single largest investment of an individual's savings,<sup>9</sup> as well as a

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9. John G. Steinkamp, *A Case for Federal Transfer Taxation*, 55 ARK. L. REV. 1, 74 (2002)(citing Edward N. Wolff, *Recent Trends in Wealth Ownership, 1983-1998*, 13, tbl.5 (Jerome Levy Econ. Inst. Working Paper No. 300, 2000),

major source of personal comfort and security, most home purchasers in America rely solely upon the seller's broker to prepare the form purchase and sale contract. Yet, a buyer may not realize that the purchase and sale contract creates the basic rights and obligations of the parties with respect to the transaction and that, typically, the broker's primary duties are to the seller rather than the buyer.<sup>10</sup> By contrast, if that buyer hired an attorney to counsel her with respect to the contract, the attorney would have a duty to place the buyer's interests above the interests of all other parties to the deal<sup>11</sup> and, presumably, an attorney would be better trained than a real estate broker to spot potential problems with the deal and to modify the deal as necessary to safeguard the client's interests and to meet the client's expectations.<sup>12</sup> In

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available at <http://www.levy.org/docs/wrkpap/pdf/300.pdf>). Mr. Steinkamp states that for most Americans, the principal residences are their largest investment, constituting approximately 60% of all assets held by the middle 60% of households in 1998. *Id.* See also ABA Special Comm. on Residential Real Estate Transactions, *Residential Real Estate Transactions: The Lawyer's Proper Role-Services-Compensation*, 14 REAL PROP. PROB. & TR. J. 581, 591 (1979) (noting that "[t]o the buyer, at least, the purchase of a house may be the most important legal and financial transaction of a lifetime" and "[b]ecause of the complexity of property law, a 'minor' slip may cause great expense and inconvenience").

10. *Klawitter v. Billick*, 242 N.W.2d 588, 592 (Minn. 1976).

11. See MODEL RULES OF PROF'L CONDUCT R. 1.6 (1983) (setting forth the duty of confidentiality), R. 1.7 (setting forth the duty to avoid conflicts of interest and to place the client's interest ahead of the lawyer's interests), and R. 1.15 (setting forth the duty to safe-keep property). See also Michael C. Ksiazek, *The Model Rules of Professional Conduct and the Unauthorized Practice of Law: Justification for Restricting Conveyancing to Attorneys*, 37 SUFFOLK U. L. REV. 169, 175-76 (2004) (citing various duties lawyers have to their client under the Model Rules of Professional Conduct).

12. One empirical study has called into question whether enough attorneys do, in fact, competently represent their clients in a residential deal. See Joyce Palomar, *The War Between Attorneys and Lay Conveyancers - Empirical Evidence Says 'Cease Fire!'*, 31 CONN. L. REV. 423, 520 (1999) (suggesting that the public does not bear a sufficient risk from lay provision of real estate settlement services to warrant blanket prohibition of those services under the auspices of preventing the unauthorized practice of law). One major limitation with drawing conclusions from this data is that it focuses on the impact of attorneys who are involved in the closing of a deal rather than in negotiating the terms of the contract, and concludes that while there was some positive impact, that impact was not statistically significant enough to require their participation. See *id.* at 487-93 (describing the methodology and observed samples of the survey). See also *id.* at 527 (suggesting that the practicing bar's true motivation when insisting that only attorneys should be permitted to draft instruments and close residential real estate transactions is proprietary or self-protective in nature). The study did not include any data on the impact of attorneys being involved in the negotiation of contracts, or exercising their rights under an attorney approval clause in a signed contract. See also *id.* at 485-93 (describing the methodology and observed samples of the survey).

This author contends that because the basic rights and obligations of the

addition, most buyers in America fail to hire an attorney to represent them with respect to the important contingencies that generally occur prior to closing (such as obtaining a physical inspection of the home, obtaining a loan commitment, and obtaining a title insurance commitment), again, typically relying upon the seller's broker for assistance. In some cases, the buyer is also unrepresented at the closing, relying instead upon the title company with respect to title matters, the lender with respect to the funds necessary to close, and the broker or seller's attorney to make sure that the technical requirements necessary to close the deal are accomplished.

Although courts in several jurisdictions have stated that, theoretically, being represented by their own attorney would better protect the interests of both the buyer and the seller, these courts have resolved the issue of the unauthorized practice of law in favor of allowing buyers and sellers to choose whether to seek such representation, and have allowed brokers to fill in a standard form purchase contract.<sup>13</sup> Some jurisdictions also allow brokers and title companies to prepare the closing documents as well.<sup>14</sup>

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parties are based upon the contract, the attorney can do the most good for her client by being involved at that stage. See *infra* Part II and accompanying notes (describing how a well-trained attorney can protect lawyers and sellers at the contract-formation stage). Nevertheless, in light of the data collected in Palomar, where lawyers could not identify specific problem areas, it appears that few attorneys receive sufficient training to provide the type of competent representation that parties should be able to count on, and this has contributed to the diminishing role of attorneys in this practice area. See *id.* at 515-20 (presenting findings of survey on complaints against attorneys). See also, *supra* note 1, at 241, 247 (presenting the results of his own survey where he found that many attorneys had difficulty specifying the hazards against which their advice insured).

13. *Quinlan & Tyson, Inc.*, 214 N.E.2d at 774; *Pope County Bar Ass'n, Inc. v. Suggs*, 624 S.W.2d 828, 830 (Ark. 1981); *New Jersey Ass'n of Realtor Bds.*, 461 A.2d 1112 at 1115.

14. See *Pope County Bar Ass'n*, 624 S.W.2d at 829 (holding that in a "simple" real estate transaction, warranty deeds, quitclaim deeds, release deeds, and bills of sale may be filled out by a broker if the forms have been approved by an attorney, parties to the transaction have declined to employ an attorney, the broker makes no extra charge for preparation of the forms, the broker gives no legal advice and uses the forms only in connection with the transaction). The court adhered to the chancellor's definition of a "simple real estate transaction":

[T]hose which involve a direct, present conveyance of a fee simple absolute between parties, which becomes effective immediately upon delivery of the title document. Such transactions do not include conveyances involving reservations or provisions creating life estates, limited or conditional estates, contingent or vested remainders, fee tails, easements or right-of-way grants, or any other conveyance of future, contingent or limited interest.

*Id.* See also *In re Opinion No. 26 of the Comm. on the Unauthorized Practice of Law*, 654 A.2d 1344, 1348 (N.J. 1995) (holding that, under certain

These courts identify four principle reasons to allow non-attorneys to negotiate and document a residential real estate deal: it has become customary for brokers to do this work in connection with their work as a broker on residential deals; buyers and sellers should have a freedom of choice; allowing non-lawyers to perform these functions will lead to an anticipated cost savings; and, perhaps most importantly, a lack of data that buyers or sellers are in fact harmed when they have not hired an attorney.<sup>15</sup> National

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conditions, brokers may conduct closing settlements without the presence of an attorney). By requiring that the attorneys involved in drafting the closing documents refrain from playing a role in drafting or approving the purchase and sale contracts, courts are basically closing the barn door after letting out the horses. As discussed in Part I, *infra*, the most important role the attorney plays is negotiating the terms of the contract that create the rights and obligations of the parties. For example, if the contract calls for a quitclaim deed, it does the buyers little good to have an attorney represent them at closing to review the deed, since the buyers will only be entitled to a quitclaim deed; at this stage, the attorney cannot insist upon a general warranty deed.

Florida, Ohio, Oregon, South Carolina, and Washington outright prohibit non-attorneys from being involved in drafting closing documents. *See, e.g.*, *Keyes Co. v. Dade County Bar Ass'n*, 46 So.2d 605, 606 (Fla. 1950) (holding that the filling in of blank deeds and the like by a real-estate broker constituted the practice of law); *Cooperman v. West Coast Title Co.*, 75 So.2d 818, 820 (Fla. 1954) (echoing that real estate brokers practiced law by completing standard conveyance forms, such as deeds, mortgages, and satisfactions); *Collacott Realty, Inc. v. Homuth*, 13 Ohio Ops. 250, 28 Ohio L. Abs. 211 (Mun. Ohio 1939) (holding that a real-estate agent or broker cannot prepare contracts, deeds, mortgages, land contracts, leases, etc., nor can he fill in appropriate blanks for these items, even when no charge is made therefore, and the only interest that the real-estate broker has is consummating a deal in which he was involved as a broker, as these acts constitute the practice of law); *Oregon State Bar v. Security Escrows, Inc.*, 377 P.2d 334, 339-40 (Or. 1962) (holding that informed or trained discretion must be exercised in selection or drafting of document to meet needs of persons being served, that the practice of law includes drafting or selection of documents and giving of advice in regard thereto, but that practice of law excludes filling in of blanks under direction of customer upon form or forms selected by customer); *State v. Buyers Service Co.*, 357 S.E.2d 15, 17-19 (S.C. 1987) (holding that forms useful for conveyancing, preparing documents affecting title, handling real estate and mortgage closings, and even transporting or mailing documents to the county recorder's office as part of real estate transfer, all fell within the realm of the attorney's task, and that a non-attorney's performance of these acts constituted the unauthorized practice of law); *Doe v. McMaster*, 585 S.E.2d 773, 777-78 (S.C. 2003) (reaffirming *Buyers Service Company* and holding that an independent attorney must properly supervise all of the steps of the transaction and be physically present at the closing); *Washington State Bar Ass'n v. Washington Ass'n of Realtors*, 251 P.2d 619 (Wa. 1952) (holding that a non-attorney invaded the practice of law when he prepared four deeds – three simple in form and one containing a mortgage clause – by completing printed forms or statutory warranty deeds supplied by a title insurance company).

15. *See In re Opinion No.26*, 654 A.2d 1344 at 1346 (reasoning that the South New Jersey practice of conducting closings without attorneys shows that there is no demonstrable harm to buyers and sellers, and that such practice saves money).

broker associations have fought hard and successfully to exclude attorneys from the residential real estate table because they perceive lawyers, at best, as deal delayers and nit pickers and, at worst, as deal killers.<sup>16</sup>

Twenty years ago, New Jersey attempted to strike a balance in the war between brokers and lawyers over handling residential real estate deals. It allowed brokers to fill in the blanks of a standard form purchase and sale contract so long as the contract contained an “attorney approval” clause which would permit either party a three-day period to rescind the deal based upon their attorney’s review of the contract.<sup>17</sup> In addition to New Jersey, the practice of including an attorney approval clause or a clause that allows the attorney to propose modifications to the contract has spread to several other states.<sup>18</sup> Courts favor such clauses because they allow, but do not force, a buyer or seller to hire an attorney, and because it is hoped that if an attorney is hired, that attorney, through the exercise of the attorney approval clause, can protect a buyer or seller in a fashion similar to the case where the party hired the attorney before entering the contract. Even brokers have an incentive to use form contracts that include attorney approval clauses because they reduce the likelihood that the brokers will be successfully sued for negligence when they serve the functions that attorneys typically perform.<sup>19</sup> Also, brokers can

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16. See *Trenta v. Gay*, 468 A.2d 737, 738 (N.J. Super. Ct. Ch. Div. 1983) (acknowledging that brokers fear that the doubts that afflict people entering substantial transactions may unravel perfectly good deals while the lawyers pick nits); *Brokers to the Brokers*, REGISTERED REP., at 6 (June, 2002) (“Not many houses would sell if [buyers] had attorneys and CPAs in the process too early.”). See also PETER BIRNBAUM, *MANAGING REAL ESTATE TRANSACTIONS IN THE NINETIES*, 407 PRACTICING L. INST. REAL EST. L. & PRAC. COURSE HANDBOOK SERIES 685, 688-89 (1994). (“Brokers frequently see lawyers as the only thing between themselves and their commission, and this tension alone is enough to make the two professions natural adversaries.”).

17. *New Jersey Ass’n of Realtor Bds.*, 461 A.2d 1112 at 1115 (conditioning brokers’ right to fill out contracts on inclusion of a conspicuous clause making the contract subject to review by an attorney within three business days).

18. Attorney approval clauses are used or discussed in the following eleven states: California, see, e.g., *Converse*, 205 Cal. Rptr. 242 (Cal. Ct. App. 1984); Colorado, see, e.g., *Hein Enters., Ltd.*, 720 P.2d 975 (Colo. Ct. App. 1985); Connecticut, see, e.g., *Tavarozzi*, 2001 Conn. Super. LEXIS 402; Illinois, see, e.g., *Quinlan & Tyson Inc.*, 214 N.E.2d 771; Louisiana, see, e.g., *Stassi*, 120 So.2d 489; Massachusetts, see, e.g., *Smith*, 461 N.E.2d 1237; Minnesota, see, e.g., *Nelson*, 415 N.W.2d 694; New York, see, e.g., *Duncan & Hill Realty Inc.*, 405 N.Y.S.2d 339; New Jersey, see, e.g., *New Jersey Ass’n of Realtor Bds.*, 461 A.2d 1112; North Dakota, see, e.g., *Davis*, 383 N.W.2d 831 at 832-33; and Ohio, see, e.g., *Stevens*, 714 N.E.2d 956.

19. *Pope County Bar Ass’n*, 624 S.W. 2d at 831 (Hickman, J., concurring) (warning realtors, who sought and gained the right “to practice law,” to be aware that their negligence in preparing such legal documents may well be examined by applying a standard of care expected of attorneys and that, with this convenience, comes a heavy responsibility to the public).



assure a reluctant buyer or seller that the contract they will sign will be subject to an attorney's review and approval. Attorneys in many states have acquiesced in this compromise since they would prefer to join the dinner party a bit late and enjoy a "half loaf"<sup>20</sup> rather than be completely excluded from the deal table altogether. Unfortunately, courts have, at times, misinterpreted the attorney approval clauses and have confused the attorneys who seek to competently and ethically represent their clients under those clauses.

## II. WHAT A COMPETENT AND WELL TRAINED LAWYER WOULD DO IF REPRESENTING A HOME BUYER OR HOME SELLER

When I teach a law school course on real estate law, we cover not only the relevant laws, but also a "transactional skills" framework that all transactional lawyers should follow.<sup>21</sup> Under this framework, attorneys should follow four essential steps when reviewing a contract that their client is considering entering into. Most of the points raised within this framework relate to the buyer's attorney, as there are more risks and special issues for the home buyer than the home seller. At the end of this section, however, I will separately address the recommended course of action for a competent and well trained seller's attorney.

### A. *Four Essential Steps That Buyer's Attorney Should Follow When Reviewing the Contract*

#### 1. *Find out the buyer's goals, expectations, special needs, and plans*

As the first step in the transactional skills framework, the buyer's attorney should inquire about the client's goals and expectations, what promises have been made to the client about the property, what special needs or future plans the client has regarding the property, and, ultimately, make certain that all of these expectations, needs, and plans will be met through their incorporation into the contract as conditions, covenants, and/or

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20. See Stephen E. Alloy, *Real Estate Contracts and Approval Clauses*, CHI. DAILY L. BULLETIN, Mar. 20, 1995, at 6 (arguing that since attorneys get to review a contract only after it is signed, their role is limited: within just a few business days an attorney must either approve the contract or make modifications that would inevitably put the client at risk of losing the deal). Mr. Alloy states that "the opportunity to modify a contract on behalf of a client . . . is half a loaf-better than no opportunity to modify but not as good as being involved in the negotiation." *Id.*

21. See generally DEBRA POGRUND STARK, ET AL., COMMERCIAL REAL ESTATE TRANSACTIONS: A PROJECT AND SKILLS ORIENTED APPROACH (Lexis Publishing 3d ed.) (2001); DEBRA POGRUND STARK, RESIDENTIAL REAL ESTATE LAW: A TRANSACTIONAL SKILLS ANALYSIS (Carolina Academic Press) (2004).

representations and warranties. For example, if, after closing, the buyer plans to attach a garage to the eastern portion of the house, the attorney should add to the contract, as a condition to closing, that the buyer obtain from the city a building permit, and that the location of such addition will comply with any governmental or privately created set-back requirements or other restrictions that encumber the property. Even the best form purchase contracts (i.e. ones that are comprehensive and balanced between the buyer and the seller rather than favoring one over the other) will not contain any provisions relating to a client's special plans or needs. It is the attorney's job to discover such plans and needs during the attorney approval period, and to make sure that the contract provides related protections.

Another example related to ensuring that the client's reasonable expectations are met arises in the common situation where the seller or the seller's broker has made one or more oral promises or representations to the buyer that the buyer relied upon when she signed the purchase contract. Often many such oral promises ("Oh, don't worry, we will address that water stain issue at the walk-through stage!"<sup>22</sup> or, "Don't worry about getting a loan, the seller will provide you a loan!"<sup>23</sup>) are not added to the form contract by the brokers. If the promises are not kept or if, after closing, the buyer discovers that the representations turn out

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22. *Woods v. Pence*, 708 N.E. 2d 563, 564 (Ill. App. Ct. 1999). In that case, the sellers' realtors told the buyers who questioned about water stains in the walls that the issue would be addressed at the final walk-through prior to closing, but no walk-through occurred. *Id.* Even if such walk through did occur, it would not necessarily protect the buyers. Most form contracts state that the buyer has the right to inspect the property forty-eight hours prior to closing and that it is a condition to closing that the property is in the same condition as on the date the contract was signed. This does not adequately protect the buyer from the potential problem that the roof is defective and in need of repair or replacement since that is the condition of the roof at the time the buyer signed the contract. More often than not, if the buyer were to tell the attorney about the water stain conversation, the attorney would then check to make sure that there is a physical inspection contingency in the contract, which occurs within a few days of the signing of the contract, to make sure it provides for the ability of the buyer to rescind the deal if the inspection detects a defect, or perhaps to provide at the buyer's option for the seller to repair the defect prior to closing or to get an adjustment to the purchase price to reflect the estimated costs for the repair or replacement. If these provisions are not present in the contract, the attorney should propose revisions to the contract to contain such conditions and covenants.

23. *Moore v. Doyle*, 85 Pa. Super. 406, 408-10 (Pa. Super. Ct. 1925). In that case, the buyer and the seller orally agreed that the seller would provide a mortgage to the buyer. The seller's broker filled out the contract, but left a few spaces blank, telling the buyer that the spaces could not be filled at that time and that the contract will reflect all the terms of the oral agreement. However, the final contract did not include the mortgage provision. Subsequently, the seller refused to provide the mortgage. *Id.*

to be untrue, the buyer's expectations will not be met and the buyer's remaining option will be an expensive and uncertain fraud claim to obtain damages. It is up to the attorney to find out from the buyer if the seller or broker made any representation that influenced the buyer to agree to the purchase, and to turn any important promises into covenants if not already provided for in the contract.

2. *Determine what can go wrong with this deal and how to fix it*

The second step in the transactional skills framework at the contract formation stage is to attempt to ascertain potential problems arising from the way in which the deal has been structured, the terms in the proposed contract, or any other facts that the client tells the attorney. Then, when possible, the attorney should draft modifications to the contract containing the necessary combination of conditions, covenants, representations, and warranties or indemnifications that address these risks in a comprehensive fashion. For example, if the client is buying a condominium unit in a building not yet constructed, many form contracts used by builders and developers provide only an estimated date for when construction will be substantially completed, saying that closing will occur when substantial completion occurs and that the seller will not be in default if the building is not completed by the estimated date. As a result of this clause, even if it is now one year past the estimated date of completion, the seller would not be in default and the buyer would be unlikely to successfully sue the seller for the buyer's damages, or even be able to get her earnest money back.

Even when the buyer successfully sues the seller, many form contracts limit the buyer's remedies when the seller defaults solely to the return of the earnest money deposit. If, three months after the seller and the buyer enter into a contract containing such limitation, the seller finds a new buyer who is willing to pay more for the same property, the seller can refuse to sell to the buyer and will be liable only for the return of the buyer's earnest money.<sup>24</sup>

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24. In general, courts will enforce the bargain that the parties strike on any matter, including remedies upon default, unless the bargain struck is deemed unconscionable. One exception to this is when the parties agree to a liquidated damages clause, in which case, the court will more closely scrutinize what has been agreed to. *See* *Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Trust Co.*, 607 N.E.2d 1337, 1347 (Ill. App. Ct. 1992) (holding that the liquidated damages provision in the contract was unenforceable and that the non-breaching seller was allowed to recover only actual damages). Liquidated damages clauses in a real estate contract will be valid when: "(1) the parties intended to agree in advance to the settlement of damages that might arise from the breach; (2) the amount of liquidated damages was reasonable at the time of contracting, bearing some relation to the damages which might be sustained; and (3) actual damages would be uncertain in amount and difficult

Most form contracts that builders and developers use are lengthy and few buyers actually read the terms of the contracts that they sign. This reinforces the buyer's need for an attorney to explain these risks and, as step four discusses below, to try to reduce these risks by negotiating for changes to the contract. Even if the attorney is unable to induce the seller to modify the contract (this is especially a possibility when it is a "seller's market") the buyer has been well served by the attorney alerting her to these risks and it will allow her to make an informed decision on whether to accept or terminate the deal.

### 3. *Know local law*

The third fundamental step taken by a competent attorney under the transactional skills framework at the contract formation stage is to become familiar with the customary terms for a deal of this nature and the location of the property, and to make sure that the contract complies with their client's interests. For example, if it is customary for the seller to pay for title insurance, then, as the buyer's attorney, you would want to ensure that the contract reflects this custom, especially when the form provides various options for certain terms or for the filling in of certain blanks.

### 4. *Negotiate effectively on behalf of your client*

The fourth and final step in the transactional skills framework represents the pinnacle of the attorney's involvement at the contract formation stage. Here, the attorney should adeptly negotiate for and draft modifications to the form contract so as to create the necessary conditions, covenants, and representations and warranties to meet the client's expectations and needs as described above. Before negotiating for any changes, the attorney should become familiar with what rights and obligations the client would have under case law and any relevant statutes if the contract is silent. Also, the attorney should understand how the contract might be adding to or taking away from those rights and obligations. This is especially important when, due to market conditions, either the seller or the buyer can exercise more negotiating power. In such circumstances, raising an issue that you want clarified or handled a certain way can backfire and lead to the contract being revised in a way that is adverse to the client's interests.

A good example of the interplay between protections under existing law and the need to negotiate for additional protections

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to prove." *Id.* at 1346. If the parties agreed that in the event of the seller's default the buyer's sole remedy is return of the buyer's earnest money, this basically provides for rescission and restitution and may not be viewed by a court to be an unconscionable term in a contract.

arises in the context of a buyer that is purchasing a condominium unit rather than a detached single family home. Due to the common areas shared among owners in a condominium building and the close proximity of each owner to the other, condominium developments are subject to a declaration of covenants and restrictions on use. Because the declaration can create highly burdensome financial obligations and restrictions on use, several states have created statutory protections for purchasers of condominium units, including the right to receive certain condominium documentation (the declaration, the bylaws for the condominium association, the rules and regulations, etc.). In Illinois, for example, upon written request, the seller is required to provide these documents to the buyer.<sup>25</sup> Of course, what good does it do the buyer to receive these documents if they do not have the right to approve them as a condition to closing? That issue arose in the case of *Nikolopoulos v. Balourdos*<sup>26</sup> where the buyer learned that there would be a large special assessment to pay for window replacement throughout the entire building. The court ruled that there is an implied right to rescind a purchase under the Illinois Condominium Property Act ("ICPA") when the provided condominium documents reflect a substantial financial burden that would be imposed on the buyer as a new owner.<sup>27</sup>

Yet, both ICPA and *Nikolopoulos v. Balourdos* allow gaps in the protections provided to condominium buyers. For example, it is up to the buyer to initially request these documents, and a buyer might not ask for them, or might receive them from a broker who does not encourage the buyer to carefully read them. Second, the case only addresses the situation where a substantial financial obligation is disclosed in the condominium documents. It does not address a right to rescission if any other matter revealed in the condominium documents is objectionable to the buyer, such as the presence of use restrictions that interfere with the buyer's intended uses of the property, like restrictions on the ability to

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25. Illinois Condominium Property Act, Resale; Inspection by Purchaser, 765 I.L.C.S. § 605/22.1 (2005) (requiring an officer of a condominium association other than developer to provide such information within thirty days of a written request in cases of condominium re-sales).

26. *Nikolopoulos v. Balourdos*, 614 N.E.2d 412, 416 (Ill. App. Ct. 1993). The condominium financial statement revealed that the windows of the building had to be replaced at a cost of \$2,750,000 and that the work would be performed over a period of five to seven years. *Id.*

27. *Id.* The court found that implied in the right to review is the right to terminate the contract within a reasonable time after being furnished information revealing previously undisclosed material expenses. The cost of replacing the windows directly impacted upon the buyer's financial burden if he were to purchase the unit. This previously undisclosed condition allowed the buyer to terminate the contract and entitled him to the return of his earnest money plus interest accrued. *Id.*

lease out the unit or to keep a pet in the unit. It is up to the attorney during the negotiation of the contract or the attorney approval period to require the receipt of these documents, to condition the closing upon buyer's approval of all the provided documents, and to bargain for the buyer's right to rescind if these documents reveal not only financial obligations but use restrictions or any other matters that are unacceptable to the buyer.

*B. Beyond The Four Essential Steps: Ensure That The Buyer's Contract Rights And Protections Are Enforced.*

When a buyer hires an attorney pursuant to the attorney approval clause, not only should the buyer receive the kind of advice and representation described above, but the lawyer should also determine whether the conditions to closing have been satisfied. As previously mentioned, there are three common conditions to closing: a satisfactory physical inspection of the property, a satisfactory loan commitment, and a satisfactory title commitment. Although it is the terms of the contract that create these conditions (or modify them in the case of the implied covenant of marketable title) and the basis for the right to rescind under them, it is the buyer's attorney who will review the inspection report, the loan commitment, and the title commitment to determine whether the right to rescind exists. The attorney will review the physical inspection report to ensure that the property has no major physical defects, or if it does, determine with the client whether to rescind or adjust the purchase price, or make provision for the seller to repair the defects before closing. The attorney will also review the loan commitment that the buyer receives to determine whether the lender has unconditionally agreed to make the loan promised to the borrower (i.e. no conditions that are not within the control of the buyer). The attorney may also advise the buyer on whether the loan is overpriced or one that the borrower can afford to pay.<sup>28</sup> Finally, the attorney will review the title commitment and survey to detect whether they reveal any encumbrances on title to the property which are currently violated, financially burdensome, or that would interfere with the buyer's intended uses of the property.

*1. Inspection of title matters before and during closing*

In particular, a lawyer is in the best position to review the

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28. See generally Debra Pogrud Stark, *Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER L.J. 129 (2005) (pointing to the increase in the number of predatory loans in the residential real estate industry and proposing a mortgage counseling intervention law).

title commitment to determine if it adequately protects the buyer's expectation of good title not subject to unacceptable encumbrances. Mere receipt of a title commitment provides little protection to a home buyer because the title company can raise in Schedule B to the commitment a myriad of third party interests that encumber the insured property, such as mechanic liens, unpaid and delinquent real estate taxes, easements, restrictive covenants that impair the buyer's use of the property, and even defects with seller's title to the property. If these exceptions are raised in Schedule B to the title commitment, the title company is not insuring any losses that the buyer or other insured party experiences after closing due to the listed exceptions. Very few buyers who have not been represented by competent attorneys are aware of this<sup>29</sup> and, thus, do not know that it is in the buyer's interest to have the title company "insure" over these risks (i.e. commit to reimburse the buyer for any losses the buyer experiences due to these encumbrances), or to rescind the deal due to their existence. In addition, a competent lawyer will know the boilerplate terms in a standard title insurance policy and the fact that without "extended coverage" over the general title exceptions, the title policy would not cover many important potential title problems such as encroachments of improvements, rights of tenants under unrecorded leases, and inchoate mechanic lien claims (lien claims not yet of record but that could arise for work commenced within a certain period that have not been paid for in full).

When problems or disputes arise between the parties regarding these contingencies or any other matter, it is the attorney's job to know the client's rights based upon the contract signed, along with any relevant case law or statutes, and to negotiate a resolution favorable to the client in light of these rights. Even a buyer's broker (a broker hired by the buyer rather than the seller) rarely takes on this role on behalf of a buyer in a dispute with the seller, and a seller's broker certainly would not and could not due to their duty of loyalty to their principal. If this dispute arises prior to closing and the buyer is not represented by an attorney, the likely result is the deal will close with the buyer inadequately protected.<sup>30</sup>

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29. See, Braunstein *supra* note 1, at 260 (presenting research results that indicates that title insurers have been so successful at advertising their services, that consumers generally perceive the title insurance to give them more protection than it actually does).

30. See, e.g., *Trenta*, 468 A.2d 737 (affirming dismissal of the buyers' complaint for specific performance). In *Trenta*, unrepresented buyers signed a form real estate contract that the seller's broker filled. Then, the sellers found an attorney who disapproved the contract without disclosing a reason). See also *Stevens*, 714 N.E.2d at 959-60 (reversing judgment of the trial court for the buyers and holding that the sellers' attorney could withhold approval if the

## 2. Variations in the transactional skills framework from the seller's point of view

Although a seller's attorney would follow a similar transactional skills framework at the contract formation stage, the major issues that typically concern a seller are more limited in nature than those of the buyer. There are two key concerns that the seller's attorney must address at the contract formation stage: (1) making it more certain that the closing will occur (which requires a careful review of the conditions to closing to make sure that none are likely not to be satisfied and to provide the seller with adequate remedies in the event that the buyer defaults and fails to close) and (2) making sure that the seller is not exposing herself to undesirable potential liability in connection with the sale through reviewing the accuracy of any representations or warranties under the contract with the client, reviewing any covenants under the contract with the seller to ensure that the seller can perform them, and reviewing the remedies section of the contract to make sure that the seller's liability is minimal or non-existent for matters outside of the seller's control, such as a mere right of rescission and restitution rather than a right to damages or specific performance which might include equitable adjustments to the purchase price. In addition, the seller's attorney will work with all of the other real estate professionals in satisfying the conditions to closing and in documenting the closing of the deal as required by law.

### III. THE CHALLENGES TO EFFECTIVE REPRESENTATION POSED BY TYPICAL ATTORNEY APPROVAL CLAUSES AND HOW COURTS HAVE MADE A TOUGH SITUATION EVEN WORSE

It is beyond the scope of this Article to discuss the wisdom of using an attorney approval clause as compared with requiring an attorney to negotiate and draft the contract. Others have already addressed this issue quite well, pointing out, among other things, the terrible time constraints that the attorney must operate in (usually just a day or two) and the psychological difficulty an attorney faces with proposing changes to a deal after it has already been negotiated and signed, as well as the constraints posed on what the attorney can actually do based upon the wording of the approval clause.<sup>31</sup> However, these criticisms are

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attorney considered the project economically unreasonable for his client).

31. See Alice M. Noble-Allgire, *Attorney Approval Clauses in Residential Real Estate Contracts-Is Half a Loaf Better Than None?* 48 KAN. L. REV. 339 (2000) (citing Harold I. Levine, *Avoiding Malpractice-Attorney Approval*, ATT'YS TITLE GUAR. FUND, INC., at 2 (1986)). Mr. Levine argued that such time frames are outrageous:

Broker, seller and buyer can spend weeks or months negotiating a deal, but the lawyer has 72 hours to review the contract and be charged with



still relevant to this article since they shed light on drafting and interpretation issues with respect to attorney approval clauses which have become the norm in several jurisdictions.

*A. Typical Attorney Approval Clauses Contain Problematic Language – Case Studies From New Jersey And Illinois.*

*1. New Jersey*

New Jersey<sup>32</sup> is the only state that requires that a residential sales contract contains an “attorney approval” clause. However, it is useful to begin by analyzing the New Jersey language because courts and practitioners outside of New Jersey have been influenced by this language and the rationale behind it. The following language is required in New Jersey at the top of the first page of the contract:

THIS IS A LEGALLY BINDING CONTRACT THAT WILL BECOME FINAL WITHIN THREE BUSINESS DAYS. DURING THIS PERIOD YOU MAY CHOOSE TO CONSULT AN ATTORNEY WHO CAN REVIEW AND CANCEL THE CONTRACT. SEE SECTION ON ATTORNEY REVIEW FOR DETAILS.<sup>33</sup>

The rationale behind this broad language (note there is no exclusion for rejecting a contract based upon the purchase price, a limitation common in many form contracts with attorney approval clauses outside of New Jersey) is that the clause is intended to allow the buyer and seller a three day escape clause during which the contract may be disapproved “at the unfettered discretion of that party’s attorney.”<sup>34</sup> New Jersey courts have interpreted the clause to allow the attorney to disapprove the contract during the attorney review for “any reason,” including that the seller has received a higher offer, without explanation.<sup>35</sup>

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the responsibility. Those of us who labor in the valleys of the law will tell you that the lawyer usually gets the contract in the last 24-36 hours. *Id.* Mr. Levine also found the procedural requirements “onerous.” *See id.* (noting that one rider in Illinois commonly used “requires service on specific parties at specific times, and there are whole areas such as pricing, closing, [and] possession, which cannot be negotiated”). Another major problem attorneys face when they work on a residential deal is the low fees that attorneys in the market can charge for what could become a highly time consuming matter.

32. In New Jersey, a settlement agreement following the case of *New Jersey State Bar Ass’n v. New Jersey Ass’n of Realtor Bds.*, on the unauthorized practice of law led to certain prescribed attorney approval language being attached to each form residential real estate purchase and sale agreement. 461 A.2d at 1115.

33. *Id.*

34. *Denesevich v. Moran*, 211 N.J. Super. 554, 556 (App. Div. 1986)

35. *See, e.g., Trenta*, 191 N.J. Super. 617; *Indoe v. Dwyer*, 424 A.2d 456, 458

However, based upon the analysis of what a well-trained and competent attorney would do for her client at the contract formation stage, the clause is both over-inclusive and under-inclusive. It is over-inclusive because it contains no express limitations on the basis by which an attorney would disapprove a contract.<sup>36</sup> For example, if we were to apply normal contract principles of interpretation, most home buyers or sellers would be surprised to find out after they signed a contract subject to “attorney” approval that the buyer or seller could now get out of the deal because either party has changed her mind on the agreed purchase price. However, court decisions in New Jersey would allow this.<sup>37</sup> Lawyers typically do not advise their clients on the purchase price for a deal and, consequently, most parties would not expect that the other party could rescind the deal based upon this factor under an attorney approval clause. In addition, it is even possible in New Jersey that a court would find that an attorney approval clause was not exercised in bad faith when a client directs the attorney to reject the contract because the client has simply changed her mind on doing the deal at all (i.e., unrelated to any advice that the attorney provides to the client), or because she has now found a better deal (again unrelated to any advice that the attorney has provided relating to the contract), since the court characterizes the attorney approval clause as akin to an absolute right of rescission.<sup>38</sup>

Rejection of the contract for any of these reasons should not be permitted under the attorney approval clause because it is not only inconsistent with the reasonable expectations of buyers and sellers (unless brokers are telling the parties that this is basically a three-day right of rescission unrelated to attorney advice), but it is also inconsistent with permitting rejections based upon the advice that a competent attorney would give to her client when the contract was first formed (the purpose of requiring the clause in the first place). If the clause is truly a simple three-day right of rescission, unrelated to attorney advice, then the clause should more clearly state that so the parties will be better informed about what they have signed. Even if the clause was more clearly drafted to reflect that there is basically a three-day rescission period, it is still not good policy for attorney involvement to run

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(N.J. Super. Ct. 1980)

36. There is a case law created requirement of “good faith” that would limit how an attorney can exercise the attorney approval, but in light of the broad basis that New Jersey courts have construed the attorney’s right to disapprove, it is hard to fathom on what basis disapproval would qualify as “bad faith.”

37. *Carmagnola v. Hann*, 559 A.2d 478, 481 (N.J. Super. Ct. App. Div. 1989).

38. *Id.*

along these lines. When the clause is interpreted, in essence, as an absolute three-day right of rescission, it is being interpreted in an under-inclusive fashion in terms of meeting the goal of putting the client in the position they would have been in had they been represented by an attorney during the formation of the contract. As Part I discusses above, effective lawyering includes not only spotting problems, but resolving them as well, so that the deal can proceed in a revised fashion that meets a client's goals and expectations. The attorney approval clause language in New Jersey, which only permits an attorney to approve or disapprove the contract and does not include the right to make recommended changes to the contract, seriously impedes the normal negotiation functions that adequately trained and competent lawyers would perform for their clients.

## 2. Illinois

Although there is no requirement in Illinois that all residential purchase and sale agreements filed in by a broker must contain an attorney approval clause, it is a widespread practice in Illinois (and the practice in ten other states based upon reported decisions in those states) that residential purchase and sales contract contain some type of attorney approval clause, and the reported decisions in Illinois, and elsewhere, reflect certain basic similarities in how they are drafted with some important variations.<sup>39</sup> This section will critique the different types of attorney approval clauses used in Illinois in light of the goal of allowing the creation of a binding contract to reflect the meeting of the minds that the broker has facilitated, while at the same time allowing the parties the opportunity to have the same kind of representation as they would have had (or as close to it as possible) if the attorney had been consulted before the deal was signed.

a. VERSION ONE: Approval As To Form, Requiring Notice Of Approval - At issue in the case of *Denis F. McKenna Co. v. Smith*.<sup>40</sup>

*This contract is contingent upon the approval hereof as to form by the*

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39. Attorney approval clauses are used or discussed in the following eleven states: California, *see, e.g., Converse*, 205 Cal. Rptr. 242; Colorado, *see, e.g., Hein Enters.*, 720 P.2d 975; Connecticut, *see, e.g., Tavarozzi*, 2001 Conn. Super. Ct. LEXIS 402; Illinois, *see, e.g., Quinlan & Tyson Inc.*, 214 N.E.2d 771; Louisiana, *see, e.g., Stassi*, 120 So.2d 489; Massachusetts, *see, e.g., Smith*, 461 N.E.2d 1237; Minnesota, *see, e.g., Nelson*, 415 N.W.2d 694; New York, *see, e.g., Duncan & Hill Realty Inc.*, 405 N.Y.S.2d 339; New Jersey, *see, e.g., New Jersey Ass'n of Realtor Bds.*, 461 A.2d 1112; North Dakota, *see, e.g., Davis*, 383 N.W.2d 831; and Ohio, *see, e.g., Stevens*, 714 N.E.2d 956.

40. 704 N.E.2d 826, 828 (Ill. App. Ct. 1998).

*attorneys for Purchaser and Seller within 5 (five) business days after Seller's acceptance of this contract. Notices shall be given pursuant to Paragraph 14 on the reverse side hereof.*

There are several problems with the way this clause is worded. First, the word "form" is problematic. It could be misinterpreted to literally mean a problem with the form of the contract, rather than substance of the contract, but this misinterpretation has not been adopted in any reported decision reviewed. Second, there are no specific exclusions as to matters that cannot serve as the basis for an attorney not to approve the contract, such as purchase price or receipt of a better offer after the seller or buyer had already signed the contract. As previously discussed, the purchase price is not a matter that a competent and well-trained attorney would advise a client on. Third, as a procedural matter, it would make more sense to require the attorney to put a notice of disapproval in writing rather than require a notice of approval within the five-day time frame in order to avoid an unintended voiding of the contract. Fourth, and perhaps most importantly, the clause fails to provide the attorney with the opportunity to propose changes to the contract rather than merely approve or disapprove it. As previously discussed with respect to New Jersey's clause, this severely limits the attorney's role to spotting problems and killing the deal, rather than also solving the problem, by negotiating for modifications to the contract to cure the identified potential problems or otherwise meet the client's special needs and objectives. A fifth final critique is that the attorney is not required to specify a reason for disapproval and there is no requirement that the reason asserted be reasonable. This last critique will be fully addressed in the discussion of version four below.

b. VERSION TWO: Approval As To Form, Requiring Notice Of Disapproval - At issue in the case of *Hubble v. O'Connor*.<sup>41</sup>

*This contract is contingent upon the approval hereof as to form by the attorney(s) for Buyer and Seller within 5 (five) Business days after Seller's acceptance of this contract. Unless written notice of disapproval is given within the time period specified above, then this contingency shall be deemed waived and this contract will remain in full force and effect. If written notice of disapproval is given within the time period specified above, this contract shall be null and void and the earnest money shall be returned to the Purchaser.*

All of the points raised with respect to Version One hold true for Version Two except that Version Two contains a better procedure for exercise of the clause for the reasons stated above.

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41. 684 N.E.2d 816, 819 (Ill. App. Ct. 1997).

c. VERSION THREE: Attorney review and modification of the contract, excluding price, requiring notice of disagreement on changes – at issue in the case of *Olympic Restaurant Corporation v. Bank of Wheaton*.<sup>42</sup>

*Attorney Review: The parties agree that their respective attorneys may review and make modifications, other than stated purchase price, mutually acceptable to the parties, within ten (10) business days after the date of the Contract acceptance. If the parties do not agree and written notice thereof is given to the other party within the time specified, then this contract will become null and void, and all monies paid by the Purchaser will be refunded. IN THE ABSENCE OF WRITTEN NOTICE WITHIN THE TIME SPECIFIED HEREIN, THIS PROVISION WILL BE DEEMED WAIVED BY ALL PARTIES HERETO AND THIS CONTRACT WILL BE IN FULL FORCE AND EFFECT.*

Version Three is preferable to Versions One and Two because it does not contain the approval limitation “as to form,” it permits attorney modification of the contract, it contains an explicit limitation against modification of the purchase price (and by requiring modification of the contract will make it much more difficult for either party to be able to get out of the deal based upon receiving a subsequent better offer), and it procedurally requires notice of disagreement over any proposed modifications. Nevertheless, Version Three has several problems. Perhaps the most important problem with the clause is one of its strengths: it requires the attorney to make modifications to the contract rather than be empowered to simply disapprove the contract. While in most situations, after spotting problems with the contract or the deal, an attorney can modify the contract to eliminate or reduce the problems, there are times when problems cannot be solved with a simple modification of the contract.

For example, as discussed in Part I, in today’s marketplace, a lawyer should also provide advice to a prospective home buyer as to whether the loan necessary to close the deal is one that is prudent for the buyer to enter into. If it turns out that, in order to close, a condominium buyer will need to enter into a loan where more than forty percent of the buyer’s gross monthly income must go towards monthly payments of principal, interest, taxes, and condominium assessments, then the attorney should be able to counsel the buyer that the purchase of a home at that price at this time is not financially prudent. If the buyer then decides to take that advice, the buyer would want to be able to rescind the deal through the attorney exercising the attorney approval clause, but could not do so if the clause only permits the attorney to either approve the contract or make changes to the contract other than

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42. 622 N.E.2d 904, 906 (Ill. App. Ct. 1993).

purchase price. A more efficient way to address the problem that some parties will use the attorney approval clause to get out of a deal that they already signed because they receive an offer with more favorable financial terms during the attorney approval phase, is to draft the contract to expressly prohibit such conduct and to require the attorney to specify the reason(s) for disapproval, which the attorney and client believe in good faith are not curable by modification to the contract.

d. VERSION FOUR: Attorney approval or modification of the contract, excluding price and dates,<sup>43</sup> requiring notice of disagreement on changes and requiring reasonable disapproval - At issue in the case of *Groshek v. Frainey*.<sup>44</sup>

*It is agreed by and between the parties hereto as follows: That their respective attorneys may approve or make modifications, other than price and dates, mutually acceptable to the parties. Approval will not be unreasonably withheld, but if within [five business] days after the date of acceptance of the Contract, it becomes evident agreement cannot be reached by the parties hereto, and written notice thereof is given to either party within the time specified, then this Contract shall become null and void, and all monies paid by the Purchaser shall be refunded.*

Version Four is similar to Version Three in that it allows attorney modification of the contract, but it is unclear whether the attorney is allowed to simply disapprove the contract. The clause in Version Four reads “approval or modification” and fails to also state “or disapproval.” Later, the clause refers to “approval” not being withheld unreasonably (i.e. contemplating the possibility of disapproval), but it is unclear whether the “disapproval” being referred to is disapproval of the contract or disapproval of proposed modifications to the contract. In contrast, The Multi-Board Residential Real Estate Contract 3.0 form is an example of a form contract containing an attorney approval clause that makes it very clear that the attorney can approve, disapprove, or make modifications to the contract.<sup>45</sup>

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43. The Attorney-Approval Rider of the Chicago Association of Realtors residential real estate form contract contains language substantially similar to Version Three except that it also included as a forbidden change the broker's compensation and dates. See Helen W. Gunnarsson, *Attorney - Approval Clauses and Residential Real Estate Contracts: Mere Modification or More?* 93 ILL. B.J. 72, 74 (2005) (reproducing pertinent parts of that contract).

44. 654 N.E.2d 467, 469 (Ill. App. Ct. 1995)

45. See Gunnarsson, *supra* note 43, at 74 (explaining the difference in the attorney approval provisions between these two commonly used form contracts in Illinois). The attorney review clause created by the Multi-Board Residential Real Estate Contract 3.0 is far more clear on this issue and provides:

ATTORNEY REVIEW: The respective attorneys for the Parties may approve, disapprove, or make modifications to this Contract, other than

A second problem with Version Four is the inclusion of the limitation on changing the dates in a contract. Why should an attorney be unable to propose or require this change for approval of the contract? For example, if the contract only allows a buyer ten days to obtain a loan commitment and in the attorney's judgment this is too short a time period, the attorney should be able to require this change to better protect the buyer's ability to have the funds on hand necessary to close the deal and an adequate time period to obtain a loan commitment before having to rescind the contract. What if the closing date is a month short of the two year holding period for exemption from federal taxes? Under this clause the seller's attorney could not disapprove or require modification of the closing date to protect the seller from incurring preventable taxes.

A third problem with the clause is that, although the clause states that the "approval" shall not be unreasonably withheld, the clause should also have stated that the attorney disapproving must provide the reason(s) for such disapproval to better effectuate the goal of preventing an "unreasonable" disapproval. The question of whether overall it is beneficial to require that the disapproval be "reasonable" is a close call. On the positive side, requiring that the approval of the contract and the modifications to the contract not be unreasonably withheld should help to prevent "bad faith" disapprovals by the parties through their attorneys. On the other hand, a problem with requiring that the approval not be withheld "unreasonably" is that a third party (the other attorney and, if the issue goes to litigation, a jury or court of law) will be deciding whether the attorney's articulated reasons for disapproval is reasonable. This adds more uncertainty to the exercise of attorney approvals and the possibility that the attorney's good faith judgment will be challenged. Currently, in all jurisdictions that have interpreted attorney approval clauses, courts have required that the attorney exercise the clause in "good faith." It is difficult to define "good faith" and "bad faith" in any context, including this one. Yet, one way of doing so is to ask whether the disapproval is based upon the attorney's review of the contract and the attorney's determination after consultation with the client that the contract does not meet with the client's needs,

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stated Purchase Price, within five (5) business days after the Date of Acceptance. Disapproval or modification of this Contract shall not be based solely upon stated Purchase Price. Any notice of disapproval or proposed modification(s) by any Party shall be in writing. If within ten (10) business days after Date of Acceptance written agreement on proposed modification(s) cannot be reached by the Parties, this Contract shall be null and void and earnest money refunded to Buyer upon written direction of the Parties to Escrowee. If written notice is not served within the time specified, this provision shall be deemed waived by the Parties and this Contract shall remain in full force and effect.

goals, and expectations when the client entered into the contract, or that the contract poses problems that cannot be cured through modification of the contract. A contract clause requiring that the exercise be “reasonable” will impose a higher standard. The issue of whether it is better to require good faith or to require the disapproval to be reasonable will be addressed in Part IV. Finally, a potential problem arises with regard to revealing confidential information in the process of specifying the reasons for the disapproval.<sup>46</sup>

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46. The reported decisions in Illinois have not yet ruled on the issue of whether an attorney may reveal confidential information accumulated during the representation of his client, despite the attorney-client privilege, to the extent that the information is necessary to show that the disapproval of the contract pursuant to the attorney approval clause was made in good faith. This is an important issue, because in most of the discussed cases, the attorneys for the disapproving parties have had to testify regarding the negotiation process between the parties. See e.g., *McKenna*, 704 N.E.2d at 829 (providing parts of the deposition and testimony of the buyer’s attorney regarding the transaction at issue); *Whitlock v. Labadie*, No. 73AP-461, 1974 Ohio App. LEXIS 3501, at \*9 (Ohio Ct. App. 1974) (holding that the seller had waived the attorney-client privilege when the seller called the counsel that disapproved the contract pursuant to the attorney approval clause to the stand, and posed questions concerning the exercise of good faith in the giving of advice to the seller, and that the buyer had the right to cross-examine the seller’s counsel concerning the exercise of good faith).

The absence of much case law on whether an attorney may reveal such confidential information can be partly credited to both *Olympic Restaurant* and *McKenna*, which held that “[w]hile the review clause must be invoked in good faith, it is not necessary for a party to state a reason when rejecting a contract pursuant to a review clause because the attorney’s right to disapprove is a proper exercise of his or her judgment.” *McKenna*, 704 N.E. 2d at 829, quoting *Olympic Restaurant v. Bank of Wheaton*, 622 N.E.2d 904, 909 (Ill. App. Ct. 1993). In addition, the Supreme Court of Illinois Rules of Professional Conduct permit, but do not require, an attorney to use or reveal confidential information necessary to defend against accusations of wrongful conduct. ILL. SUP. CT. R. PROF’L CONDUCT R 1.6 (2005).

If the non-disapproving party wants to force the attorney for the disapproving party to reveal specifics about the decision to disapprove the contract in the face of a challenge based on privilege, one way to do so would be to show that the disapproval falls within the crime-fraud exception to the attorney-client privilege. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 82 (2000) (providing that the attorney-client privilege does not apply to a communication occurring when a client: (a) consults a lawyer for the purpose, later accomplished, of obtaining assistance to engage in a crime or fraud or aiding a third person to do so, or (b) regardless of the client’s purpose at the time of the consultation, uses the lawyer’s advice or other services to engage in or assist in a crime or fraud). Comment *f* explains that the exception becomes relevant only after the attorney-client privilege is successfully invoked and the person seeking access to the communication must present a prima facie case for the exception. *Id.* at § 82, cmt. F. Fraud requires a knowing or reckless misrepresentation (or non-disclosure when applicable law requires disclosure) likely to injure another. *Id.* at § 82, cmt. d.

Hence, the courts must decide whether crime or fraud allegations should



### B. How Courts Have Made A Tough Situation Even Worse

Several decisions from Illinois and other jurisdictions have characterized the presence of an attorney approval clause as a conditional acceptance and an attorney's proposed changes to the contract as counteroffers.<sup>47</sup> This characterization allows either party to then claim that there was no binding contract to begin with, and consequently, no requirement for a good faith termination of the contract. If the attorney approval clause in the contract had been characterized as creating a conditional contract or a condition subsequent (as many other conditions contained in a standard form contract are, such as the condition that the buyer obtains a specified type of loan commitment), then there would be a binding contract subject to good faith performance of the condition.

#### 1. The Negative Consequences of Mischaracterizing Attorney Approval Clauses as Conditional Acceptances Rather Than Conditional Contracts

In a few rare cases, characterizing the attorney approval clause as a conditional acceptance and any proposed changes as a counteroffer would be accurate,<sup>48</sup> but in most other cases, the characterization is in fact incorrect<sup>49</sup> and can lead to bad faith terminations of contracts. When a party, such as the buyer, signs a contract and the seller does not sign the contract in the form signed by the buyer, but instead adds to or otherwise changes the terms of the form contract signed by the buyer, this constitutes a

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be the only instances when the exception to the attorney-client privilege will apply in the context of good-faith disapprovals of the contracts, or whether such exception will apply to other circumstances that impose lesser proof burdens on claimants. So far, the attorney's own judgment will decide not only whether to disapprove a contract pursuant to the attorney approval clause, but also whether she can fend away any accusations of "bad faith" disapproval by revealing confidences of her client. See also *infra*, note 149 and accompanying text (discussing how the procedural decision of which party will have the burden of proving good faith will potentially affect the issue of disclosing confidential information). As explained later in the article on what is good faith, if the client directs an attorney to disapprove for an impermissible reason, the attorney obviously should not disapprove the contract and will then not have to reveal a confidential discussion with her client.

47. *Groshek*, 654 N.E.2d at 470; *McKenna*, 704 N.E.2d at 829.

48. *Davis*, 383 N.W.2d at 833 (finding conditional acceptance and a counteroffer where a seller accepted a buyer's offer to buy a mobile home, but added a number of new terms including an attorney approval clause); *Converse*, 205 Cal. Rptr. at 245-46 (finding conditional acceptance where a buyer accepted an offer, but included a provision stipulating that the offer was subject to her obtaining an approval from an attorney, an accountant, and her son).

49. *Groshek*, 654 N.E.2d at 470; *McKenna*, 704 N.E.2d at 829.

conditional acceptance of the contract and the new or changed terms are a counter offer.<sup>50</sup> Thus, if an attorney approval clause is added to the contract by the seller after the buyer has already signed the contract without such clause, this change would cause the seller's acceptance of the contract to be a conditional acceptance and causes the contract to not be binding in any fashion. If, however, a form contract contains an attorney approval clause, and both parties sign the contract with this clause already in it, and the parties do not unilaterally add to or otherwise change the terms of the contract, the contract is now valid and binding subject to the condition that both parties' attorneys have a right to approve the contract, which the parties through their attorneys must exercise in accordance with the terms in the attorney approval clause and in good faith.

Unfortunately, there are certain cases in Illinois and in some other states where courts have characterized an attorney approval clause in the originally signed contract as a conditional acceptance, reasoning that when a party merely proposed changes to the contract under this clause, such action constituted a counteroffer that invalidated the contract.<sup>51</sup> In trying to understand how Illinois courts have mixed up conditional acceptances with conditional contracts (whether as a condition precedent or a condition subsequent), a close reading of the case of *Anand v. Marple*<sup>52</sup> is in order since it is one of the first published cases that involved an attorney approval clause and the issue of conditional acceptance; and, although that case was correctly decided, it has been cited to incorrectly by several Illinois courts.

a. *Anand v. Marple* – The misunderstood case

In *Anand*, the form contract was very badly drafted. The contract contained no legal description and the parties unilaterally added terms to the contract, which in some cases contained indecipherable words. The buyer signed the contract first.<sup>53</sup> Three days later, the seller signed the contract and checked a box indicating that she had made a counteroffer.<sup>54</sup> The next day, the buyer signed a handwritten statement at the bottom of the contract that stated "Buyer countered 1-23-87 at 7:20 pm."<sup>55</sup> The

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50. *Davis*, 383 N.W.2d at 833 ("In order to form a contract . . . there must be an unqualified and absolute acceptance of an offer by either party. [Any] modification of the terms of a proposal, made in response to a proposal, changes the terms of the original proposal, the modification is a new proposal or counter offer."). *Id.*

51. *Groshek*, 654 N.E. 2d at 470. See also *Stevens*, 714 N.E.2d at 959; *Converse*, 159 Cal. App. 3d at 91.

52. *Anand v. Marple*, 522 N.E.2d 281 (Ill. App. Ct. 1988).

53. *Id.* at 282.

54. *Id.*

55. *Id.*

bottom of the contract contained two other handwritten sentences. The first stated "Both seller's and buyer's attorney's [sic] will complete terms and conditions of sale."<sup>56</sup> The second sentence stated "This offer is subject to seller's [indecipherable words]."<sup>57</sup> The seller's attorney sent a letter to the buyer's attorney confirming a prior conversation in which the seller's attorney indicated that the contract contained a seller's attorney approval clause and that the attorney now disapproved and rejected it, that the terms and conditions they had discussed were not acceptable, and that the seller was not interested in further negotiations.<sup>58</sup>

The court correctly stated that in the suit by the buyer for specific performance of the purported contract, the key issue was whether the disputed document was a valid, enforceable contract or merely preliminary negotiation.<sup>59</sup> Because the seller in *Anand* did not simply sign the contract that was signed by the buyer, but inserted a handwritten change, such conduct gave rise to the issue of conditional acceptance. The buyer then signed the contract a second time with a notation that the buyer "countered" at a specific date and time. In such instances, when a buyer or seller fails to sign a contract in the form signed by the other party and instead adds to or otherwise changes the terms of a contract that the other party has signed, the issue of conditional acceptance is a proper consideration for the court. Hence, the court correctly pointed out:

[T]he [seller] signed the document on January 22 when she presented her counteroffer, but she did not sign it again after the [buyer] countered on January 23. It is elementary that for a contract to exist there must be an offer and acceptance, and the acceptance must comply strictly with the terms of the offer. A conditional acceptance or one which introduces new terms that vary from those offered constitutes a rejection of the original offer and becomes a counterproposal which must be accepted by the original offeror before a valid contract is formed. In this case, there was an original offer and two counteroffers, but there is no indication of mutual assent to any or all of the terms contained in the document.<sup>60</sup>

Thus, it was not the presence of the attorney approval clause that made the court conclude that there was no offer and acceptance in *Anand*, but rather the failure of the parties to agree to all of the counteroffers that occurred in that case. Indeed, the court characterized the "subject to attorney [indecipherable word]" to indicate "that the document was subject to some unknown,

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56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 282-83 (internal citation omitted).

illegible, and indecipherable *condition subsequent*.<sup>61</sup> It also made sense for the court to discuss whether a valid and binding contract was created because the form contract lacked a legal description and the “subject to attorney” language added to the contract did not refer to the attorney’s approval as a condition to closing, but instead referred to the terms of the deal being *completed* by the attorneys for both parties. Finally, it is also noteworthy that in the case of *Loeb v. Gray*, cited by the court on the issue of conditional acceptance, the seller never signed the original contract, but only the listing agreement and an addendum to the contract that contained terms different from those of the contract that the buyer signed.<sup>62</sup> In both *Loeb* and *Anand*, the courts ruled that there was never a binding contract because there was never offer and acceptance by the parties in those cases, not because there was an attorney approval clause in the original form contracts that the parties signed.

Unfortunately, some Illinois courts have cited *Anand* as the basis for ruling that the presence of an attorney approval clause creates a conditional acceptance or that proposed changes under it constitute a counter offer, even when the clause in those cases was in the original form contract signed by both parties.<sup>63</sup> The first such recorded case to cite *Anand* in this incorrect fashion was *Olympic Restaurant Corporation v. Bank of Wheaton*,<sup>64</sup> decided in 1993 by the Illinois Appellate Court for the Second District. Like *Anand*, *Olympic Restaurant* is a case that reached the correct result,<sup>65</sup> but that contained some incorrect dicta that unfortunately has been applied by other Illinois courts in even more harmful ways which have impeded the basic goal behind the presence of attorney approval clauses.

b. *Olympic Restaurant Corporation v. Bank of Wheaton* – When dicta overshadows the holding

In *Olympic Restaurant*, the printed form contract contained an attorney review clause authorizing the parties’ attorneys to review and make modifications, other than stated purchase price, mutually acceptable to the parties and stating that if the parties did not agree (presumably to these required changes) and written

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61. *Id.* at 283.

62. *Loeb v. Gray*, 475 N.E.2d 1342, 1348 (Ill. App. Ct. 1985) (“[A] new term was introduced, namely, the disposition of the proceeds of an oil and gas production. That term was never accepted; hence, no contract was formed.”).

63. *Olympic Restaurant Corp.*, 622 N.E.2d at 908; *Groshek*, 654 N.E.2d at 470; *McKenna*, 704 N.E.2d at 829.

64. *Olympic Restaurant*, 622 N.E.2d at 904.

65. One could argue, however, that the court was incorrect on the notice issue. See *supra*, note 59 (discussing how the court chose to consider the two letters of December 7th as notice of disagreement).

notice thereof was given to the other party (presumably of such failure to agree to such required changes) within ten days, the contract would become null and void.<sup>66</sup> On November 7, 1991, the attorney for the sellers sent a letter to the buyer and his lawyer, stating that the attorney did not "approve" the contract and thus was enclosing his modifications and/or changes. That same day, the buyer's attorney wrote back that certain changes to the contract "should" be made and further stated that, "With regard to Seller's attorney approval letter dated November 7, 1991, I disagree with the following modifications and/or changes..." There was no further correspondence between the parties until November 11, 1991, when the seller's attorney sent a letter to the buyer stating "My clients advise that they do not wish to accept your counter offer [sic] of November 7, 1991, and thus have authorized the return of your earnest money deposit. They thus consider this matter to be closed."

The attorney for the buyer, operating under the attorney review clause, had clearly required that certain changes be made to the contract, as did the attorney for the seller. The two attorneys failed to agree on the required changes and both the trial and appellate courts ruled that such failure "nullified" the contract (a term consistent with the valid creation of a contract that has now become null and void through an unfulfilled condition).<sup>67</sup> This result (and this portion of the terminology for the result) was correct. The case on one level was a relatively easy case to resolve (except, perhaps for a procedural question on the exercise of the notice of disapproval and the issue of good faith).<sup>68</sup> There was a contract, the contract was subject to a condition that the parties' lawyers have the right to review and require changes to the contract that if not agreed upon would make the contract null and void, and the parties each required certain changes which were not agreed to, and therefore, the contract became null and void.

However, certain dicta from this case are wrong and have caused problems for Illinois lawyers in the proper exercise attorney approval rights.<sup>69</sup> Both the trial and the appellate courts

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66. See *supra*, Part I, b. VERSION THREE.

67. *Olympic Restaurant*, 622 N.E.2d at 908.

68. One could argue that neither party properly notified the other within the required time frame that they had not agreed to the other's proposed changes. See *id.* at 906 (summarizing how neither side accepted the other's modifications, and that the only other correspondence presented in the record was a letter from the sellers' attorney to the buyers dated three days after the ten day review period had expired). The court, however, relied upon the November 7th letters as the basis for the required notification of disagreement. *Id.* at 910.

69. See Gunnarsson, *supra* note 43 (presenting an overview of the disagreement between several prominent residential real estate attorneys in

incorrectly referred to the letters as “counteroffers.” The appellate court cited to *Loeb v. Gray* for the rule of law that when an acceptance requests modification or contains terms that vary from those offered, this constitutes rejection of the original offer and becomes a counterproposal that must be accepted by the original offeror before a valid contract is formed. But, as previously discussed, in *Loeb*, the seller had never signed the purchase contract in the form that the buyer had, and the seller had inserted new and different terms into the contract. *Loeb* does not stand for the proposition that a requested change to a contract under an attorney review clause which was in the original printed form contract that the parties had signed constitutes a counteroffer. The *Olympic Restaurant* court also misapplied *Anand* by stating that the presence of the hard-to-read attorney approval clause in that case was what caused the contract to fall short of a binding and enforceable contract.<sup>70</sup> As previously discussed, a series of other facts caused the court to rule that no binding contract had ever been created in that case.<sup>71</sup>

The consequence of concluding that the attorney review clause creates a conditional acceptance or calling the communications made pursuant to the clause a counteroffer is that there is no longer a requirement that the disapproval under the clause be in good faith. As the court in *Olympic Restaurant* stated after discussing whether the sellers had acted in good faith or not (the court stated in dicta that there was a question of bad faith here on the part of the sellers since the seller signed a contract with another buyer for a higher purchase price during the review period), “[we have] concluded, and we agree, that the November 7

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the Chicago area as to the impact of an attorney approval clause in a purchase and sale agreement). Mr. Steven Bashaw, who authors the Real Estate Flash Points for the Illinois ICLE, points to the *Olympic* rationale and terminology to claim that a proposal for modification under the attorney approval provision constitutes a rejection of the contract and a counteroffer to form a new contract. *Id.* at 74.

Mr. John O'Brien, chair of the Illinois Real Estate Lawyers Association, agrees with Mr. Bashaw, evoking the common law ‘mirror image’ rule, and the language of the Multi-Board Residential Real Estate Contract 3.0. *Id.* Indeed, both Mr. Bashaw and Mr. O'Brien agree that the increasingly common practice in Illinois of adding to a requested change the statement “The foregoing is not to be construed as a counteroffer” is not effective and that the suggested change will still be construed as a counteroffer. *Id.*

However, Mr. Ben Cohen, another Chicago attorney, disagrees with both Messrs. Bashaw and O'Brien. “I don't see how a proposal for modification does anything but put talk into the air” and points to the Attorney Approval Rider prepared by the Chicago Bar Association's Real Property Law Committee, which recognizes that a valid contract exists, regardless of whether the attorney for either party serves to the other a suggestion for modification. *Id.*

70. *Olympic Restaurant*, 622 N.E.2d at 908-09.

71. See *supra* notes 53-59 and accompanying text (discussing how the court chose to consider the two letters of December 7th as notice of disagreement).

letter written by [the buyer's attorney] was by itself a rejection of the original contract and a counteroffer. Thus, regardless of the [seller's] apparent bad faith, [the buyers] disapproved the October 25 agreement and made a counteroffer that was never accepted." If the buyer had not so clearly required certain changes to be made to the contract in the November 7 letter and had merely suggested certain changes, then the issue of the seller's bad faith in exercising its attorney review right would have been an appropriate inquiry, but one that the court still might not have recognized because of the court's mischaracterization of both letters as counteroffers. This means that there was no binding contract in the first place, and thus, no requirement of good faith exercise of the approval right.

c. *Groshek v. Frainey* – The amplification of *Olympic Restaurant's* mischaracterization

In 1995, the decision of the Illinois Appellate Court for the First District, Second Division in the *Groshek v. Frainey*<sup>72</sup> case illustrated the points made above. The *Groshek* court cited both *Anand* and *Olympic Restaurant*, as well as a treatise on contract law,<sup>73</sup> to characterize the presence of an attorney approval clause in a form contract signed by both parties as a conditional acceptance rather than a conditional contract. The *Groshek* case, however, is more troubling than *Olympic Restaurant* because the court went even further by clearly stating in dicta that even *proposed* modifications (as compared to modifications that the sellers' attorney *required* in *Olympic Restaurant*) under an attorney approval clause constitute a counteroffer, citing to *Olympic Restaurant* and *Anand* for support.<sup>74</sup>

The *Groshek* dicta put a lawyer in a terrible bind. If the lawyer sees certain problems with the contract that the attorney and the client would like to address through revising the contract, *if possible*, (rather than as a deal-breaker point) they take a big risk if they propose or suggest a change to the contract that will allow the other side to get out of the deal without forwarding any good faith basis. Relying on dicta from *Groshek* and *Olympic Restaurant*, the other party can simply say that the lawyer's *requested* changes to the contract constitute a counteroffer which

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72. *Groshek*, 654 N.E.2d at 467.

73. The court in *Groshek* cited to RICHARD A. LORD, WILLISTON ON CONTRACT § 6:13, 104-18 (4th ed. 1991) for the proposition that "conditional acceptance occurs when a party to an agreement imposes as a condition of the bargain the favorable opinion of his lawyer." But the cases cited in the footnote for support of this proposition, where the facts of the cases are discussed, involve examples of the unilateral imposition of an attorney approval right.

74. *Groshek*, 654 N.E.2d at 471.

they decline to accept, and thus, there is no binding contract.<sup>75</sup> Such dicta create a “straight-jacket” that impedes the attorney’s ability to adequately represent her client. On the one hand, attorneys would like to use their knowledge and skills to competently represent the client. This would include identifying potential problems with the way the deal is currently documented and structured and solving these problems in a fashion acceptable to both parties. On the other hand, attorneys fear that their actions will lead to a bad faith termination of the contract that courts will allow to occur.

The mischaracterization of *suggested* changes in the context of an attorney approval clause as a counteroffer also encourages parties to use the counteroffer dicta to terminate a contract in bad faith. A party would only argue the counteroffer point with respect to a recommended change if they now have a better deal to pursue, or if they simply changed their mind on selling altogether for reasons unrelated to an attorney’s advice. If the other side was not trying to get out of the deal in bad faith and they really did not like the recommended change, they could simply say “No” to it and have the contract continue without this change. This is because the party proposing the change was only asking, not demanding, that these changes be made in the hopes of convincing the other party to agree if they did not really object to the change or to bargain over it during the negotiation of other changes. This is part of the give and take of negotiating a deal and problem solving rather than simply killing a deal upon detection of a potential problem. If one party, after consultation with the attorney, voiced true objections to the contract that could not be fixed through revision to the contract, they could write a letter to the other side disapproving the contract. But, when the real reason why they do not want to proceed with the deal is that they now have a better offer, they can latch onto the dicta in these two cases to, in essence, terminate the contract in bad faith.

d. *Hubble v. O’Connor* – The Illinois court that correctly characterizes attorney approval clauses and proposed recommendations under it.

There is one ray of hope, however, and it came from the Illinois Appellate Court for the First District, Sixth Division, in

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75. It is upon this rationale that Messrs. Bashaw and O’Brien claim that attorney approval provisions operate as counteroffers that terminate the contract the parties have already signed. *See* discussion *supra*, note 69. According to them, the end result of *Olympic*, *Groshek*, and the attorney approval provisions modeled after the Multi-Board Residential Real Estate Contract 3.0 is that when an attorney proposes a modification to the contract, even if it is just moving the closing date by one day, it’s a counteroffer and could result in killing the deal. Gunnarsson, *supra* note 43, at 74.



the 1997 case, *Hubble v. O'Connor*.<sup>76</sup> The *Hubble* court correctly characterized the attorney approval clause contained in the form contract signed by the buyer and the seller as creating a condition subsequent to a binding contract, since the clause was in the buyers' original offer and that offer was accepted by the seller.<sup>77</sup> The court concluded that the parties entered into a valid contract when they signed the agreement. It then addressed whether the parties' subsequent discussions concerning the proposed rider to the contract constituted an implied disapproval of the contract under the attorney approval clause. The court ruled that in analyzing the legal significance of the discussions of the parties' attorneys under the attorney approval clause, the mirror image rule is not relevant because this was not a case of contract formation. "A counteroffer rejects an offer only when made *before* a contract is formed. Here, the contract was formed when defendants' offer was accepted by plaintiffs on June 8, 1993."<sup>78</sup> Consequently, the only question was whether one of the attorneys had disapproved the contract within the stated disapproval period.

The *Hubble* court also ruled that if an attorney merely proposes changes to a contract under an attorney approval clause requiring notice of disapproval for termination (Version 2 in Part I), this will not lead to a termination of the contract.<sup>79</sup> To hold otherwise would be fundamentally unfair because it would "allow one party to give ambiguous disapproval so as to play both sides of the fence, i.e., to argue that a binding contract exists or that no contract exists, depending upon the development of subsequent events."<sup>80</sup>

The court concluded that neither the seller nor the buyer's attorney had timely disapproved the contract. The first letter from the buyers' attorney referred to a "proposed" rider which, according to the court, merely requested changes to what was, at that time, a binding agreement. After most of the requested changes had been agreed to and memorialized in the rider, the buyer's attorney, on the last day of the attorney disapproval period, sent a letter proposing a final change. "I would like to propose a final additional provision to the Rider . . . I would like to add a provision which. . ." The court concluded that this letter hardly constituted "disapproval" of the agreement. The court in *Hubble* correctly distinguished its facts from the facts in both *Olympic Restaurant* and *Groshek* as to whether the attorney letters constituted disapproval of the contract:

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76. *Hubble v. O'Connor*, 684 N.E.2d 816 (Ill. App. Ct. 1997).

77. *Id.* at 821.

78. *Id.*

79. *Id.* at 822.

80. *Id.*

In *Olympic*, the sellers' attorney wrote a letter to purchasers' attorney within the disapproval period and stated 'I do not approve said contract.' . . . That same day, purchasers' attorney wrote to sellers' attorney: ' . . . please be advised the following modifications should be made to the Contract'. . . [T]hese letters were fair notice by and to each party of the other's intention to invoke the attorney disapproval. . . . See also *Groshek v. Frainey* . . . where attorney unambiguously wrote within the disapproval period, 'I hereby withhold my approval of said contract.'

By contrast, the buyers' attorney in *Hubble* failed to clarify that they intended to disapprove the contract. Indeed, it appears that the buyers changed their mind only after expiration of the attorney approval period because one of the buyers discovered that he had a business opportunity to relocate from Chicago to Budapest, Hungary, and due to this subsequent development, the buyers attempted to invalidate the contract or argue that they had in fact disapproved the contract.<sup>81</sup>

e. Despite *Hubble*, Illinois attorneys cannot predict whether courts will still follow the flawed reasoning of *Olympic Restaurant* and *Groshek*.

Unlike the courts in *Olympic Restaurant* and *Groshek*, the court in *Hubble* not only had it right in terms of the result in the case, but the court's rationale was on sound footing in terms of both the analysis of the law and the policy concerns that seek to discourage bad faith terminations. The problem persists, however, because there is inconsistent case law in Illinois on construing attorney approval clauses and attorneys encounter difficulty in predicting how a court will construe this issue if it were to arise again.<sup>82</sup> One would like to think that courts would follow the reasoning of the *Hubble* case rather than that of the *Olympic Restaurant* and *Groshek* decisions. Yet, the dicta from the Illinois Appellate Court for the First District, First Division in 1998 in *Dennis F. McKenna Co. v. Smith*<sup>83</sup> still cited to *Groshek* to support the following inaccurate statement of law: "If a contract with an attorney approval clause is accepted before an attorney's approval, the acceptance is construed as a qualified or conditional

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81. *Id.* at 822-25

82. *Hubble v. O'Connor*, 684 N.E.2d at 821, points out this inconsistency. The case stands for the proposition that when two parties sign a purchase and sale agreement containing an attorney approval clause, a binding contract is formed subject only to a condition subsequent. *Id.* In support, the *Hubble* court cited a well known treatise standing for the rule of law that "an offer that states that it is 'subject' to the approval of the attorneys of both parties creates a contract the moment it is accepted." 1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS, § 3.7, 336 (Rev. Ed. West Pub. Co.) (1993).

83. *McKenna*, 704 N.E.2d at 829.

acceptance of the terms of the contract.”<sup>84</sup> Notwithstanding that statement, the issue in the *McKenna* case according to the court was whether the seller’s attorney exercised the right to disapprove the contract in good faith.<sup>85</sup> This is strange, because if the clause truly created a conditional acceptance, then there was no contract formed, and thus, there should be no obligation to act in good faith when exercising a right of disapproval under the clause. The court ruled that the seller’s attorney had in fact exercised the clause in good faith, even though the seller received and accepted a higher offer from another purchaser during the attorney approval period,<sup>86</sup> a result that will be addressed below in Part IV.B.2, in the discussion of courts’ problems with distinguishing good faith from bad faith attorney contract disapprovals.

Hence, Illinois case law on the nature of an attorney approval clause is clearly divided and attorneys lack the predictability they need to know how to work with these clauses. Most troubling, the majority of the reported decisions contain dicta that do not accurately reflect the law, that create incentives for bad faith disapprovals, and that prevent attorneys from competently and ethically doing their job. Other jurisdictions also suffer from this problem, with some courts incorrectly interpreting these clauses and others correctly doing so.<sup>87</sup>

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84. *Id.*

85. *Id.*

86. *Id.* at 830. The court basically accepted the seller’s attorney’s testimony that the reason for the disapproval was the fact that the buyer insisted that the contract state that the offer from the buyer was only good for three hours and that the disapproval was not based upon the other offer at a higher purchase price. *Id.*

87. For cases that hold that attorney approval clauses in a contract signed by both parties are counteroffers or create conditional acceptance of the purchase and sale agreement, see, e.g., *McKenna*, 704 N.E.2d at 829 (holding that if a contract with an attorney approval clause is accepted before an attorney’s approval, the acceptance is construed as a qualified or conditional acceptance of the terms of the contract)(citing *Groshek*, 654 N.E.2d at 467; *Converse*, 159 Cal. App.3d at 91 (concluding that the signing of the deposit receipt did not constitute an unqualified acceptance of the plaintiffs’ offer, but was only a conditional acceptance); *Pelusio v. Chen*, 787 N.Y.S.2d 679 (N.Y. Supp. 2003) (holding that when the contract language makes the agreement subject to the approval of attorneys, then the contract is not binding and enforceable until approved)). The case of *Davis v. Satrom*, 383 N.W.2d 831, 833 (N.D. 1986) is distinguishable, because the *Davis* court properly held that the seller’s acceptance of the commercial purchase agreement after inserting several additional handwritten conditions constituted a counteroffer and that there was no contract at that point because there had never been an unqualified acceptance of an offer without the introduction of additional terms and conditions.

For cases that hold that attorney approval clauses are conditions subsequent or create a binding but conditional purchase and sale agreement, see, e.g., *Hubble*, 684 N.E.2d at 821 (holding that an attorney approval clause is a condition subsequent, i.e., only if either attorney disapproved of the

One has to wonder why some courts have mischaracterized attorney approval clauses as conditional acceptances and have construed proposed changes to be counteroffers when the attorney approval clause was in the contract signed by both parties. Perhaps it is because the nature of the condition relates to the terms of the contract rather than something more outside of the contract, such as obtaining a satisfactory loan commitment or satisfactory title commitment. Even if this distinction could be argued so as to turn a conditional contract into a conditional acceptance, when one contemplates the consequences of this classification, that there is no obligation to act in good faith and that a party can now in essence terminate the contract for any reason, this should cause a court to classify the clause as creating a conditional contract rather than a conditional acceptance. Allowing parties to extricate themselves in bad faith from a signed agreement is not only inconsistent with sound public policy, but is also inconsistent with the reasonable expectation of parties when they enter into an agreement that is subject to attorney approval. It is hoped that the Illinois Supreme Court, if given the opportunity to address this issue, will adopt the *Hubble* analysis on classification of attorney approval clauses, and will reject, to the extent inconsistent, the *Olympic Restaurant*, *Groshek*, and *McKenna* cases.

2. *Courts Also Encourage Bad Faith Disapprovals By Failing to Adequately Define "Good Faith" And By Not Requiring An Attorney To Specify The Reasons for Disapproval.*

a. The mixed baggage from the *Olympic Restaurant's* ruling: Helpful dicta on defining bad faith, but adopting the inimical New Jersey rule that an attorney does not have to specify the reasons for disapproval.

*Olympic Restaurant*<sup>88</sup> is the first reported Illinois decision to

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contract within a certain period would the contract become void); *Austin v. Trybus*, 524 N.Y.S.2d 895, 896 (N.Y. App. Div. 1988) (holding that the buyer's failure to contact an attorney for more than three months after acceptance of the purchase offer and the attorney's delay in disapproving the contract until the date of closing were unreasonable as a matter of law and that the condition of attorney approval ceased to exist because it was not timely exercised); *Frank Realty, Inc. v. Handelsman*, 17 Mass. L. Rptr. 433, 2004 WL 808976, \*1 (Mass. Super. 2004) (holding that the attorney approval clause and other conditions in the contract are not conditions precedent to the formation of the contract); *Hein Enterprises*, 720 P.2d 975 at 979-80 (holding that where an attorney approval clause is unambiguous, it must be enforced as written, it is limited only by the requirement that the attorney act in good faith and that good faith disapproval by the attorney terminates an already formed contract).

88. *Olympic Restaurant*, 622 N.E.2d 904.

discuss the requirement of good faith as a possible limitation on the grounds on which an attorney may disapprove a contract under an attorney approval clause. On October 30, 1991, the sellers and the buyer entered into a contract containing an attorney approval clause that permitted the parties' attorneys to review it and to propose modifications, other than the stated purchase price, within ten business days of acceptance of the contract.<sup>89</sup> Five days later, the sellers entered into a contract with Olympic Restaurant to sell to Olympic Restaurant the very same property for \$20,000 more.<sup>90</sup> On November 7, 1991, the sellers' attorney sent a letter to the buyer and his lawyer stating that he did not approve the contract and enclosed certain modifications to it (the attorney could not simply disapprove the contract because of the wording of the attorney approval clause).<sup>91</sup> This letter was sent within the ten-day review period that expired on November 8, 1991. Later on that same day, the buyer's attorney also sent a letter requiring that certain changes be made to the contract. The court concluded that these two letters constituted disapproval of the proposed modifications by each party, and thus, the contract became null and void under the attorney review clause.<sup>92</sup> The buyer, however, sued for specific performance of the contract and argued that the sellers' attorney's exercise of the attorney review clause was invalid. One of the arguments raised by the buyer was that the sellers' attorney acted in bad faith, pointing to the other deal that the sellers signed during the attorney review period.

The court agreed that the sellers' actions in signing a contract with Olympic Restaurant while their agreement with the buyer was pending "raised a question of bad faith" on the sellers' part.<sup>93</sup> The court also agreed that the other deal may have tainted the November 7th letter that the sellers' attorney wrote.<sup>94</sup> The court ruled that it did not have to further explore the issue of bad faith because the trial court ignored the sellers' attorney's letter and was able to rule that the contract became null and void based upon the buyer's attorney's letter of November 7th.<sup>95</sup> Nonetheless, the dicta from the *Olympic Restaurant* case makes clear that if a seller enters into another contract to sell property they had already contracted to sell, this raises a question of bad faith and may taint the sellers' attorney's exercise of the attorney review clause. The fact that the second contract was financially more lucrative to the sellers is also relevant to the issue of bad faith and the court notes

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89. *Id.* at 906.

90. *Id.*

91. *Id.*

92. *Id.* at 908.

93. *Id.* at 909.

94. *Id.*

95. *Id.*

this aspect when it discusses the possibility that the attorney review was tainted.<sup>96</sup>

Although some of the dicta in *Olympic Restaurant* on the issue of good faith is helpful in trying to determine what would be a bad faith exercise of the attorney approval right (i.e. the relevance of the receipt of a more lucrative deal and execution of another sales contract), the court made it more difficult to prevent bad faith terminations when it adopted a rule from a New Jersey case that an attorney does not have to specify the reason for disapproval in the notice of disapproval, "because the attorney's right to disapprove is a proper exercise of his or her judgment."<sup>97</sup> Since the court in *Olympic Restaurant* had already ruled that an attorney must exercise the right of approval in good faith, how would requiring the attorney to specify the good faith reason for the disapproval impede the attorney's exercise of his or her judgment? Requiring the attorney to state the reason for the disapproval should not change the standard for review of the disapproval, which would be one of good faith, unless the contract clause required more. It is hard to understand why New Jersey does not require attorneys to state the reason for their disapproval in the notice of disapproval. Perhaps the reason why New Jersey provides otherwise is the fact that their attorney approval clauses are more in the nature of a three-day absolute right of rescission. The court in the case of *Indoe v. Dwyer*<sup>98</sup> (the seminal New Jersey case on interpreting attorney approvals) noted that, when the buyer signed the purchase contract, the buyer thought of it as a mere offer or bid, rather than a document that might become a binding contract.<sup>99</sup> After *Indoe*, a settlement agreement between brokers and lawyers in New Jersey led to a specifically required three-day attorney approval clause that is in the nature of a three-day absolute right of rescission.<sup>100</sup>

It appears that the *Olympic Restaurant* court discussed and adopted the New Jersey rule that an attorney does not have to specify the reason for disapproval in reaction to the unusual language in the contract at issue in *Olympic Restaurant*, which stated that the attorney may "review and make modifications" to the contract to clarify that an attorney should be able to disapprove a contract without doing so based upon the wording of the contract. The court explained:

[T]he purpose of such an attorney approval clause is to provide the purchaser or seller with the opportunity of obtaining legal advice with respect to the transaction, and its value lies in the fact that the

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96. *Id.*

97. *Id.*

98. *Indoe*, 424 A.2d 456.

99. *Id.* at 457.

100. See *supra* notes 24-25 and accompanying text.

contract may be canceled upon receiving such advice. Parties to a real estate transaction are entitled to the benefit of the judgment of a trusted counselor, and an approval contingency is designed to accord this right to those who, for some reason enter into a purchase and sale agreement before reviewing the matter with their attorney.<sup>101</sup>

In other words, the *Olympic Restaurant* court seems to have adopted the New Jersey rule in order to empower an attorney to disapprove a contract based upon advice that the attorney provides to the client relating to the transaction generally rather than just the words in the contract. As the court explained:

[T]he only reason to have an attorney review clause is to give the parties to a contract, who may not be sophisticated in matters relating to real estate and/or contracts, a chance to have their attorneys scrutinize the offer before final acceptance. In the present matter, if there was no way for the parties to get out of the October 25 contract during the review period, the review clause was meaningless and the attorney review process was a pointless exercise.<sup>102</sup>

In most versions of attorney approval clauses, however, there is no requirement for the attorney to simply review and make modifications to the contract; most call for the attorney to be able to approve or disapprove the contract as well. In the absence of clear limiting language to the contrary, a court could expansively interpret an attorney review clause to authorize disapprovals based on the transaction generally, rather than based only on the words of the contract. Consequently, the *Olympic Restaurant* court should not have adopted the New Jersey rule that an attorney need not specify the reason for disapproval of a contract as a means to cure a badly worded contract in the court's judgment. A better cure for this clause would have been to interpret it expansively in light of the policy reasons behind the clause and the reasonable expectations of the parties who rely on an attorney review of the contract. Instead, the court "fixed" the potential problem in the case before it by adopting a rule that increases the likelihood of bad faith terminations.

b. The problematic language of the attorney approval clause also forced the Groshek court to embrace the *Olympic Restaurant's* reasoning

The next reported Illinois decision to discuss the issue of good faith when exercising an attorney approval clause was *Groshek v. Frainey*.<sup>103</sup> The attorney approval clause in this case required that

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101. *Olympic Restaurant*, 622 N.E.2d at 909(citing *Indoe*, 424 A. 2d at 460).

102. *Id.*

103. *Groshek*, 654 N.E.2d 467.

the approval not be unreasonably withheld, but it did not expressly require the attorneys to specify their reasons for disapproval in the notice of disapproval.<sup>104</sup> The attorney approval clause stated that the attorneys may “approve or make modifications, other than price and dates, mutually acceptable to the parties.” The buyers’ attorney sent a timely notice of disapproval of the contract without specifying any reasons for the disapproval and without proposing any changes to the contract. The sellers argued that, because the clause stated that the attorney may “approve or make modifications” to the contract, the buyer’s attorney could not simply disapprove the contract but, instead, must propose modifications to the contract.<sup>105</sup> In addition, the sellers stated that the buyers’ attorney had told them that he was withholding approval of the contract because the buyers had changed their minds and that any other reasons the attorney gave were a mere pretext.<sup>106</sup> The buyers, however, alleged that the buyers’ attorney had explained to the sellers that he was withholding his approval for several reasons, including some concerns over the zoning of an adjacent parcel.<sup>107</sup>

In analyzing whether the buyers’ attorney’s disapproval of the contract was valid, when the attorney failed to propose modifications to the contract to explain why he was disapproving the contract, the court noted,

[The] courts that have interpreted the clause have given the attorney a much wider scope of authority [than simply negotiating the inclusion of certain standard clauses or the modification of already included provisions], permitting disapproval of the contract for any reason, limited only by an implied covenant of good faith.<sup>108</sup>

The court affirmed the rule in *Olympic Restaurant* that an attorney is not required to specify the reason for disapproval.<sup>109</sup> The court also stated that, unlike that in *Olympic Restaurant*, the contract clause in the case at hand more clearly permitted an attorney to simply disapprove a contract rather than make changes to it, and that simply disapproving the contract without proposing changes to it is not unreasonable.<sup>110</sup> The court briefly noted the argument that it might be unreasonable to disapprove a contract and refuse to specify a reason for the disapproval, but without ruling on this argument, the court stated that this did not

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104. *Id.* at 469.

105. *Id.* at 469-70.

106. *Id.* at 469.

107. *Id.*

108. *Id.* at 470.

109. *Id.* at 471.

110. *See id.* at 471 (stating that although the court in *Olympic Restaurant* found some ambiguity in the approval clause at issue, no similar ambiguity existed in the clause at hand).



occur in the facts of this case since the buyers' attorney offered to provide the reasons to the sellers after the sellers argued that the buyers had improperly exercised the right of attorney approval.<sup>111</sup>

The *Groshek* case is quite similar to the *Olympic Restaurant* case in that the court appeared to be influenced by the problematic language in the attorney approval clause (the lack of clear authority in the clause to simply disapprove the contract as opposed to being required, if not approving the contract, to make changes to it) when it ruled that an attorney does not have to specify a reason for the disapproval. In addition, the court did not adequately give effect to the contractual language in this case, which required that any disapproval not be unreasonable, and instead, only implicitly required that the attorney state the reasons for disapproval when the other party demands to know the reasons. The court did not address, in dicta, what reasons may or may not be "reasonable."

c. While the *Hubble* court is not required to address the good faith issue, the difficult facts in the *McKenna* case lead to a problematic decision

The third reported decision on attorney approvals in Illinois, the *Hubble* case,<sup>112</sup> does not shed much light on the issue of good faith versus bad faith terminations under the attorney approval clause. In *Hubble*, the court ruled that the attorney disapproval right was never timely exercised.<sup>113</sup> Consequently, the court did not rule on the issue of whether the buyer's claimed termination under the attorney approval clause was exercised in good faith. This would have been an interesting issue because, during discovery, the buyers admitted that part of their motivation for trying to terminate the deal was the fact that after signing the contract, the buyers had a business opportunity to relocate in Budapest.<sup>114</sup>

Although the *Olympic Restaurant* case indicates that it would be bad faith for a seller to use the attorney approval clause as a means to get out of the deal in order to enter into a second deal at a higher purchase price (when the attorney approval clause excludes the purchase price as a basis to terminate),<sup>115</sup> it appears

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111. *Id.* at 472.

112. *Hubble*, 684 N.E.2d 816.

113. *Id.* at 822.

114. *Id.* at 820.

115. It is interesting to note, however, that when there is no such qualification in the attorney approval clause, some courts have permitted attorney disapproval based upon the purchase price. See *Ulrich v. Daly*, 650 N.Y.S.2d 496, 497 (N.Y. App. Div. 1996) (holding that an attorney may disapprove a contract on the basis of the price and a better offer since the attorney approval clause did not expressly exclude such disapproval). *But see infra* notes 147-148 and accompanying text (discussing how there is a split

that the seller in the *McKenna* case<sup>116</sup> did precisely this, and yet, the court ruled that the attorney disapproval was in good faith. In *McKenna*, the seller, an unsophisticated homeowner, was pressured by a real estate developer to sign a purchase and sale agreement for the sale of her home. After a few hours of negotiating, the developer ultimately offered to buy the home at \$9,000 less than the list price, but forced the seller to “take it or leave it” with only about two hours to decide.<sup>117</sup> The seller went ahead and signed the contract, even though she wanted to consult her attorney first, because there was an attorney approval clause in the contract and her attorney’s secretary told the seller that she would be protected with the clause in place.<sup>118</sup>

Similar to the seller in *Olympic Restaurant*, the seller in *McKenna* received a higher offer for the property during the attorney approval period (an offer of \$480,000 compared with the developer’s offer of \$450,000). The seller’s attorney sent a disapproval letter to the developer’s attorney one day after the higher offer came in, but within the time frame required in the contract. About one week later, the seller accepted the second buyer’s higher offer. The developer argued that the disapproval was invalid since it was based upon the purchase price, rather than the form of the contract, as required by the language of the attorney approval clause. The seller’s attorney stated that the other offer was not relevant to the attorney’s rejection of the first contract and that the reason for the disapproval was the attorney’s objection to one of the paragraphs in the contract, which only gave the seller a maximum of three hours to accept the contract.<sup>119</sup> The trial court accepted and believed the seller’s attorney’s testimony and the appellate court upheld the directed verdict that there was no bad faith termination.<sup>120</sup>

The *McKenna* ruling that the attorney approval clause was exercised in good faith is troublesome because it is difficult to understand how the three-hour period, by itself, is objectionable if the contract contained a satisfactory attorney approval clause that would allow the attorney to approve or disapprove the contract in a broad, good faith fashion. But during discovery, the seller’s attorney apparently failed to identify any problems with the attorney approval clause, with any other terms in the contract, or with the deal generally. How was the client harmed by the three-hour period for response (the typical period is usually as little as

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between courts when the approval clause does not contain a limitation on price considerations when seeking to disapprove the contract).

116. *McKenna*, 704 N.E. 2d at 829.

117. *Id.* at 828.

118. *Id.*

119. *Id.* at 829.

120. *Id.* at 829-30.

one day to as many as several days)? Without a more plausible explanation for the disapproval, the most obvious reason was that the seller had received a better offer during the attorney approval period. One must ask, if that offer had not come in, or if the developer had offered \$480,000 for the property, would the seller's attorney have objected to the three-hour period? Implicit in the case, though, is the understanding that it would be considered bad faith if the attorney disapproved based on the other deal or the purchase price in the contract.<sup>121</sup> The court simply chose to believe the testimony of the attorney that the real reason for the rejection was the timing provision in the contract rather than the second, higher offer.<sup>122</sup>

It appears that the *McKenna* court relied so heavily upon the seller's attorney's testimony (although in *Olympic Restaurant* the court stated in dicta that in similar circumstances the exercise of the attorney approval could be considered tainted with bad faith) because of the heavy-handed way in which the sophisticated buyer pressured the seller to sign the contract.<sup>123</sup> Indeed, when the seller's attorney failed to send the attorney disapproval notice to the buyer and its attorney as required by the contract (the seller's attorney sent the notice to the buyer's broker instead), the court ruled that this still complied with the requirements of the contract because the buyer clearly received notice from the broker since the buyer thereafter recorded a memorandum of the contract to cloud the title to the property.<sup>124</sup> The *McKenna* case may well represent one of those situations where hard facts make bad law.

d. Courts in New Jersey and New York have faced dilemmas similar to those faced by Illinois courts

Due to the paucity of Illinois case law to define the scope of good faith in the context of an attorney approval clause, it is useful to look at how courts in other jurisdictions have defined and applied the concept in the context of an attorney approval clause.

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121. This may be true even though the contract clause does not specifically prohibit disapproval based on the purchase price. The clause simply states that the contract is contingent on approval hereof as to "form." The seller's attorney could have argued that a second reason for the disapproval was the purchase price, which is a term in the form just as the three hour period is a term in the form. Perhaps the seller's attorney did not raise this argument for fear that the court would rule that the purchase price is not a matter that an attorney can raise in good faith.

122. Another possibility would be that the attorney may not think it wise for the client to deal with a buyer who would put so much pressure on the seller. The attorney may be concerned that the buyer will be unreasonable throughout the transaction, but this possibility was not raised in the case as a point that the attorney made.

123. *McKenna*, 704 N.E.2d at 829-30.

124. *Id.* at 830.

We have already mentioned the broad discretion that courts in New Jersey afford attorneys under an attorney approval clause. The court in *Indoe v. Dwyer*<sup>125</sup> (a case that pre-dated the settlement agreement between brokers and attorneys) interpreted an attorney approval clause stating in part, “[T]his contract, except as to price and financing terms (if any), is contingent upon approval by the respective attorneys for purchasers and sellers within three (3) business days of the date hereof.”<sup>126</sup> The buyer’s attorney in that case stated during pre-trial discovery that the reasons why he disapproved the contract were: carpeting was not included in the sale as the buyer had expected, there was no specification as to what personal property was included, the close proximity of the swimming pool to the kitchen doors, the lack of potability and septic system tests, the shortness of the time period for satisfaction of the mortgage contingency, the fact that the buyer’s husband had not signed the contract [the wife had thought that the contract she signed was merely a bid and that a contract would be prepared with the assistance of her attorney with terms acceptable to her attorney and her husband], and “other intangible considerations.”<sup>127</sup> At the time of the exercise of the disapproval, however, the buyer’s attorney had merely stated that the disapproval was for reasons other than purchase price and financing terms.<sup>128</sup>

The *Indoe* court ruled that the scope of the attorney approval is not limited to legal deficiencies with the contract, as the plaintiff in the case argued, but can include disapproval based upon the “practicability or desirability of undertaking the sale or purchase. . . to avoid precipitous actions which may prove to be legally, financially, or socially disadvantageous.”<sup>129</sup> The court also ruled that, because the purpose of the clause is to permit parties to a real estate transaction the benefit of a trusted counselor when they have entered into a contract before reviewing the matter with their attorney, this right should not be “diluted or denied by requiring that the attorney’s judgment be measured by some standard, other than good faith, or another’s opinion.”<sup>130</sup> If the parties wanted the attorney approval power to be limited to disapproving only on objectively reasonable grounds, the contract should have so stated.<sup>131</sup> The court held that the disapproval at issue was valid because the disapproval voiced by the buyers’

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125. *Indoe*, 424 A.2d 456.

126. *Id.* at 458.

127. *Id.* at 457.

128. *Id.*

129. *Id.* at 460.

130. *Id.*

131. *See id.* (stating that buyers were entitled to the benefit of their bargain).

attorney was an exercise of his judgment “and his reasons therefore were not subject to review or contradiction,” and because there was “no basis for a claim of bad faith or capriciousness on the part of the defendants [the buyers], or their attorney, in the use of this contingency provision, which would render the notice of disapproval ineffective.”<sup>132</sup>

The *Indoe* court granted a broad scope for the attorney’s review consistent with the underlying purpose of the attorney approval clause: to allow the parties to have the benefit of advice from a competent attorney relating to potential problems with the deal. The court concluded that, to maintain that purpose, a good faith standard should be applied to scrutinizing the validity of the disapproval rather than requiring that the attorney’s reasons be “reasonable” according to an “objective” standard. It makes sense to not require an attorney to satisfy some objective standard of what is reasonable and to allow the attorney wide discretion in advising her client on the prudence of the deal, especially since many attorneys who are not adequately trained in transactional skills fail to note and address various risks and this should not be used against a well-trained attorney who does raise these points with the client. Yet, the *Indoe* court could and should have required the attorney to state the reasons for disapproval at the time of the exercise of attorney approval to ensure that the disapproval is in good faith and not a mere pretext.

New York courts have also broadly interpreted an attorney’s right to disapprove a contract under an attorney approval clause. In *Ulrich v. Daly*,<sup>133</sup> the attorney approval clause stated, “[T]his agreement is contingent upon Purchaser and Seller obtaining approval of this Agreement by their attorney as to all matters contained therein.”<sup>134</sup> The seller’s attorney disapproved the agreement because the seller received a second offer for a higher purchase price, with no mortgage contingency clause and an earlier closing date. The court ruled that it was not bad faith for the attorney to consider other offers, as this provided extrinsic evidence relating to the terms of the contract.<sup>135</sup> For example, the court reasoned, a seller’s attorney should be able to disapprove a contract if the interest rate on the financing contingency is below market rates and the attorney should be able to consider the extrinsic fact of market rates in approving the matters contained in the contract, unless the contract specifies to the contrary.<sup>136</sup> The court also ruled that there was no evidence of bad faith by the

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132. *Id.*

133. *Ulrich*, 650 N.Y.S. 2d 496.

134. *Id.* at 497.

135. *Id.*

136. *Id.* at 497-98.

sellers because “there [was] no evidence that defendants interfered and prevented their attorney from considering the contract.”<sup>137</sup>

The *Ulrich*'s result and dicta are sound. The attorney approval clause stated that it related to “all matters” in the contract and did not exclude the purchase price, financing clause, or closing date. One could argue that, notwithstanding this language, it is rare for an attorney to provide advice on the purchase price, and so it was not in the reasonable contemplation of the parties that this term would also be included. Yet, at the same time, the language is quite clear when it says “all” terms. In addition, allowing an attorney to consider extrinsic factors, such as market level interest rates for a prime loan, when the contract allowed disapproval on the basis of any of the terms in the contract, including the financing terms, is consistent with the underlying purpose of the attorney approval clause.<sup>138</sup> Finally, the ruling that there was no evidence of bad faith, because there was no evidence that the sellers had interfered with or prevented their attorney from considering the contract, provides a very helpful test on the issue of what constitutes a bad faith disapproval.

The court in *McKenna v. Case*<sup>139</sup> ruled that an attorney disapproval of a contract will be considered in bad faith and invalid if it is based upon instructions from the client to disapprove, rather than based upon the attorney's review of the contract with the client.<sup>140</sup> The court in *Tavarozzi v. Emmanuel*<sup>141</sup> applied this rule. The sellers in *Tavarozzi* argued that the attorney approval clause could be used to void the contract for any reason whatsoever.<sup>142</sup> The attorney approval clause had been added to the contract by the seller's broker and it stated that the contract was contingent upon the sellers' attorney's review and approval of the contract within fourteen days of acceptance - with a separate, similar provision for the buyer's attorney's review and approval of the contract. The buyer argued that the reason for disapproval under this clause must relate to the attorney's actual review of the contract.<sup>143</sup> The court agreed with the buyer and ruled that under the implied covenant of good faith, an attorney cannot disapprove a contract in order for the seller to void the deal to pursue a deal with someone else. Thus, the sellers' attorney's disapproval of the contract in the case violated the covenant of

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137. *Id.* at 498.

138. The underlying purpose of the attorney approval clause is to receive all of the advice that a competent attorney would provide to her client, such as disapproving the contract if it would require the buyer to obtain an overpriced or unaffordable loan. *See generally supra*, note 20 and accompanying text.

139. *McKenna v. Case*, 507 N.Y.S.2d 777, 777 (N.Y. App. Div. 1986).

140. *Id.*

141. *Tavarozzi*, 2001 Conn. Super. LEXIS 402.

142. *Id.* at \*5.

143. *Id.*

good faith implied in all contracts and rendered the disapproval invalid.<sup>144</sup>

e. Lessons to be drawn from these cases.

The key guidepost that attorneys can turn to from these cases on what constitutes good faith in the context of an attorney disapproval clause is that the disapproval cannot be based upon a direction from the client to disapprove, but must be based upon the attorney's actual review of the contract. If the client is not asking the attorney to review the contract and to provide counsel to the client on the contract and the deal, but is instead directing the attorney to disapprove the contract unrelated to any advice from the attorney on the deal, then it is not a proper exercise of the attorney approval right.

The cases also underscore how the wording of the attorney approval clause greatly impacts what will be considered a proper basis for its exercise. Courts have enforced approval clauses that clearly state that disapproval cannot be based upon the purchase price.<sup>145</sup> When the approval clause does not contain this limitation, there is a split on what occurs. Some courts still would impose this limitation since it is presumed that is what the parties intended.<sup>146</sup> Yet, some courts allow an attorney in this circumstance to disapprove on the basis of the price and a better offer since the clause did not expressly exclude this (indeed, the clause spoke of approval as to *all* matters in the contract) and an attorney may advise the client on the prudence of the deal

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144. *Id.* at \*15. The court also ruled that to read the attorney approval clause in the broad fashion that the seller proposed would be inconsistent with some of the other provisions in the contract where certain other conditions to closing were established during the same fourteen day period (such as the right of the buyer to review the Declaration and other restrictions on use as a condition to closing). *Id.* at \*11-12. The court argued that if the buyer or seller could terminate the contract for any reason for a fourteen day period under the attorney review clause, then there would be no reason to require all these other conditions to closing during the same period. *Id.* at \*12. Consequently, the attorney review clause was not intended to permit termination for any reason whatsoever.

145. *See Indoe*, 424 A.2d at 460 (holding that an attorney approval clause that prohibits modifications or disapprovals as to price or financing terms will be enforceable as to those terms and the requirement of good faith).

146. *See Olympic Restaurant*, 622 N.E.2d at 908 (hinting that when a seller's disapproval is motivated by higher prices, a court could rule that such actions diverge from good faith obligations imposed by the contract); *Groshek*, 654 N.E. 2d at 471 (discussing *Olympic Restaurant* and finding no ambiguity in the attorney approval clause). Yet, both *Olympic Restaurant* and *Groshek* failed to reach the merits of such issue, because these courts held that the attorney disapproval served as a counteroffer that terminated the original contract.

generally, not just on purely legal issues.<sup>147</sup> Thus, if an attorney approval clause is as broadly worded as in the *Ulrich* case (allowing approval or disapproval as to *all* matters contained in the contract), then the attorney might even be able to disapprove based on the purchase price in the contract in light of another offer on the table. However, if a court rules that the clause is ambiguous and then admits extrinsic evidence regarding the reasonable expectations of the parties (based upon the surrounding circumstances and any conversations the parties and the broker may have had regarding the clause), it is possible that the court would find disapproval on this basis to be invalid.<sup>148</sup>

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147. *Ulrich*, 650 N.Y.S. 2d 497; *Stevens*, 714 N.E.2d 956, 962-63; *Trenta*, 468 A.2d at 739-40.

148. In determining whether a written contract is ambiguous, the traditional and mechanical approach has been to ascertain whether the contract is “complete-on-its-face,” also known as the “four corners rule.” Yet, some courts have tended to move away from that approach and have accepted evidence of the parties’ negotiations and of other relevant and external circumstances in order to ascertain whether a written contract is ambiguous. Ferdinand S. Tinio, Annotation, *The Parol Evidence Rule And Admissibility Of Extrinsic Evidence To Establish And Clarify Ambiguity In Written Contract*, 40 A.L.R.3d 1384 at \*4 (1971). One case from New Jersey has often been cited as a pioneer in this approach. See *Garden State Plaza Corp. v. S.S. Kresge Co.*, 189 A.2d 448, 454 (N.J. Super. 1963). The court stated:

[I]n the process of interpretation and construction of the integrated agreement all relevant evidence pointing to meaning is admissible because experience teaches that language is so poor an instrument for communication or expression of intent that ordinarily all surrounding circumstances and conditions must be examined before there is any trustworthy assurance of derivation of contractual intent, even by reasonable judges of ordinary intelligence, from any given set of words which the parties have committed to paper as their contract. Construing a contract of debatable meaning by resort to surrounding and antecedent circumstances and negotiations for light as to the meaning of the words used is *never* a violation of the parol evidence rule.

*Id.* (emphasis added).

Illinois has not been as forward as New Jersey, but there are several cases stating that relevant parol evidence is always admissible to assist in the determination of what the words used in an integrated writing mean. See, e.g., *Sunstream Jet Express v. Int’l Air Serv. Co.*, 734 F.2d 1258, 1266 (7th Cir. 1984) (applying Illinois law). “Admitting evidence of prior negotiations and agreements for the purpose of discovering the meaning of the terms used in the integration does not violate the parol evidence rule.” *Id.* (quoting *Ortman v. Stanray Corp.*, 437 F.2d 231, 235 (7th Cir. 1971)). See also, *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Prods. Inc.*, 212 F.3d 373, 380 (7th Cir. 2000) (holding that “notwithstanding the parol evidence rule, extrinsic evidence can be admitted to discover the parties’ genuine intent when a contract is ambiguous, but ‘there must be either contractual language on which to hang the label of ambiguous or some yawning void . . . that cries out for an implied term.’”)(quoting *Bidlack v. Wheelabrator Corp.*, 993 F.2d 603, 608 (7th Cir. 1993) (en banc)(plurality opinion)).

In addition, that the contract may appear integrated and that one party may have fulfilled its obligations under the contract will not excuse that party



### 3. *Analysis of Whether Attorney Disapproval In Various Scenarios Would Be Deemed To Be In Good Faith*

Attorneys have encountered difficult scenarios when operating under an attorney approval clause navigating the territory between the duty to zealously represent their client and the duty to exercise the attorney approval clause in good faith. The following are scenarios that attorneys have faced, or may face in the future, and an analysis based on current case law on whether the attorney could in good faith disapprove the contract in each circumstance.

a. *The buyer finds out during the attorney approval period that she needs to relocate to another city. For this reason, she directs her attorney to disapprove the contract.*

This would be a clear case of a bad faith termination even though the buyer is not terminating to pursue a better deal. There is case law that makes it clear that an attorney cannot disapprove a contract based solely on the client's direction to do so. If the client instructs the attorney to review the contract and find a reason to disapprove, the same result should apply. A false review of the contract should be construed as the charade that it is. If the client tells the attorney of her situation and asks what can be done under the attorney approval clause, the attorney should be able to review the contract to raise any points they would ordinarily raise, looking at such issues as the right to assign contract rights and remedies for default in light of the client's special needs and proposing changes to the contract to permit assignment (if not permitted) or to limit the remedies if the default occurs soon after the contract is entered into (within the first week or so, since reliance is not as great if the termination occurs soon after the contract is signed).

b. *The attorney has reviewed the contract and raised various issues with the seller. After consultation the seller directs the attorney to disapprove the contract, but the attorney knows that part of the reason for the disapproval is the fact that the seller has received during the attorney approval period a higher priced offer.*

This scenario assumes that the form contract prohibits an attorney from disapproving based on the purchase price.<sup>149</sup> Some

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from liability for breach of the implied covenant of good faith. See e.g., *Zenith Insurance Co. v. Employers Insurance of Wausau*, 141 F.3d 300, 308 (7th Cir. 1998) (holding that "a party may be liable for breach of the implied covenant of good faith even though all the terms of the written agreement may have been fulfilled"). "A party seeking to recover under this theory must show something that can support a conclusion that the party accused of bad faith has actually denied the benefit of the bargain originally intended by the parties." *Id.*

149. If the contract permitted disapproval based on any term in the contract,

form contracts actually address this issue. For example, the Illinois multi-board and bar association form purchase and sale agreement provides that an attorney can disapprove when part of the reason for the disapproval is the purchase price. However, if the buyer can show that “but for” the second, higher offer, the attorney would not have disapproved the deal (i.e. the real motive for the disapproval was the other deal), then a court might rule that the disapproval was not in good faith. For example, if the attorney in the *McKenna* case from Illinois had disapproved the contract due to the three hour time limit for the seller to accept the buyer’s offer, even if the seller had not received a higher purchase offer during the attorney approval period, then this would have been a good faith disapproval, even though the other deal was a factor as well. But if the seller’s attorney would not have disapproved the contract “but for” the other offer, then one could argue that the disapproval was in bad faith.

*c. The seller asks her attorney to review the contract under the attorney approval clause and the attorney advises her, after asking her when she purchased the home, that the seller will suffer adverse tax consequences from the sale because she will be selling it in less than two years from buying it. Seller’s attorney disapproves the contract on this basis.*

Assuming that the attorney approval clause is broadly worded (as opposed to requiring the attorney to solely “review and modify” the contract), this should not be deemed an improper exercise of the attorney approval. It is clearly not being exercised in bad faith and it relates to the type of counseling that a well trained attorney would provide for her client. If the attorney approval clause requires the attorney to review and modify (rather than only disapprove) the terms of the contract, one way to address the client’s problem within the parameters of the contract is to require that the closing date be changed to occur on the date that coincides with the second anniversary of the seller’s purchase of the home (assuming that the closing date is not explicitly excluded as a term of the contract that can be proposed to be revised under the attorney approval clause).

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including the purchase price, then there is little issue of good faith since the other offer is extrinsic evidence of the reasonableness of the price, a term of the contract that the attorney is allowed to review based on the express language of the contract.

d. *The buyer asks her attorney to review the contract under an attorney approval clause. The buyer's attorney notices that the interest rate in the financing contingency looks high compared with market rates for a prime loan. The attorney asks her client about the loan that she has sought and learns that the buyer has good credit but that she is making a small down payment and, if she closes on this deal, about 50% of her monthly income will go towards paying the monthly principal and interest on the loan and the estimated monthly real estate taxes and insurance. After reviewing these numbers with her attorney and learning that this is a very imprudent deal, the buyer and the attorney decide that the attorney should disapprove the contract.*

Although, in the past, it was not customary for an attorney representing a buyer to provide the buyer with extensive advice on the financial terms of the loan that she planned to enter into, today, this should no longer be the case and disapproval (or requiring changes) based on the loan described in the contract being overpriced or unaffordable should not be deemed to be in bad faith. Due to the increased complexity and myriad of choices among loan products<sup>150</sup> and the prevalence of predatory lending,<sup>151</sup> it is sometimes imperative and almost always highly advisable that an attorney explain to the home buyer the basic terms of the loan she has entered into,<sup>152</sup> and to provide advice to the client on whether the loan sought is one the client can afford to pay<sup>153</sup> and not overpriced in light of the buyer's credit score.<sup>154</sup> Because a well

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150. See Debra Poggrund Stark, *Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER J. 129, 131-34 (2005) (describing the evolution of the mortgage industry in the latter half of the 20th century in the United States., the development of predatory lending, and the difficulties with trying to prevent it).

151. *Id.*

152. For example, a buyer may be told that the interest rate is at 6% and the monthly payments are \$1,500 per month, but the loan might be one where it starts off as interest only and at a fixed rate and then three years later converts to interest and principal and at a floating rate. This could lead to the buyer later not being able to make payments on the loan.

153. See *id.* at 138-39 (suggesting that counselors, working together with the borrower, review the borrower's financial situation and income to debt ratio under the proposed loan, and "advise the borrower that he is in grave danger of defaulting on the loan if the monthly payments on this and any other mortgages on his home (plus taxes, insurance, and any condominium assessments, if applicable) are greater than 50% of the borrower's monthly gross income," that a conservative debt service ratio is 25%, and that anything over that amount is imprudent).

154. See *id.* at 137 (suggesting how a mortgage counselor could easily and cheaply determine online the borrower's credit score and the borrower's market APR figure in light of this score).

The counselor can then compare what the lender is offering with the

trained and competent attorney should, in today's real estate finance market, provide advice on these issues,<sup>155</sup> the attorney should also be able to disapprove a contract when the buyer must enter into an unaffordable loan to close the deal. As for an overpriced loan, if the contract states that the buyer must accept a loan that the attorney determines is overpriced, rather than disapprove the contract, the attorney could instead require revisions of the loan terms specified in the contract to reflect a properly priced loan in terms of interest rate and points.

However, if the attorney approval clause is worded narrowly, such as limiting the review to the terms of the contract (excluding the purchase price) and requiring the attorney to make changes to the terms rather than simply disapprove, then it would be beyond the scope of the attorney review clause to disapprove the contract because the deal would cause the buyer to enter into an imprudent or unaffordable loan. If the attorney approval clause allows disapproval (as opposed to requiring proposed changes) based on the terms of the contract, one could argue that the term of the contract that is being disapproved is the financing term (i.e. it states a loan amount that the buyer cannot prudently afford to pay each month), and disapproval would therefore be in good faith and within the mandate of the attorney approval clause. Even though the loan amount is based in large part on the purchase price (which some attorney approval clauses expressly state cannot be renegotiated), it is also based upon the buyer's anticipated equity in the purchase and so, this should not be construed as a means to revise the purchase price.

*e. The attorney approval clause states that the attorney has five days to approve or disapprove the contract, excluding disapproving based on any "business" terms of the contract (including without limitation, the price and dates in the contract). The seller's attorney wishes to disapprove the contract because the financing contingency in the contract is too long (90 days) causing the seller to hold the property off the market for too long in case the condition is not satisfied. The seller's attorney decides to disapprove based upon the narrow wording of the attorney approval clause.*

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market APR figure . . . The mortgage counselor should be knowledgeable of the typical closing cost items and what the customary charges are for these items. The counselor can then let the borrower know if the good faith estimate reflects market or above market figures.

*Id.*

155. Prior to the advent of the widespread development of predatory lending beginning in the 1990's, it was not typical for an attorney to review in detail the economics of a home buyer's mortgage loan. Today, however, an attorney should at the very least address with her client this topic generally (especially if a non-sophisticated client) and ask the client if the client would like advice on the loan terms.

Once again, the analysis of the validity of this disapproval is based upon satisfaction of two criteria: good faith and compliance with the wording (and therefore the scope) of the attorney approval clause at issue. As for good faith, a potential problem exists here. Mitigating against a finding of bad faith is the fact that the disapproval is not based on a desire to get out of the deal for matters unrelated to what an attorney would normally counsel (such as the occurrence of a subsequent better offer). However, the attorney's real reason for disapproval in this scenario is a matter specifically excluded from consideration under the express language of the attorney approval clause. Yet, if the attorney approval clause were worded differently, the attorney would be able to disapprove in good faith if the other party would not agree to modify the contract to contain a shorter, more customary, period. Disapproving based on the wording of the attorney approval clause is not a disapproval based on a business point and so, it is arguably proper under the terms of the clause itself.

But where does one draw the line? For example, what if the attorney felt that the broker pressured the buyer to enter into a deal where the purchase price was way too low and disapproved based on the wording of the approval clause in the contract that excluded purchase price from the terms the attorney can review? One way to address this scenario is to allow attorney disapproval of the wording of the attorney approval clause when the wording is different from what is customary, because this would hinder an attorney from representing their client in a competent fashion, or would permit an attorney to go beyond what a competent attorney would normally be doing when reviewing the contract.

#### IV. RECOMMENDATIONS TO THE COURTS AND TO REAL ESTATE PROFESSIONALS

##### A. *Recommendations to the Courts on the Proper Interpretation of Attorney Approval Clauses*

In light of the prior analysis of case law and summary of the steps taken by a properly trained attorney competently representing a home buyer or home seller, the author offers five recommendations to courts interpreting an attorney approval clause in the context of a residential real estate deal. Also, due to the division of opinions within the Illinois courts, this issue is ripe for review by the Illinois Supreme Court and it is hoped that the Illinois Supreme Court will create a better judicial "North Star" for attorneys to follow based upon the recommendations in this article.

First, when the attorney approval clause is contained in the purchase and sale contract that both parties have signed, the court should correctly interpret the clause as creating a conditional

contract (hence, requiring “good faith” in its exercise) rather than as a conditional acceptance (a characterization that produces the undesirable effect that “good faith” is not required in the exercise of the clause, since no contract has been created in the first place). This interpretation will not only prevent many bad faith terminations of the purchase and sale contract on an incorrect technicality, it will also remove the straight-jacket in which attorneys currently operate when, normally, they would desire to propose certain changes to a contract without potentially killing a deal. If the law becomes clear that these clauses create conditional contracts, then a mere suggestion for a change before the attorney approval period is over will not allow the other party to claim that this is a counteroffer and that there is no binding deal due to the suggested change.

Second, the court should require that if an attorney elects to disapprove the contract, the attorney must specify the reasons for the disapproval at the time of the disapproval (when a contract is silent on this point) to discourage attempted bad faith terminations under the attorney approval clause. The test for good faith would be based upon whether the attorney had in fact reviewed the contract and the deal with the client in the manner that a competent, well trained attorney would, and whether the reason for the disapproval is based upon this review (which would then be a good faith termination) as opposed to a disapproval based on a collateral matter not within that review, or based upon a direction from the client independent of that review (which would then constitute a bad faith termination). It is recommended that the party who exercises the disapproval right bear the burden of proving good faith if the issue is litigated,<sup>156</sup> but it would not be

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156. *Supra* note 46, discusses the issue of whether a party's attorney disapproved the contract in good faith and whether the non-disapproving party can force that attorney to disclose confidential information to support (or reveal lack of) good faith, are closely intertwined. Further, the reported decisions from Illinois and elsewhere have not discussed the issue of who should bear the burden of proving that the contract disapproval pursuant to an attorney approval clause was made in good faith. Other areas of law have adopted, statutorily or through common law, various standards regarding which party should bear the burden of proving good faith in contract disputes. There is a line of cases which have held that the party seeking to recover under the theory of breach of the implied covenant of good faith has the burden of proving that the other party had acted in bad faith. *See, e.g., Zenith*, 141 F.3d at 308 (holding that a party may be liable for breach of the implied covenant of good faith even though all the terms of the written agreement may have been fulfilled, and that the party seeking to recover under this theory has the burden of proving that the party accused of bad faith has actually denied the benefit of the bargain originally intended by the parties). *See also St. Louis Smelting & Refining Co. v. Nix*, 224 P. 982, 984 (Okla. 1924) (stating that where the buyer sought to rescind a contract of sale of certain mining leases because the titles thereto were disapproved by his attorney, the seller

desirable to apply a reasonableness test to the attorney disapproval, as some attorneys are better trained than others and may raise points that a typical attorney may not have considered. Another reason against adopting a reasonableness test is the different levels of risk that each client can tolerate, where some clients will accept risk that others would not in light of the potential problem raised by the attorney.

To illustrate this point, assume that the home the buyer wants to purchase encroaches onto a neighbor's property. The contract may call for the buyer to accept title subject to this risk so long as the risk is insured over by a title company. Some purchasers, after being counseled by their attorney on the ramifications of this situation, would decide to go ahead on this basis, but others might in good faith decide not to. If a "reasonableness" standard is employed, a party who in good faith does not want to take on certain risks might be forced to do so. This is inconsistent with the reason for the attorney approval clause, namely, to put the parties in the position they would have been in if a competent, well-trained attorney had been representing them at the time the contract was formed.

Third, if the reason specified for the disapproval is one that could have been addressed through a modification of the contract, and the non-disapproving party proposes such rider to the contract in response to the disapproving party's disapproval, then the disapproving attorney should change her disapproval into an approval based upon this change to the contract. That is, unless the disapproving attorney can show that the revision would not adequately address the reason for the disapproval. The test for whether the change adequately addresses the client's concerns, needs, or goals would be based on good faith rather than reasonableness because different clients have different risk tolerance levels or value certain attributes of the property they are purchasing at different levels.

Fourth, when confronted by a situation involving mixed motives (i.e., when the disapproving party is doing so in part for legitimate reasons and in part for reasons that would be considered in bad faith because the reason goes beyond the scope

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who pleaded bad faith upon the part of such buyer and his attorney in disapproving such titles had the burden of establishing such bad faith). However, there are other areas of the law where the burden of proving that a discretionary right was exercised in good faith rests upon the party that claims to have exercised the right in good faith. See *e.g.*, *Ollice v. Alyeska Pipeline Service Co.*, 659 P.2d 1182, 1187 (Alaska, 1983) (discussing how in action for wrongful interference with employment contract in which third party conceded that it instructed employer to fire employee from security guard position on basis that she consumed alcohol on company premises, the third party had burden of proving that it acted in good faith, and that its justification was not mere pretext, shielding improper ulterior motive).

of the wording of the attorney approval clause), the court should apply a “but for” test to determine if the exercise is valid. Under the “but for” test, the court would ask and answer this question: “But for the bad faith reason, would the attorney still have disapproved the contract?”

Finally, the court should analyze the validity of any disapproval, based not only on the wording of the clause, but also on the policy reasons for having the attorney approval clauses. The purpose behind the attorney approval clause is to enable the parties to the contract to be placed in the position that they would have enjoyed had an attorney been providing them with the kind of advice that a competent, well-trained attorney would have provided to her client at the time that the contract to purchase and sell was formed.

*B. Recommendations To Attorneys On How To Both Zealously Represent Their Clients and Exercise The Attorney Approval Right In Good Faith*

This Article also offers some recommendations to practitioners on how to both zealously represent their clients and exercise the attorney approval right in good faith in light of current case law.

First, attorneys should alert their clients that, under current case law, there exists the possibility that if the attorney suggests any changes to the contract, the other party could terminate the contract in bad faith.<sup>157</sup> Consequently, it is important for the attorney and the client to decide up front whether the changes desired are worth potentially terminating the deal.

Second, if the client informs the attorney that she does not want to terminate the deal, but would like to have the benefit of certain changes to the contract, the attorney should consider telephoning the other attorney to see if she desires any changes to the contract and if the other side would be receptive to changing the terms of the contract. It is hoped that such telephone calls will not be considered a counteroffer, but it is still possible that they will be construed as such. When sending any written communication asking for these changes, one could view this as a mere request that does not constitute a counteroffer, but if a court incorrectly construes contract law by applying the mirror image rule to an already signed contract that contained the attorney approval clause, then this language is unlikely to work.

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157. See *supra* Part III.B.1. (discussing how the current state of law in Illinois considers attorney approval clauses as creating conditional acceptances of the contract, and how such incorrect characterization can lead to bad faith terminations of contracts).



Third, if a client directs an attorney to disapprove a contract before the attorney has had a chance to review the contract and counsel the client, the attorney should either cease representing this client, or explain to the client that this is improper and then propose and follow a proper course of action.

Finally, if an attorney believes that a client's real reason for directing the attorney to disapprove after consultation with the attorney is improper, the attorney should cease representing the client or explain that this action is impermissible and propose and follow a proper course of action. Although current case law does not require an attorney to specify the reasons for disapproval,<sup>158</sup> when the issue of good faith has been litigated, the disapproving attorneys have been deposed and forced to testify at trial as to the real motivations for the disapproval.<sup>159</sup> If the client's motives are based partially on legitimate matters (based upon the advice that the attorney gave to the client in light of the attorney's review of the contract and the deal) and partially on illegitimate matters (such as receipt of a better deal during the attorney approval period when the attorney approval clause prohibits disapproval based on purchase price), the attorney should apply the "but for" test outlined above in Part IV.A. to determine if disapproval would be in good faith (i.e., would the client have directed the attorney to disapprove the contract but for the impermissible reason).

### *C. Recommendations To Brokerage Associations And Bar Associations On The Wording Of The Attorney Approval Clause*

Part III of this Article already contains a detailed evaluation of the effectiveness of the wording of the attorney approval clauses in several reported decisions in Illinois. Each attorney approval clause was found to be lacking to varying degrees in terms of the goal of enabling an attorney to perform the type of review of the contract and the deal that a competent, well-trained attorney would perform, while at the same time preventing bad faith terminations.

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158. *McKenna*, 704 N.E. 2d at 829, (citing *Olympic Restaurants*, 622 N.E. 2d at 909 (stating that "[w]hile the review clause must be invoked in good faith, it is not necessary for a party to state a reason when rejecting a contract pursuant to a review clause because the attorney's right to disapprove is a proper exercise of his or her judgment")).

159. See e.g., *McKenna*, 704 N.E. 2d at 829 (providing parts of the deposition and testimony of the buyer's attorney regarding the transaction at issue); *Whitlock*, 1974 Ohio App. LEXIS at \*6 (holding that the seller had waived the attorney-client privilege when the seller called the counsel that disapproved the contract pursuant to the attorney approval clause to the stand, and posed questions concerning the exercise of good faith in the giving of advice to the seller, and that the buyer had the right to cross-examine the seller's counsel concerning the exercise of good faith).

The attorney approval clause that best serves this dual goal and is most frequently utilized by parties is the attorney review clause contained in the Multi-Board Residential Real Estate Contract 3.0 (the "Multi-Board Clause").<sup>160</sup> As previously noted, the Multi-Board Clause clearly allows an attorney to make modifications to the contract, rather than only allowing approval or disapproval of the contract in its entirety. It also provides for an additional five business days after a modification is proposed for the parties to try to reach agreement on the proposed modification(s). The Multi-Board Clause also clarifies that the modification<sup>161</sup> cannot be based solely upon the stated purchase price, a limitation that is probably consistent with what most buyers and sellers would expect, and does not contain any other limitation on the attorney's scope of review of the contract.

The Multi-Board Clause, however, should be revised to require that the attorney specify the reason for the disapproval at the time she gives notice of the disapproval to prevent bad faith terminations. It should also be revised to permit the other attorney to propose modifications to the contract that would address the disapproving party's attorney's reason(s) for the disapproval, requiring the disapproving party and her attorney to consider in good faith the proposed modification(s) as an alternative to disapproval. The clause should provide for an additional five-business-day period for the disapproving attorney to reconsider, and a requirement to notify the other party of whether they still disapprove or accept the proposed modification. Although adding to the time period and required notices for the attorney review condition increases the complexity of its exercise, this added complexity could help to prevent a bad faith termination of a contract and could lead to a signed contract being carried out rather than terminated or ending up in litigation.

#### CONCLUSION

Adding an attorney approval clause to a residential real estate contract is designed to achieve the twin goals of being able to quickly sign up an interested buyer and seller to a deal that the broker has helped the parties to reach, and being able to have an attorney review the contract that the parties signed to make sure that the client's objectives and needs are in fact being met through the contract she entered into.<sup>162</sup> Unfortunately, the wording of

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160. See *supra* note 45 (providing the full text of the attorney review clause found in the Multi-Board Residential Real Estate Contract 3.0).

161. The clause should probably clarify that not only the modification, but the disapproval cannot be based upon the purchase price.

162. See *supra* note 3 and accompanying text (discussing how the primary purpose of attorney approval clauses is to provide the public with the opportunity to have an attorney review the contract so as to protect the client's

some attorney approval clauses has impeded the latter goal by providing an inadequate time period for the attorney to do the review and by limiting the attorney to either approving or disapproving the contract (i.e. limiting attorneys to being merely problem spotters), rather than proposing modifications to the contract (i.e. allowing attorneys to be problem solvers).<sup>163</sup>

Even more troubling, some court interpretations of attorney approval clauses have also impeded the goal of competent attorney representation of buyers and sellers by incorrectly interpreting attorney approval clauses contained in a signed purchase and sale agreement as “conditional acceptances” rather than as “conditional contracts,” and by characterizing any suggested changes to the contracts as “counteroffers.”<sup>164</sup> This misinterpretation of contract principles creates an incentive for bad faith terminations of contracts<sup>165</sup> and imposes a straight jacket on attorneys who would like to be able to negotiate changes to a contract to resolve problems that the contract poses for her client without terminating the contract.<sup>166</sup> As previously discussed, if a court construes the presence of an attorney approval clause to create a conditional acceptance (as opposed to a conditional contract), then, if an attorney proposes any changes to the contract under the clause, this will be construed as a counter offer, even when the proposal is clarified as mere suggestion. The other party can then claim that there is no binding contract and no obligation to approve or disapprove the contract in good faith.<sup>167</sup>

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objectives and needs).

163. In addition, some attorney approval clauses only allow an attorney to modify the terms of the contract rather than disapprove the contract, which is also too narrow a right in light of the purposes of the clause. *See supra* Part III.A. (discussing how many typical attorney approval clauses contain problematic wording that defeats the purpose for which those clauses were inserted in the contract in the first place).

164. *See supra* Part III.B.1. (discussing the negative consequences of mischaracterizing attorney approval clauses as conditional acceptances rather than conditional contracts).

165. *See supra* Part III.B.1.b. (discussing the negative consequences of concluding that the attorney review clause creates a conditional acceptance or calling the communications made pursuant to the clause as a counteroffer since the *Olympic Restaurant* decision).

166. *See supra* Part III.B.1.e. (arguing that the case law in Illinois on the nature of attorney approval clauses is clearly divided and attorneys lack the predictability they need in order to work with these clauses). Most troubling, the majority of the reported decisions contain dicta that do not accurately reflect the law, that create incentives for bad faith disapprovals, and that prevent attorneys from competently and ethically doing their job. *Id.*

167. *See supra* Part III.B.1.c. (arguing that after *Groshek*, the mischaracterization of *suggested* changes in the context of an attorney approval clause as a counteroffer also encourages parties to use the counteroffer dicta to terminate the contracts in bad faith).

Court interpretations of attorney approvals have also fallen short in terms of the handling of the “good faith” requirement. By failing to require attorneys to specify a reason for the disapproval at the time of its making, courts have facilitated bad faith terminations.<sup>168</sup> This Article proposes that in defining good faith exercise of the attorney approval, courts should require attorneys to specify the reasons for a disapproval of the contract at the time the disapproval is made.<sup>169</sup> In addition, in order to meet the requirement of good faith, courts should require attorneys to propose a modification to the contract rather than disapprove the contract if a modification to the contract could address the problems that the attorney detected with the contract or the deal.<sup>170</sup> The test for whether the modification would adequately address the problem should be based on whether the attorney and her client in good faith believed that a modification to the contract would not solve the problem identified by the attorney, rather than requiring the attorney to satisfy a “reasonableness” test on this issue.<sup>171</sup>

Courts are correct in not requiring attorneys to show that their disapproval was “reasonable” because some attorneys are better able to spot legitimate problems than others and because clients have different levels of tolerance to risk and assign different values to various contractual terms, making it counter-productive to apply an objective test to the disapproval.<sup>172</sup> Rather than apply an objective test to combat bad faith terminations, this Article proposes the requirement of specifying a reason for the disapproval and the requirement to propose modifications when feasible (again subject to a good faith test to determine if a modification would address the client’s concerns) as the better way to prevent bad faith terminations. Requiring good faith should not compromise an attorney’s ability to competently and zealously represent her client’s legitimate interests.<sup>173</sup> In determining what types of reasons for disapproval would be considered in good faith and appropriate, courts should look to the framework that a competent, well trained attorney would follow when representing a buyer or seller of residential real estate as detailed in this

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168. See *supra* Part III.B.2. (discussing how the courts’ failure to adequately define “good faith” and require an attorney to specify the reasons for disapproval also encourage bad faith disapprovals).

169. See *supra* Part IV.A. (recommending to the courts how to properly interpret attorney approval clauses).

170. *Id.*

171. *Id.* The reason for requiring only a good faith showing that the modification would not adequately address the client’s concerns is the same for why a court should not require a showing of “reasonableness” for disapproval.

172. *Id.*

173. *Id.*

article.<sup>174</sup> When interpreting attorney approvals and the good faith requirement, courts should keep the purpose of these clauses in mind, as well as the transactional skills framework that attorneys should be engaging in when operating under an attorney approval clause.<sup>175</sup>

Currently, attorneys are in a near impossible situation when trying to correctly navigate through an attorney approval clause. It is hoped that bar associations and brokerage associations will revise the attorney approval clauses that they have prepared in their standard form purchase and sale contracts in light of the recommendations raised in this article. It is also hoped that courts will adopt the recommendations raised in this article in their future decisions, thereby creating a better judicial “North Star” for attorneys to follow.

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174. *See supra* Part II. (explaining what a competent and well trained lawyer would do if representing a home buyer or home seller).

175. *Id.*