

Resources

Seventh Circuit Court of Appeals Holds That Illinois Mortgages May Not Be Avoided in Bankruptcy for Failure to State Interest Rate and Maturity Date

December 30, 2013

Nearly two years ago, a bankruptcy court in the Central District of Illinois caused considerable consternation in the lending community when it held that the provisions of Section 11 of the Illinois Conveyances Act (the “Act”) (765 ILCS 5/11) were mandatory rather than permissive. *Crane v. Richardson (In re Crane)*, 20121 WL 669595 (Bankr. C.D. Ill. Feb. 29, 2012). Section 11(a) of the Act provides a “form” of mortgage, which form specifically includes the interest rate on and the maturity date of the loan. The bankruptcy court determined that the omission of any of the provisions delineated in the form mortgage, including the interest rate and the maturity date, failed to provide constructive notice to a bankruptcy trustee or a third party purchaser, thereby allowing a bankruptcy trustee to avoid the mortgage.

On December 23, 2013, the U.S. Court of Appeals for the Seventh Circuit restored calm in the lending community, holding that a bankruptcy trustee could not avoid an Illinois mortgage for lack of “constructive notice” when the mortgage did not expressly state the maturity date of, or interest rate on, the underlying debt (*In Re Crane*, No. 13-1518 (7th Cir. Dec. 26, 2013)). In a consolidated appeal, the Seventh Circuit determined that the Act’s provisions regarding the maturity date and interest rate were permissive. Although Illinois law required that the amount of the debt be stated in the mortgage, the Act did not require statements of the interest rate and maturity date.

Prior to the Seventh Circuit’s decision, and in response to the decision of the bankruptcy court, the Illinois legislature passed Public Act 97-1164, which adds Section 11(b) to the Act, effective June 1, 2013. The provisions of Section 11(b) of the Act confirm the permissive nature of Section 11(a) and reiterate that the omission of some of the information provided in the form mortgage in Section 11(a) neither affects the validity or priority of the mortgage nor renders the recording of the mortgage invalid for notice purposes. However, as Section 11(b) was not effective until June 1, 2013, lenders obtaining mortgages prior to such date could not avail themselves of the protections in the amended Act. The Court’s holding applies to and protects the validity of mortgages that did not include the interest rate or the maturity date prior to the effective date of the amended statute.

In light of the Seventh Circuit’s unequivocal holding and the Illinois legislature’s amendment to Section 11 of the Act, lenders can comfortably return to the common practice of incorporating certain terms of the loan, such as the interest rate, into a mortgage by reference to the promissory note, as the failure to expressly state such terms will not *per se* result in a mortgage’s invalidity for failure to provide “constructive notice” to a bankruptcy trustee or a third party purchaser.

Please contact Michael Rothstein at 312-627-2280, or Jimmy Angelakos at 312-627-2297 if you have any questions.

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