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NEWSLETTERS

Seventh Circuit Holds That A Trustee Had Constructive Notice Of A Mortgage Under Illinois Law

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In Crane v. Richardson (In re Crane), - F.3d -, 2013 WL 6731850 (7th Cir. Dec. 23, 2013), the United States Court of Appeals for the Seventh Circuit examined the 2012 version of the Illinois mortgage recording statute, 765 Ill. Comp. Stat. 5/11 (2012), to determine whether the requirements of the statute were permissive or mandatory. The Court held that the requirements of the 2012 version of Section 5/11 were permissive. Therefore, so long as a mortgage substantially complies with the statute, its recordation would be deemed constructive notice to third parties. Accordingly, bankruptcy trustees could not avoid mortgages because they did not state the maturity date or interest rate for the secured debts.

Before June 1, 2013, Section 5/11 provided:

Mortgages of lands may be substantially in the following form:

The Mortgagor (here insert name or names), mortgages and warrants to (here
insert name or names of mortgagee or mortgagees), to secure the payment of
(here recite the nature and amount of indebtedness, showing when due and the
rate of interest, and whether secured by note or otherwise), the following described real estate (here insert description thereof), situated in the County of ...., in the State of Illinois.

Dated (insert date).

(Signature of mortgagor or mortgagors)

Under this statute, federal bankruptcy courts in Illinois were divided as to whether the elements set forth in Section 5/11 were mandatory or permissive. Some courts had held that if a mortgage did not include the rate of interestand when the mortgage was due, that the mortgage did not conform to Section 5/11. In light of these court decisions finding that these elements were mandatory for a mortgage to be validly recorded, Illinois amended 765 ILCS 5/11 to include a subsection (b) which provided that:

The provisions of subsection (a) regarding the form of a mortgage are, and have always been, permissive and not mandatory. Accordingly, the failure of an otherwise lawfully executed and recorded mortgage to be in the form described in subsection (a) in one or more respects, including the failure to state the interest rate or the maturity date, or both, shall not affect the validity or priority of the mortgage, nor shall its recordation be

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ineffective for notice purposes regardless of when the mortgage was recorded.

Although the current version of Section 5/11, effective on June 1, 2013, makes it clear that the elements set forth in the statute are permissive and not mandatory, and that substantial compliance with Section 5/11 would likely be sufficient for mortgages recorded after June 1, 2013, the division in the federal court system on how to interpret mortgages recorded before June 1, 2013 remained.

The Seventh Circuit addressed this division in In Re Crane, where bankruptcy trustees, in two separate cases, argued that recorded mortgages that did not specifically state the interest rate and the maturity date were avoidable. The Seventh Circuit noted that since the bankruptcy actions were filed before the amendment became effective, that it did not need to decide whether the 2013 amendment should be treated as clarifying the prior version of the statue. Rather, the Court said it would reach the same result under either version of the statute because the requirements of the statute have always been permissive rather than mandatory.

In concluding that the terms in Section 5/11 (2012) were permissive, the Court noted that the opening sentence of the section stated that the “mortgages of lands may be substantially in the following form.” (emphasis in original). The Court then explained that “[t]he statute simply does not say that a recorded mortgage must set forth every element listed for the recording to be effective against third parties.” The Court concluded that “[s]trict compliance with the suggested form is not required to ensure a valid mortgage enforceable against subsequent lenders and purchasers.” Since the recording statute contains permissive terms, even under the 2012 version, a recording may be deemed sufficient if it contains the indispensable elements (such as the amount of debt) of a mortgage even if the recorded document does not include every element listed in the recording statute.

The Seventh Circuit held that while mortgages that do not contain all of the elements of the recording statute would not receive the benefit of a statutory safe harbor, they could nonetheless qualify as valid mortgages entitled to priority and were not avoidable.

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