

## Bankruptcy Court in Illinois Holds that a Mortgage is Avoidable in Bankruptcy if the Mortgage as Recorded Does Not State the Maturity Date and Interest Rate of the Underlying Debt

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In a decision that potentially has serious implications for mortgage financing transactions in Illinois, the Bankruptcy Court for the Central District of Illinois recently held that a mortgage is avoidable in bankruptcy if it fails to include the maturity date and the interest rate of the underlying debt within the mortgage document as recorded. *In re Crane, Case No. 11-90592, U.S. Dist. Ct. C.D. Ill., February 29, 2012; Supplemental Opinion and Order, April 5, 2012*. The court found that the failure to include the maturity date and the interest rate in the mortgage violated the express requirements of Illinois conveyancing statutes, and thus did not provide the constructive notice to the trustee necessary to prevent the avoidance.

The facts of the case are simple and undisputed. The Debtors, Gary and Marsa Crane, filed for relief under chapter 7 of the Bankruptcy Code, and a trustee was appointed. The Gifford State Bank claimed a mortgage lien on various parcels of real estate owned by the Debtors. In an adversary proceeding, the trustee claimed that the mortgages were defective and subject to avoidance pursuant to 11 U.S.C. § 544, because both mortgages failed to state the interest rate and the maturity date thereof, in violation of the Illinois conveyancing statutes, specifically 765 ILCS Sec. 5/11. This failure to comply with Illinois statutes, argued the trustee, meant that the mortgages did not give constructive notice to subsequent bona fide purchasers, and that the trustee had the power to avoid the mortgages per 11 U.S.C. § 544(a)(3).

In a succinct opinion and order, United States Bankruptcy Judge Gerald D. Fines ruled in favor of the trustee, and ordered that the mortgage lien of the Gifford State Bank was avoided as to the subject real estate. The court relied on an interpretation of section 11 of the Illinois Conveyances Act (as set out in relevant part below), which dictates strict conformity with the

statutory form for the mortgage to have the effect of providing constructive notice to bona fide third-party purchasers (and trustees in bankruptcy). The relevant statute states:

“Sec. 11. 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)...” Emphasis supplied. 765 ILCS 5/11.

In this regard, the court relied on the earlier decision of *In re Berg*, 387 B.R. 524 (Bankr. N.D. Ill. 2008), where a trustee in a chapter 7 proceeding was also able to avoid a mortgage because of the mortgage’s failure to comply with the requirements of the same section 11. In *Berg*, the court relied upon 19th-century precedent, particularly *Bullock v. Battenhausen*, 108 Ill. 28 (1883), to construe the Illinois statutory mortgage requirements strictly, reasoning that disclosing the underlying detail as to the indebtedness on the record serves to lessen possible prejudice to subsequent purchasers or creditors because of possible “secret conspiracies” between mortgagor and mortgagee as to the nature and extent of the indebtedness.

This decision is alarming because its strict reading of the statute, and harsh result for the mortgagor, is inconsistent with modern mortgage finance practices, including the common use of the incorporation by reference of promissory notes, as opposed to setting out the detailed terms of the note, including interest rate and maturity date, which this decision would appear to require in each instance. The statutory language states only that mortgages “may be substantially in the following form,” which suggests a flexibility and a practicality not recognized in the court’s decision and reasoning.

This may not be the last word on the subject, however, as an appeal of this decision has been filed, and legislation has been introduced at the state level to supersede its effect, presumably by amending the Conveyances Act appropriately. We will continue to monitor the status of this case as it is addressed by the higher courts and/or the state legislature.



**Practice Tip:** Unless and until the *Crane* decision is overruled by the higher courts or through legislation, mortgages secured by real estate located in Illinois should include the interest rate and maturity date on the mortgage document as recorded, and otherwise fully comply with section 11 of the Illinois Conveyances Act, to prevent an avoidance

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