2016 IL App (2d) 150571-U
No. 2-15-0571
Order filed April 21, 2016
Modified upon denial of rehearing June 9, 2016

IN THE

APPELLATE COURT OF ILLINOIS

SECOND DISTRICT

VILLAGE OF MONTGOMERY, Plaintiff, v. FIDELITY AND DEPOSIT COMPANY OF MARYLAND, Defendant and Third-Party Plaintiff-Appellant, (TRG Venture Two, LLC, Defendant and Third-Party Defendant-Appellee).	)	Appeal from the Circuit Court of Kane County. No. 10-MR-598 Honorable Thomas E. Mueller and David R. Akemann, Judges, Presiding.

JUSTICE JORGENSEN delivered the judgment of the court.
Justices Burke and Birkett concurred in the judgment.

ORDER

¶ 1 *Held*: The trial court erred in dismissing, for failure to state a claim, surety's complaint seeking, among other relief, indemnity/reimbursement from successor owner of subdivision for payments for public improvements that surety had secured with bond it issued to initial developer, who had defaulted. Annexation agreement between municipality and initial developer, which is binding on successor owners, provided that initial developer would not be released of its obligations until property was conveyed and substitute bond was posted, the latter of which never occurred. Although the initial developer was never released, agreement's substitute-bond provision did not apply to successor owner, who, upon acquisition

> of property, became primarily liable for payment for the improvements and surety remained secondarily liable. Further, surety stated a claim for indemnity/reimbursement. Reversed and remanded.

¶ 2 After a subdivision developer, Kimball Hill, Inc. (KHI), went bankrupt, plaintiff, the Village of Montgomery (Village), demanded that defendant and third-party plaintiff, Fidelity and Deposit Company of Maryland (Fidelity), complete certain public improvements secured by a subdivision bond Fidelity had issued to KHI. After Fidelity refused, the Village sued Fidelity, alleging breach of the subdivision bond. Defendant and third-party defendant, TRG Venture Two, LLC (TRG), had purchased all of KHI's remaining property in the subdivision from KHI's bankruptcy estate. Fidelity filed an amended third-party complaint against TRG, alleging that TRG, as successor owner, was primarily liable to the Village for the installation of certain public improvements in the subdivision covered by Fidelity's subdivision bond and that Fidelity, as surety, was only secondarily liable. Fidelity brought claims for indemnity/reimbursement, exoneration, and *quia timet*/collateralization, all of which were premised on its argument that it adequately pleaded a surety relationship between it and TRG. TRG moved to dismiss Fidelity's third-party complaint (735 ILCS 5/2-615 (West 2014)), and the trial court granted TRG's motion and dismissed Fidelity's complaint with prejudice. (Subsequently, the Village and Fidelity settled their dispute.) Fidelity appeals the dismissal of its third-party complaint against TRG, alleging primarily that the Illinois Municipal Code (65 ILCS 5/1-1-1 *et seq.* (West 2014)) and/or an annexation agreement between the Village and KHI reflect that TRG, as successor in title to KHI's holdings, assumed KHI's obligations to install public improvements in the subdivision and that TRG's obligations are primary and Fidelity's obligations are only secondary. For the following reasons, we reverse and remand.

¶ 3 I. BACKGROUND

¶ 4 A. Annexation Agreement

¶ 5 On September 22, 2003,[1] the Village, a non-home-rule municipality in Kane and Kendall Counties, and KHI[2] entered into an annexation agreement, subsequently recorded, whereby the Village annexed certain property consisting of about 108 acres in Kendall County to be subdivided and developed by KHI. The subdivision would be commonly known as the Huntington Chase residential subdivision.

¶ 6 The annexation agreement required KHI to post, prior to construction and pursuant to the Village's subdivision control ordinance, appropriate letters of credit or bonds for the public improvements in each unit of the property. Section 12.D. of the agreement addresses KHI's release of its obligation to make the public improvements. It provides:

> "Upon the sale or transfer of any portion of the Property, [KHI] herein shall be released from the obligations secured by its Letter of Credit for public improvements upon the submittal and acceptance by the [Village] of a substitute letter of credit or other surety approved by the [Village], securing the costs of the improvements set forth therein by the proposed DEVELOPER [*sic*]."

¶ 7 Similarly, paragraph 17 of the agreement provides:

> "This Agreement shall be binding upon and insure to the benefit of the Parties hereto, *their successors and assigns including*, but not limited to, successor owner[s] of record, successor developers, lessees and successor lessees, and upon any successor municipal authority of the [Village] and successor municipalities for a period of twenty

[1] The parties executed an amendment on May 22, 2006, which is not at issue here.

[2] The agreement lists Huntington Chase Limited Partnership as the owner and, KHI, an affiliated entity, as the developer. We collectively refer to them as KHI.

> (20) years from the later of the date of execution hereof and the date of adoption of the ordinances pursuant hereto. Upon the conveyance of all or a portion of the Property, [Huntington Chase Limited Partnership], or [KHI] as the case may be, *shall be released* of any and all obligation or liability under this Agreement for that portion of the Property conveyed (if the entire Property is not so conveyed), *immediately upon conveyance and the substitution of any performance bond or letter of credit* (provided such performance bond or letter of credit is so required under this Agreement at the time of conveyance)." (Emphases added.)

¶ 8 The annexation agreement also states that it was made in accordance with the portions of the Illinois Municipal Code that address annexation agreements. 65 ILCS 5/11-15.1-1 through 11-15.1-5 (West 2014).

¶ 9 B. Subdivision Bond

¶ 10 On September 15, 2004, Fidelity, as surety, issued a subdivision performance bond (no. 8778054) in the penal sum of about $6.4 million to KHI, as principal, for the subdivision project. It listed the Village as obligee. A July 26, 2007, rider to the bond reduced the penal sum to $998,040.05.

¶ 11 C. Sale of KHI's Remaining Property

¶ 12 In 2008, KHI petitioned for Chapter 11 bankruptcy. A liquidation plan was approved and became effective in 2009. In April 2010, the Village, by resolution, found that KHI was in default and it authorized the making of a demand, including against the issuer (*i.e.*, Fidelity), on the subdivision bond. On May 4, 2010, the Village demanded that Fidelity fulfill its obligations under the bond.

¶ 13 On April 30, 2010, KHI's remaining property in the subdivision (apparently consisting of 47 unimproved lots) was conveyed to TRG through a special warranty deed that was subsequently recorded. On May 24, 2010, the KHI bankruptcy trust assigned its interest in the property to TRG.[3]

¶ 14 D. Trial Court Proceedings

¶ 15 On December 27, 2010, the Village sued Fidelity, seeking a determination of Fidelity's obligations under the bond. On February 21, 2012, Fidelity filed an amended third-party complaint against TRG, raising claims seeking indemnification/reimbursement, exoneration, and *quia timet*/collateralization. Its claims were premised on the theory that the Illinois Municipal Code and, separately, the annexation agreement rendered TRG a successor owner of the subject property with primary responsibility (with Fidelity's, its surety's, liability being secondary to that of TRG) to complete the public improvements in the subdivision and furnish security to the Village. On April 26, 2012, TRG moved to dismiss Fidelity's third-party complaint, and, on June 12, 2012, the trial court granted the motion and dismissed the complaint with prejudice, finding that a substitute performance bond required by the annexation agreement was never posted to act to release Fidelity from its obligation and that the annexation agreement bound Fidelity. On May 4, 2015, pursuant to a settlement agreement between the Village and Fidelity (wherein Fidelity paid the Village $750,000), the trial court dismissed the case with prejudice. Fidelity appeals the June 12, 2012, section 2-615 dismissal of its third-party complaint.

¶ 16 II. ANALYSIS

[3] The documents relating to the conveyance are not contained in the record on appeal. Thus, we must assume that they support and are consistent with the trial court's findings.

¶ 17 Fidelity argues that it sufficiently alleged its legal and equitable claims. Specifically, it asserts that it adequately pleaded the premise upon which its claims rely: a surety relationship between itself, TRG, and the Village. It contends that, pursuant to either the Illinois Municipal Code and/or as covenants running with the land, the annexation agreement bound TRG, as successor owner to KHI, and, therefore, made TRG (with whom Fidelity now had a surety relationship) primarily liable to the Village. Fidelity, as surety now to TRG, is only, it asserts, secondarily liable. Further, Fidelity notes that it discharged its obligations under the bond to the Village when it settled the Village's bond claim. Accordingly, its amended third-party complaint seeks to recover its settlement payment from TRG, the primary obligor. For the following reasons, we agree that Fidelity stated a claim for a surety relationship.

¶ 18 A motion to dismiss pursuant to section 2-615(a) of the Code of Civil Procedure (735 ILCS 5/2-615(a) (West 2014)) tests the legal sufficiency of the complaint based on defects apparent on its face. *Doe-3 v. McLean County Unit District No. 5 Board of Directors*, 2012 IL 112479, ¶ 15. A section 2-615(a) motion presents the question of whether the facts alleged in the complaint, viewed in the light most favorable to the plaintiff and taking all well-pleaded facts and all reasonable inferences that may be drawn from those facts as true, are sufficient to state a cause of action upon which relief may be granted. *Id.* ¶ 16. "[A] cause of action should not be dismissed pursuant to section 2-615 unless it is clearly apparent that *no set of facts* can be proved that would entitle the plaintiff to recovery." (Emphasis added.) *Marshall v. Burger King Corp.*, 222 Ill. 2d 422, 429 (2006). We review *de novo* a dismissal under section 2-615(a). *Doe-3*, 2012 IL 112479, ¶ 15.

¶ 19 This case involves a surety relationship. In *City of Elgin v. Arch Insurance Co.*, this court recently explained:

"A surety relationship arises when one agrees to assume liability for the payment of another's debt or the performance of another's obligations under a contract. See Black's Law Dictionary 1456 (7th ed. 1999); Restatement (Third) of Suretyship and Guaranty (hereinafter, Restatement) § 1 (1996); see also *Mercantile Holdings, Inc. v. Keeshin*, 187 Ill. App. 3d 1088, 1094 (1989) (surety relationship may arise by operation of law). A surety is a secondary obligor whose liability is collateral to that of the principal obligor. *Chandler v. Maxwell Manor Nursing Home, Inc.*, 281 Ill. App. 3d 309, 323 (1996) ('The surety's obligation, wherein he agrees to be answerable for the debt or obligation of another, is not an original and direct obligation for the performance of his own act, but rather is an accessorial obligation to the obligation contracted by the principal.'). 'As a general rule, the liability of a surety is measured by the liability of its principal.' *Village of Rosemont v. Lentin Lumber Co.*, 144 Ill. App. 3d 651, 668 (1986). Because the surety is bound to perform if the principal obligor does not, the surety has the right to compel the principal obligor to either perform its obligation or pay the costs that accrue to the surety because of the principal obligor's nonperformance. *Estate of Ramsay v. Whitbeck*, 183 Ill. 550, 567 (1900) ('When a surety signs a bond the law raises an implied promise by the principal to reimburse the surety for any loss which he may sustain ***.'); Restatement § 21. Thus, although both the surety and the principal obligor may be liable to the 'obligee' (the party to whom the principal obligor owes the obligation to perform), 'as between the principal obligor and the secondary obligor, it is the principal obligor who ought to perform the underlying obligation or bear the cost of performance.' Restatement § 1(1)(c)." *City of Elgin*, 2015 IL App (2d) 150013, ¶ 19.

¶ 20 Here, the initial principal obligor was KHI. KHI entered into the annexation agreement with the Village, under which the Village would annex certain property and KHI would subdivide and develop the property, including, as relevant here, construct certain public improvements. The annexation agreement also required that KHI post a bond guaranteeing its performance thereunder. Accordingly, KHI entered into a bond contract with Fidelity, under which KHI was the principal obligor, Fidelity was the surety or secondary obligor, and the Village was the obligee. Under the bond contract, Fidelity would be liable to the Village only if KHI failed to perform. The bond contract stated that it would be binding on the parties' successors.

¶ 21 After selling some homes, KHI filed for bankruptcy. It had not completely fulfilled its obligations to construct the public improvements under the annexation agreement. TRG subsequently acquired from the bankruptcy estate all of the remaining lots in the subdivision by special warranty deed that was subsequently recorded. In announcing its decision that Fidelity is primarily liable, the trial court noted that the annexation agreement released KHI only: (1) upon conveyance of all or a portion of its property; and (2) the substitution of a performance bond. It found that, because no such substitute bond was ever posted here, Fidelity could not be only secondarily liable for the public improvements. We disagree.

¶ 22 Section 11-15.1-1 of the Illinois Municipal Code provides that municipalities may enter into annexation agreements with landowners in unincorporated territories and that such agreements are binding for periods not exceeding 20 years. 65 ILCS 5/11-15.1-1 (West 2014); *Village of Orland Park v. First Federal Savings & Loan Ass'n of Chicago*, 135 Ill. App. 3d 520, 525 (1985) (section authorizes preannexation agreements). Section 11-15.1-4 of the Illinois Municipal Code, upon which Fidelity relies, provides:

> "Any annexation agreement executed pursuant to this Division 15.1, or in conformity with Section 11-15.1-5 hereof, *shall be binding upon the successor owners of record of the land which is the subject of the agreement* and upon successor municipal authorities of the municipality and successor municipalities. Any party to such agreement may by civil action, mandamus, injunction or other proceeding, enforce and compel performance of the agreement.
>
> A lawsuit to enforce and compel performance of the agreement must be filed within the effective term of the agreement or within 5 years from the date the cause of action accrued, whichever time is later." (Emphasis added.) 65 ILCS 5/11-15.1-4 (West 2014).

See also *Meeghan v. Village of Tinley Park*, 52 Ill. 2d 354, 359 (1972) (party to annexation agreement, including successor owners, were empowered to enforce or compel performance of annexation agreement within statutory period); *Village of Orland Park*, 135 Ill. App. 3d at 526-27 (section makes preannexation agreements binding on successor owners of land, including purchasers at a foreclosure sale and sheriff's deed; reversing section 2-615 dismissal; "[c]onsiderations of responsibility to construct or pay for public improvements *** cannot pivot upon how a party succeeds to ownership since the public and private benefits and burdens affect both the community and the subject property regardless of how that succession took place"); *Union National Bank v. Village of Glenwood*, 38 Ill. App. 3d 469, 472 (1976) (holding summarily that, pursuant to section 11-15.1-4, a party to an annexation agreement, or its successor, is bound by agreement's terms).

¶ 23 In *City of Elgin*, a recent case decided by this court that involved a similar fact pattern and many of the same parties, the issue of TRG's liability for public improvements, unlike here,

was accepted for purposes of the analysis. *City of Elgin*, 2015 IL App (2d) 150013, ¶ 21 (preliminarily noting that: the Illinois Municipal Code provides that annexation agreements are binding on successors; the annexation agreement in that case stated that it was binding on successors and that its provision obligating TRG to complete the public improvements constituted a covenant running with the land that bound TRG; and "TRG's successor liability would appear to be a matter of public record and statutory law, which is incorporated into every contract *unless the contract [(e.g., annexation agreement)] provides to the contrary*" (emphasis added); but ultimately stating that, "as the issue is not before us, we make no final determination of that liability"). Nevertheless, *City of Elgin* is helpful because it illustrates the concept that a surety relationship can arise by operation of law and a successor owner may be primarily bound by obligations in an annexation agreement. In that case, this court held that the facts that the surety (also Fidelity in that case) was not a party to the annexation agreement and that TRG (a successor owner in that case) did not execute the bonds at issue, did not defeat the claims that Fidelity had asserted in its counterclaim, including indemnity/reimbursement. *City of Elgin*, 2015 IL App (2d) 150013, ¶ 24. First, this court concluded that, because TRG assumed KHI's (also the initial owner in that case) obligations under the annexation agreement (again, a point we assumed without deciding) "and those obligations were the basis for the surety bonds, a suretyship arose as a matter of law, and TRG owes Fidelity a common-law duty to perform its obligations and to hold Fidelity harmless for its failure to do so." *Id.* ¶¶ 22, 27. Second, we explained that, even though the bond agreements did not specifically mention the subject annexation agreement, there was "no doubt" that the obligations that the bonds secured "arose out of" the annexation agreement, where the agreement expressly contemplated that bonds would be obtained at a later date to secure KHI's obligations. *Id.* ¶ 24. Also, this court stated, the

bonds conferred a direct benefit to the municipality and the party bound to perform under the agreement, which was initially KHI and was "now, TRG." *Id.* Accordingly, this court determined that the fact that Fidelity was not a party to the annexation agreement "and that TRG did not execute the bonds d[id] no[t] defeat the causes of action in Fidelity's counterclaim." *Id.* ¶ 24. (Further, this court held that the trial court erred in dismissing, for failure to state a claim, Fidelity's counterclaim for indemnity/reimbursement. *Id.* ¶ 27.)

¶ 24 Here, the annexation agreement between the Village and KHI states in one of its recitals that it was made "in accordance with the powers granted to the [Village] by the provisions of" the Illinois Municipal Code that address annexation agreements. Further, paragraph 17 of the agreement provides:

> "This Agreement shall be binding upon and insure to the benefit of the Parties hereto, *their successors and assigns including*, but not limited to, successor owner[s] of record, successor developers, lessees and successor lessees, and upon any successor municipal authority of the [Village] and successor municipalities for a period of twenty (20) years from the later of the date of execution hereof and the date of adoption of the ordinances pursuant hereto. Upon the conveyance of all or a portion of the Property, [Huntington Chase Limited Partnership], or [KHI] as the case may be, *shall be released* of any and all obligation or liability under this Agreement for that portion of the Property conveyed (if the entire Property is not so conveyed), *immediately upon conveyance and the substitution of any performance bond or letter of credit* (provided such performance bond or letter of credit is so required under this Agreement at the time of conveyance)." (Emphases added.)

Thus, the annexation agreement contemplates the Illinois Municipal Code and, pursuant to the statute and the case law cited above, is generally enforceable against successor owners.

¶ 25 However, the annexation agreement here is critically different from the one in *City of Elgin*. Paragraph 17, as the trial court found, expressly releases KHI only upon: (1) conveyance of all or a portion of the property, which occurred here; and (2) substitution of any performance bond or letter of credit, which did *not* occur in this case. Similarly, section 12.D states that, upon the sale or transfer of any portion of the property, KHI "shall be released from the obligations secured by its Letter of Credit for public improvements *upon the submittal and acceptance by the [Village] of a substitute letter of credit or other surety approved by the [Village], securing the costs of the improvements set forth herein[.]*" (Emphasis added.) The question here is whether this provision warrants a deviation from the general rule. We conclude that it does not because, *by its terms*, the annexation agreement is binding on successor owners. We hold that, when it acquired the remaining lots in the subdivision, TRG assumed the obligations for the public improvements that are set forth in the annexation agreement. We also note that the successor-owner provision in the annexation agreement constitutes a covenant running with the land. To determine whether a covenant runs with the land, a court looks to whether: (1) the grantee and the grantor intended the covenant to run with the land; (2) the covenant touches and concerns the land; and (3) there is privity of estate between the party claiming the benefit and the party resting under the burden of the covenant. *Streams Sports Club, Ltd. v. Richmond*, 99 Ill. 2d 182, 188 (1983). A covenant does not run with the land, where it is collateral and personal and not immediately concerning the thing granted. *C-B Realty & Trading Corp. v. Chicago & Northwestern Ry. Co.*, 198 Ill. App. 3d 926, 930 (1990). Each successive assignee of the land is entitled to enforce the covenant and is entitled to the benefits or obligations passing with the

covenant, "if the act to be done or permitted concerns the land or the estate conveyed." *Id.* at 930-31 (further noting that a promise to pay taxes relates directly to the land itself and runs with the land). Here, the successor-owner provision is a clear statement reflecting the contracting parties' intent that the annexation agreement run with the land.

¶ 26 We agree with Fidelity that the concept of a developer's *release* of liability is distinct and separate from a successor owner's *assumption* of obligations. The first sentence of section 17 of the annexation agreement states that the agreement "shall be binding upon and insure to the benefit of the Parties hereto, their successors and assigns, including *** successor developers." The second sentence of paragraph 17 states that KHI "shall be released of any and all *obligations and liabilities* under this agreement" (emphasis added) upon conveyance of any portion of the property *and* the substitution of a performance bond or letter of credit (which Fidelity has never asserted was posted). We agree that the fact that one of the prerequisites for KHI to be fully released was not met has no effect on the question whether TRG assumed the annexation agreement's obligations when it acquired the remaining lots in the subdivision. Here, TRG assumed those obligations when it became a successor owner. We further hold that both KHI, which has not been completely released of its obligations, and TRG, as successor owner who assumed the annexation agreement's obligations upon acquisition of KHI's remaining property, are now jointly primarily liable to the Village for completion of the public improvements at issue and that Fidelity remains only secondarily liable to both TRG and KHI.

¶ 27 Fidelity's claims are premised on the existence of a surety relationship among itself, TRG, KHI, and the Village, a claim we found above the trial court erred in rejecting. Its remaining argument is that it adequately pleaded the essential elements of claims for indemnity/reimbursement, exoneration, and *quia timet*/collateralization. As Fidelity now

concedes, its claims seeking exoneration (to compel TRG to perform under the annexation agreement, assuming it had obligations thereunder, before Fidelity had to perform) and *quia timet*/collateralization (to compel TRG to deposit with Fidelity collateral sufficient to protect Fidelity's potential liability until that liability is determined) are moot because Fidelity settled the Village's claims against it. *City of Elgin*, 2015 IL App (2d) 150013, ¶ 25. However, as to its indemnity/reimbursement claim, we conclude that it stated such a claim. In *City of Elgin*, this court held that Fidelity stated a claim for implied indemnity/reimbursement. *Id.* ¶ 27. We concluded that, where TRG assumed KHI's obligations under the annexation agreement in that case "and those obligations were the basis for the surety bonds, a suretyship relation arose as a matter of law, and TRG owes Fidelity a common-law duty to perform its obligations and to hold Fidelity harmless from its failure to do so." *Id.* Accordingly, given the identical circumstances here, we follow our precedent and hold that Fidelity stated a claim for indemnity/reimbursement.

¶ 28 Finally, we emphasize that the procedural posture of this case is an appeal from the trial court's granting of a section 2-615 motion to dismiss. The issues before us are whether the allegations in Fidelity's complaint, when construed in the light most favorable to it and taking all well-pleaded facts and all reasonable inferences drawn therefrom as true, were sufficient to state a cause of action upon which relief may be granted. We concluded above that Fidelity adequately pleaded the premise upon which its claims rely: a surety relationship between itself, TRG, and the Village. We also concluded that Fidelity stated a claim for indemnity/reimbursement. Our holdings are merely that Fidelity's complaint allegations are sufficient to survive a 2-615 dismissal. We express no opinion as to whether it will prevail in its causes of action. Furthermore, in light of this case's procedural posture, nothing in this decision

should be construed to obligate any subsequent purchaser, such as the purchaser of a single lot, to assume liability for public improvements on, or related to, property that it does not own.

¶ 29 III. CONCLUSION

¶ 30 For the reasons stated, the judgment of the circuit court of Kane County is reversed and the cause is remanded.

¶ 31 Reversed and remanded.