

## Illinois Legislature and Court Clarifies Confusion on Mortgage Requirements after *In re Crane*

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A new Illinois law will close a loophole through which some mortgages could be subject to avoidance in bankruptcy. The loophole, created by U.S. Bankruptcy Court's (C.D. Illinois) 2012 *In re Crane* opinion, allowed a bankruptcy trustee to avoid a mortgage under 11 U.S.C. § 544(a)(3) unless it contained, among other provisions: 1) the amount owed, 2) the debt's maturity date and 3) the underlying interest rate.

In *Crane*, the Chapter 7 trustee, in distributing the assets of the bankruptcy estate, sought to avoid a mortgage asserted by Gifford State Bank on real estate owned by the debtors. The trustee argued that it did not have constructive notice of the mortgage because it was facially defective under the Illinois Conveyances Act ("Act"). Section 11 of the Act states in pertinent part:

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....*

(765 ILCS 5/11).

The court in *Crane* held that, notwithstanding the permissive "may" in the beginning of Section 11, a mortgage should include the terms of the note (namely the amount of indebtedness, maturity date and interest rate) in order to provide constructive notice, making these Section 11 provisions of a mortgage mandatory. As a result of the omitted information on the mortgage, the bankruptcy trustee, who is granted hypothetical status as a bona fide purchaser under Section 544(a)(3) of the Bankruptcy Code, was not deemed to be on constructive notice of Gifford State Bank's mortgage and could therefore avoid the mortgage in connection with the trustee's sale of the property.

The ruling ran contrary to the overwhelming standard practice in Illinois of including the terms of the note by reference in the mortgage instead of reciting the terms of the note verbatim. In response, the Illinois Legislature passed Public Act 97-1164, which added a new subsection (b) to Section 11 of the Act that clarifies the intended permissive nature of Section 11 as follows:

*(b) 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 ineffective for notice purposes regardless of when the mortgage was recorded.*

Public Act 97-1164 will take effect on June 1, 2013. Furthermore, the bankruptcy court's decision in *Crane* was eventually reversed. *In re Crane*, 487 B.R. 906 (C.D. Ill. 2013) (*The Gifford State Bank v Richardson*, 12-CV-21146). Nevertheless, the legislature's clarification (notwithstanding whether it was needed) of the Illinois Conveyance Act as to

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the necessary terms of Illinois mortgages reduced uncertainty in the law and eased the concerns of all Illinois mortgage lenders and their counsel. It also clarifies that the form of Illinois mortgages has always been permissive to avoid any bankruptcy trustee from arguing that any mortgages entered into prior to June 1, 2013 could be avoided.

For further guidance or more information regarding the foregoing, please contact your Miller Canfield attorney.