

ALERTS

Finance, Insolvency & Restructuring Alert - Seventh Circuit Holds That Illinois Mortgages Need Only Substantially Comply With Mortgage Form In Statute

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Recently, the United States Court of Appeals for the Seventh Circuit held that Illinois mortgages entered prior to the amendment of 765 ILCS 5/11 need not strictly conform to the form presented in the statute. *In re Crane*, --- F.3d ---, 2013 WL 6731850 (7th Cir. Dec. 23, 2013). However, the court's decision in *Crane*, considered as a whole, serves as a reminder to secured lenders to closely examine the contents of their mortgages and the requirements of applicable state law.

In April 2012, we authored an Alert regarding a decision from the United States Bankruptcy Court for the Central District of Illinois, which held that an Illinois mortgage is subject to avoidance in bankruptcy pursuant to 11 U.S.C. § 544(a)(3) unless the mortgage contains among other things, (i) the amount of the debt, (ii) the maturity date of the debt, and (iii) the underlying interest rate. A copy of the Alert from 2012 can be [located here](#).

After the United States District Court for the Central District of Illinois reversed the bankruptcy court's decision, the trustee appealed to the Seventh Circuit Court of Appeals. The Seventh Circuit affirmed the district court as part of a consolidated appeal and held that the recorded mortgages were not subject to avoidance because they substantially conformed to the form of mortgage set forth in a prior version of Illinois' mortgage recording statute. In addition, the Seventh Circuit determined that the mortgages provided the trustees with constructive record notice, and were therefore not avoidable.

In *In re Crane*, a secured lender obtained mortgages on two parcels of real estate located in Illinois and owned by the debtors, a husband and wife. The mortgages were properly executed and recorded in the county recording office. After the debtors jointly filed for relief under Chapter 7 of the Bankruptcy Code, the Chapter 7 trustee commenced an adversary proceeding against the secured lender alleging that the mortgages were defective and subject to avoidance under 11 U.S.C. § 544(a)(3) because the mortgages failed to state the interest rate and maturity date in violation of 765 ILCS 5/11.

The bankruptcy court, citing to and relying on *In re Berg*, 387 B.R. 524 (Bankr. N.D. Ill. 2008) and *In re Shara Manning Properties*, 2010 Bankr. LEXIS 3688 (Bankr. C.D. Ill. 2010), noted that the trustee, standing in the shoes of a bona fide purchaser, did not have constructive notice of the mortgages because they failed to contain the maturity date and the interest rate of the underlying debt. The bankruptcy court further explained that the provisions of 765 ILCS 5/11 are not permissive; rather,

RELATED PEOPLE



Patrick E. Mears
Of Counsel (Retired)

P 616-742-3936
patrick.mears@btlaw.com

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they are required in order to provide constructive notice of a mortgage. As such, the mortgages were subject to avoidance by the trustee because they failed to provide constructive notice to a bona fide purchaser, and thus the trustee under 11 U.S.C. § 544(a)(3).

On appeal the Seventh Circuit noted that under applicable Illinois law, a bona fide purchaser is one who acquires an interest in property for valuable consideration and without actual or constructive notice of another's adverse interest in the property. With respect to record notice, which the trustees argued was lacking due to the failure to satisfy formal requirements under 765 ILCS 5/11 (2012) , the Seventh Circuit stated that the form set forth in 765 ILCS 5/11 was permissive. Because the statute provided that mortgages "may be substantially in the following form," strict compliance was not required. Rather, the form was merely "suggested." Therefore, according to the Seventh Circuit, mortgages that fail to include all statutory elements would not receive the benefit of a statutory safe harbor, but could nonetheless qualify as valid mortgages entitled to priority under the common law and permissive terms of the statute.

While mortgages in Illinois are protected by the statutory rule of substantial compliance, statutes in other states may not be so forgiving. It is therefore prudent for secured lenders to undertake a review of mortgage statutes in other states to ensure that their mortgages used in those states comply with the express mandates of the statutes.

To obtain more information or a copy of the decision, please contact the Barnes & Thornburg attorney with whom you work or the following attorney: Patrick E. Mears at (616) 742-3936 or pmears@btlaw.com.

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