

## Resources

### U.S. Bankruptcy Court Holds Illinois Mortgage May Be Avoided for Failure to State Interest Rate and Maturity Date

April 20, 2012

In a ruling on February 29, 2012, the U.S. Bankruptcy Court for the Central District of Illinois allowed a bankruptcy trustee to avoid an Illinois mortgage as to other creditors of the estate because the mortgage failed to expressly state the maturity date of and interest rate on the underlying debt (*In Re Crane*, Case 11-90592, U.S. Dist Ct, C.D. IL, February 29, 2012). The court held that the provisions of Section 11 of the Illinois Conveyances Act (the “Act”) addressing mortgages of land (765 ILCS 5/11) are not permissive guidelines, as the language of the Act suggests, but rather are mandatory provisions with which a lender must comply in order to provide constructive notice to a trustee in bankruptcy. Mortgages that fail to contain the amount of the underlying debt, maturity date and interest rate, the court held, are avoidable by a bankruptcy trustee. Including these provisions in the mortgage by reference to the promissory note or other loan documents is insufficient. The court in *Crane* required that the amount of the debt, the maturity date and the underlying interest rate were required to be set forth expressly in the mortgage itself.

This decision is squarely at odds with standard practice in the Illinois mortgage industry. While most Illinois mortgages typically do state the maturity date and the amount of the debt, they do not normally incorporate the interest rate and only cross reference to the promissory note or credit agreement which, in turn, expressly states the rate. As a general rule, lenders prefer not to have their loan pricing in the public record and, furthermore, pricing calculations often fluctuate during the term of the loan based upon a variety of factors that are addressed in detail in the note or credit agreement and would be unwieldy and impractical to restate in the mortgage. Nevertheless, under the *Crane* decision, failure to state the maturity date and interest rate would permit a bankruptcy trustee to avoid the mortgage. Although the *Crane* decision does not establish a precedent for other bankruptcy courts or state courts in Illinois, the decision may embolden bankruptcy trustees throughout Illinois to seek to avoid similar mortgages.

The *Crane* decision has also sent shockwaves throughout the title insurance industry. The major title insurance companies operating in Illinois appear willing to continue to issue loan policies on new loans even if the mortgage fails to state the interest rate—but significantly, they have indicated that they are reserving the right to deny coverage under various exclusions to the standard title policy. Title companies have not given any guidance thus far as to how they will handle claims on existing policies if *Crane* is upheld.

The court’s decision in *Crane* speaks only to whether the mortgage at issue is specific enough to provide “constructive notice” to the bankruptcy trustee and/or third party purchaser; it does not wholly invalidate mortgages that fail to set forth the items in the Act. At present, it would appear that such mortgages are still valid against the mortgagor/borrower, whose execution of the promissory note and other loan documents is evidence of its receipt of notice of the terms of the underlying debt.

An appeal of the *Crane* decision was filed by the defendant lender, Gifford State Bank, on April 18, 2012. In addition, legislation to provide that failure to state the interest rate or maturity date does not invalidate or affect the priority of a mortgage has been proposed in the Illinois House of Representatives. Proponents of the legislation are hopeful that the legislation will be introduced and passed before the adjournment of the regular state legislative session scheduled for May 31.

Dykema will continue to provide updates regarding the *Crane* appeal, related legislative efforts, the positions taken by title insurers and other industry responses in the coming weeks. In the interim, should you have any questions about the *Crane* decision or its impact on your business, please contact **Michael Kurtzon** at 312-627-5674, **Gary Segal** at 312-627-2482, or **Diana Tsai** at 312-627-2508.

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## **Attorneys**

Gary P. Segal

Diana Y. Tsai

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Commercial Lending

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