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# The New Judicial Roles in Illinois Mortgage Foreclosures

Eric T. Freyfogle\*

In 1987 Illinois enacted a new mortgage foreclosure law, applicable to all foreclosures commenced after July 1, 1987.<sup>1</sup> The new statute represents the culmination of years of legislative lobbying and drafting, principally by lending institutions and the state bar association. The law has two salutary goals: to reduce foreclosure costs and to increase foreclosure sale prices. These same goals have prompted a number of states over the past two decades to modify their foreclosure laws.<sup>2</sup> With its new act, Illinois has followed the move to reform. The Illinois act, however, contains surprisingly novel provisions and heads the state in a direction that is far different from that chosen by other reform-minded states. The Illinois route is largely untested, and the coming years should provide a period of experimentation that other states may find instructive, if not inviting.

The route Illinois chose was to expand significantly the role of courts in supervising the foreclosure sale process. Cutting against the weight of current thinking, Illinois retained the requirement of a judicial foreclosure sale and refused to impose any limits on post-sale deficiency judgments.<sup>3</sup> Further, it reduced, but did not elimi-

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\* Associate Professor of Law, University of Illinois; B.A., 1973, Lehigh University; J.D., 1976, University of Michigan. This Article is an expanded version of a report covering the new foreclosure law prepared for the 1987 Illinois Judicial Conference. The Conference presentation on the new act was made by Judges William T. Caisley and Anthony J. Scottillo and myself, with assistance from Judges George M. Marovich, Thomas E. Hornsby, Thomas J. O'Brien, and James C. Murray, and Professor Margit Livingston of the DePaul University College of Law. Their thoughts and comments, as well as the comments of the conference participants, aided materially in the preparation of this Article. Funding for the article was provided by a David C. Baum Research Grant from the University of Illinois College of Law, for which I am grateful. The normative views expressed in this Article, however, are solely my own.

1. ILL. REV. STAT. ch. 110, paras. 15-1101 to 15-1706 (1987). The Act was amended in several technical ways by Pub. L. 85-907. 1987 Ill. Legis. Serv. 85-907, Art. I, sec. 1 (West). All references to the Act as amended are made hereafter simply by paragraph number as codified in Chapter 110 of the Illinois Revised Statutes.

2. A summary of recent statutory changes, particularly changes in judicial foreclosure and statutory redemption rights, is set forth in Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit*, 71 IOWA L. REV. 1, 3-6 (1985).

3. Paras. 15-1404 and 15-1405 (requiring judicial foreclosure and prohibiting the ex-

nate, the post-sale statutory redemption period.<sup>4</sup> At the core of the Illinois reform effort are provisions authorizing greater judicial flexibility in managing the foreclosure process and conducting the sale.<sup>5</sup> No longer must sales be conducted by public auction with purchasers given little chance to inspect the property and its title, and no opportunity to submit bids with financing and other contingencies. Now, brokers can be used, and property can be sold in ways that approximate the usual processes of selling nonforeclosure property. The judge must now decide the best method of sale, a new task that presents attractive opportunities but that threatens serious new burdens. The new law requires that judges determine, among other things, whether a defaulting mortgagor can redeem more than once,<sup>6</sup> whether a mortgagee can seize and retain the property instead of selling it,<sup>7</sup> and whether a lease junior to a foreclosing mortgage will survive a foreclosure sale.<sup>8</sup> The new judicial roles are both numerous and critical.

Taken together, these new judicial roles could dramatically change the once formal and routine foreclosure process. Judges now must examine individual cases more closely and make important choices. Their task is made more burdensome by the nearly total lack of statutory guidelines to use in making these decisions. In every key area in which judges are placed in a new role, the statute is silent on the standards that will govern. It is likely that confusion will accompany the extra burdens, at least until appellate decisions provide some guidance.

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ercise of power of sale clauses in mortgages). The Act, however, authorizes certain transactions outside the judicial foreclosure scheme. *See, e.g.*, para. 15-1401 (authorizing deeds taken in lieu of foreclosure); para. 15-1402 (authorizing consent foreclosure in which the mortgagor agrees to turn over the property to the mortgagee in full satisfaction of the debt); para. 15-1403 (authorizing common law strict foreclosure to the extent such foreclosure was "in existence in Illinois on the effective date of this Article"). Strict foreclosure occurs when a court sets a date by which the mortgagor must redeem; in the absence of redemption, the mortgagee takes the property with no obligation to conduct a foreclosure sale. G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* §§ 7.9, 7.10 (2d ed. 1985). According to the leading and most recent decision, strict foreclosure is allowed in Illinois when (1) the mortgagor is insolvent, (2) the property is worth less than the debt, and (3) the mortgagee consents to waive any deficiency. *See Great Lakes Mortgage Corp. v. Collymore*, 14 Ill. App. 3d 68, 302 N.E.2d 248 (1st Dist. 1973). *See infra* notes 73-75 and accompanying text.

4. Para. 15-1604 (setting thirty-day post-sale redemption period for a residential mortgagor when the mortgagee buys the property at the foreclosure sale at less than the amount that the mortgagor would have needed to redeem).

5. Paras. 15-1506 and 15-1507.

6. *See infra* notes 60-67 and accompanying text.

7. *See infra* notes 21-35, 36-55, 56-59 and accompanying text.

8. *See infra* notes 77-90 and accompanying text.

By its new law, Illinois has chosen to improve foreclosures by giving courts greater flexibility to fashion the right process in each case, a process that provides fairness for the mortgagor and that ultimately produces the best sale price. On the surface the approach seems sound, but in operation the troubles could prove considerable. The absence of standards will add undesirable unpredictability to the foreclosure process. But the bigger difficulty stems from the realities of life in today's clogged foreclosure courts. The foreclosure docket is crowded, especially in Chicago and neighboring counties. Judges have little time to reflect judiciously on the best way of selling each particular parcel. The crowding may be less elsewhere, but the new roles and burdens may fit no better into the foreclosure scheme. Flexibility, after all, is productive only if judges have the time to exercise it wisely. Today they often have time only to skim through the papers in the typical uncontested foreclosure action.

The key issue, then, is whether the legislature has placed too great a burden on foreclosure judges. Most foreclosure actions are uncontested, and judges process them with minimal effort. But the new law, if it is to prove effective, will require considerable judicial attention, even in the uncontested case. The judge's job now will be to ensure that the sale process is productive. If judges abdicate that role in most cases, the new act may achieve little.

This Article considers the major provisions of the new Illinois mortgage foreclosure law (the "IMFL"). It examines the new rules regarding redemptions, waiver of redemption rights, liability of guarantors for judgments in foreclosure actions, future advances lending, and nonrecord claimants. It also examines the confusing new provisions governing the applicability of the IMFL to installment land contracts and collateral assignments of land trust beneficial interests. Its particular focus, however, is on the several new provisions that create new roles and burdens for judges. After examining these roles and the vagaries that surround them, the Article offers some observations on the underlying wisdom of the roles and on how courts should respond to them.

## I. REFORMING MORTGAGE LAW

Modifying foreclosure procedures has been a regular pastime of legislators in the twentieth century.<sup>9</sup> Foreclosure procedures first

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9. A portion of the history of mortgage foreclosure law may be found in G. NELSON & D. WHITMAN, *supra* note 3, at §§ 1.1-1.7, and in Bauer, *supra* note 2, at 14-72.

were developed by courts sitting in equity.<sup>10</sup> Before long, however, legislatures intervened. Sympathy for beleaguered home-owners and farm-owners prompted many of the early foreclosure statutes. Many statutes granted a defaulting mortgagor the right to redeem his property during a specified period of time after the foreclosure sale.<sup>11</sup> Other statutes, frequently used during the depression years of the 1930's, placed moratoria on foreclosures and limited the power of mortgagees to obtain post-foreclosure deficiency judgments against defaulting mortgagors.<sup>12</sup>

According to many observers, the cumulative effect of these well-intended laws, contrary to legislative expectations, was to increase the costs and delays of foreclosures and to diminish ultimate foreclosure sale prices.<sup>13</sup> Observers most often criticized the post-sale statutory redemption period. The extra redemption right was designed to protect mortgagors from unreasonably low foreclosure sale prices by giving them the chance to redeem after the foreclosure sale. Supporters of these laws anticipated that the threat of such a redemption would prompt purchasers to bid a fair price. In practice, however, the benefits proved elusive. Indeed, according to many critics, the laws actually reduced sale prices because the sale purchaser felt constrained by the redemption law to wait until the end of the redemption period before using the property. With the delay in taking effective control and the possibility of a redemption lingering on, the purchaser was unwilling to buy the property at a price close to its fair market value. Some states aggravated the purchaser's plight further by granting the defaulting mortgagor the right to remain in possession, rent-free, during the entire statutory redemption period.<sup>14</sup>

Despite the inconclusive evidence that statutory redemption periods offered benefits, dozens of states adopted them. In recent years, however, the prevailing winds have changed directions. Redemption statistics showed that mortgagors rarely redeemed, particularly during the post-sale redemption periods. Faced with this evidence, states began reducing or eliminating statutory redemption rights in their never ending quests to increase foreclosure sale

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10. See G. NELSON & D. WHITMAN, *supra* note 3, at § 1.3.

11. *Id.* at §§ 8.4-8.8.

12. *Id.* at § 8.3.

13. The conflicting evidence is surveyed in Bauer, *supra* note 2, at 72-81, which also contains references to most of the principal studies of the subject. See also G. NELSON & D. WHITMAN, *supra* note 3, at § 8.8.

14. See *Ropfogel v. Enegren*, 7 Kan. App. 2d 644, 646 P.2d 1138 (1982); *Cross Companies, Inc. v. Citizens Mortgage Investment Trust*, 305 Minn. 111, 232 N.W.2d 114 (1975). See also G. NELSON & D. WHITMAN, *supra* note 3, at § 8.4.

prices.<sup>15</sup> The goal became cheaper, more expeditious foreclosure procedures on the theory that they would yield the highest net sale price. As the reform movement gained momentum, states also began to question their cumbersome judicial sale processes. Many states decided to let mortgagees use power-of-sale clauses that authorized foreclosure sales by nonjudicial process.<sup>16</sup> The guiding thought behind this sanctioning of nonjudicial sales was that prompt, low-cost foreclosure sales would increase net sale proceeds and thereby ultimately aid mortgagors, or at least the great majority of mortgagors who had no ability to redeem.

It was against this backdrop that Illinois undertook to amend its mortgage foreclosure rules. State after state had authorized power-of-sale foreclosures and had eliminated statutory redemption periods. As a protection to defaulting mortgagors, many states had also added limits on deficiency judgments to reduce the harmful effects on a mortgagor when a sale failed to cover the accumulated indebtedness. In 1986, when the legislature addressed the latest legislative proposal on foreclosure, Illinois stood with the distinct minority of states that (1) required judicial foreclosure, (2) retained a material statutory redemption period, and (3) placed no limits on deficiencies.

The law that emerged from the Illinois legislature remained close to the old foreclosure scheme, even though it amended many of the particulars. The drafters believed that power-of-sale foreclosures would represent too drastic a departure from the long-standing Illinois commitment to judicial foreclosure, an odd determination in light of the fact that so many states had made the transition successfully. The drafters also showed no interest in enacting an anti-deficiency rule. The only major shift was in the near elimination of statutory redemption rights. The IMFL contains lengthy rules that purport to grant to mortgagors, but not to other interested parties, extensive redemption rights. But, as explained below, the redemption periods provided by the IMFL operate almost entirely before the foreclosure sale, and therefore merely duplicate the pre-existing, and continuing, equitable rights of redemption.<sup>17</sup> Only a narrow category of residential mortgagors still have a post-sale redemption right, and that right is much

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15. See Bauer, *supra* note 2, 3-5 (noting that the number of states requiring judicial foreclosure dropped from twenty-eight to nineteen, and the states authorizing statutory redemption from nineteen to eleven, between 1924 and 1984).

16. See generally G. NELSON & D. WHITMAN, *supra* note 3, at §§ 7.1-7.32.

17. See *infra* notes 110-12 and accompanying text.

shorter than under the old law. Thus, statutory redemption rights largely have disappeared.

## II. COVERAGE OF THE NEW LAW

Among the more vaguely written provisions of the IMFL are those that explain the types of security arrangements that must be foreclosed under the statute. Because of these vagaries, judges will play an important role in deciding when the IMFL governs.

The IMFL applies to all mortgage foreclosures commenced after July 1, 1987, regardless of the date of the mortgage.<sup>18</sup> Regrettably, the new law provides no guidance on what is a "mortgage" for purposes of the IMFL. Courts sitting in equity, however, have guarded jealously the rights of mortgagors and have applied mortgage law to any arrangement functionally equivalent to a mortgage.<sup>19</sup> Over the years, shrewd lenders have tried all manners of formal arrangements in the hope of depriving borrowers of redemption and other rights that they enjoy under mortgage law. With few exceptions, Illinois courts have ignored the form of a transaction and have applied mortgage law to any arrangement that was a mortgage in substance.<sup>20</sup>

### A. Installment Land Contracts

One mortgage substitute that traditionally has remained outside mortgage law is the installment land contract.<sup>21</sup> For years states viewed the installment land contract as a distinct financing arrangement not governed by the protective rules of mortgage law. Over the past decade and a half, however, several states have shifted direction and now require foreclosure of installment contracts.<sup>22</sup> Other states have severely restricted the availability of forfeiture, the installment vendor's traditional remedy, and in various ways now delay and manipulate the vendor's remedies to give

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18. Para. 15-1106.

19. See G. NELSON & D. WHITMAN, *supra* note 3, §§ 3.1-3.38; Licht, *The Clog in the Equity of Redemption and its Effect on Modern Real Estate Finance*, 60 ST. JOHNS L. REV. 452 (1986).

20. See Cunningham & Tischler, *Disguised Real Estate Security Transactions as Mortgages in Substance*, 26 RUTGERS L. REV. 1 (1972).

21. An installment contract is an arrangement whereby the purchaser pays for the property in installments over a period of at least one year. The purchaser typically takes possession immediately but receives a deed only after completing all or nearly all of the payments. See 7 POWELL ON REAL PROPERTY ¶ 938.20[1] (1987).

22. See OKLA. STAT. tit. 16, § 11A (1981); Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979); Skendzel v. Marshall, 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974).

the defaulting purchaser a chance to complete payment of the contract.<sup>23</sup> Several states have granted purchasers the right to reinstate the contract, a right that allows them to keep the property simply by paying the past due installments rather than the entire unpaid balance.<sup>24</sup> A growing number of states allow the purchaser to obtain restitution of the amount by which his installment payments have exceeded the vendor's damages.<sup>25</sup>

Illinois never has viewed an installment land contract as the functional equivalent of a mortgage, and it has been slow to extend to defaulting purchasers many of the special protections that purchasers in other states enjoy.<sup>26</sup> Illinois is strict, however, in requiring vendors to follow forfeiture procedures exactly, and is quick to find that a vendor has waived his right to insist on prompt payment by accepting late payments in the past.<sup>27</sup> The only material statutory protection offered to Illinois purchasers is the Forcible Entry and Detainer Act<sup>28</sup> (the "FED"). The FED Act requires courts to delay the enforcement of forfeiture orders while the purchaser tries to reinstate the contract.<sup>29</sup> The length of the delay increases when the purchaser has paid a greater proportion of the total contract price and, therefore, has more to lose from a forfeiture.<sup>30</sup> The Illinois approach to installment contracts has been criticized by commentators who contend that this approach unduly favors vendors.<sup>31</sup>

The new mortgage law contains language that, on its face, seems to aid purchasers by requiring installment vendors in some cases to undergo foreclosure instead of declaring a forfeiture. The act requires foreclosure of *residential* installment land contracts when (1) the purchase price is to be paid over more than five years, (2) the unpaid principal at the time of filing of foreclosure is less than eighty percent of the original purchase price, and (3) the con-

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23. See 7 POWELL, *supra* note 21, at ¶ 938.22.

24. See *id.* at ¶ 938.23[3].

25. See *id.* at ¶ 938.23[4].

26. An excellent survey of Illinois law is set forth in Note, *Installment Land Contracts: The Illinois Experience and the Difficulties of Incremental Judicial Reform*, 1986 U. ILL. L. REV. 91.

27. See 7 POWELL *supra* note 21, at 84D-91 to 84D-92; Note, *supra* note 26, at 103-06.

28. Paras. 9-101 to 9-116 (1987).

29. See Para. 9-110; Note, *supra* note 26, at 102.

30. Para. 9-110 (up to sixty days' stay if the purchase has more than seventy-five percent of the original purchase price yet to pay; a stay of one hundred and eighty days is required if less than seventy-five percent is due, unless the vendor shows good cause why a shorter period is appropriate).

31. See 7 POWELL, *supra* note 21, at ¶ 938.23[5]; Note, *supra* note 26, at 115-24.



tract is executed on or after July 1, 1987.<sup>32</sup> When these tests are met, the purchaser is treated as the equivalent of a mortgagor and enjoys all the protections afforded mortgagors by the IMFL.

The statutory language seems to represent a step toward increased sympathy for defaulting purchasers. In operation, however, very few contracts are likely to fall within the three-part definition. The second requirement will exclude most contracts, and forfeiture will remain the more common remedy.<sup>33</sup> Indeed, in a case in which the unpaid portion is slightly less than eighty percent of the original price, a vendor might simply wait for the unpaid interest on a contract to mount, thereby avoiding the need to foreclose. The eighty percent figure may prove simple to use, but it otherwise possesses little virtue. The most significant defect is that the calculation ignores improvements made to the property by the purchaser and equity that comes about by way of inflation in home prices. Accordingly, even with the eighty percent test, a purchaser can lose far more than twenty percent of the original purchase price. Further, the statute excludes commercial installment contracts, even if less than eighty percent is owed. In short, the new statutory language does little to deal with the significant shortcomings of Illinois installment contract law.

Fortunately, courts still have authority to deal with these deficiencies. The new statute does nothing to inhibit further judicial efforts to protect the defaulting purchaser whose circumstances seem to warrant equitable intervention. The IMFL retains the old equitable rules as to what constitutes a mortgage. Specifically, the IMFL includes, within the definition of a mortgage, all "equitable mortgages"<sup>34</sup> and all "instruments which would have been deemed instruments in the nature of a mortgage prior to the effective date of this amendatory act of 1987."<sup>35</sup> Thus, room still exists, notwithstanding the statute, for an Illinois court to follow the lead of other states and conclude that a particular contract is tantamount to a mortgage. In cases in which foreclosure is not required, courts can continue to refine the rights of purchasers in particular settings by

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32. Para. 15-1106(a)(2).

33. Statistical evidence on this point is unavailable, but a review of hundreds of reported decisions revealed few in which the purchaser at the time of trial had less than eighty percent of the original purchase price to pay. Many purchasers had paid in excess of twenty percent of the original price, but interest by the time of trial typically had accumulated to the point where the amount unpaid was again in excess of the eighty percent line.

34. Para. 15-1207(d).

35. Para. 15-1207(e).

creating for them rights of restitution and greater rights of redemption and reinstatement.

The new statute fails to resolve the tough conflict between the interests of installment vendors and those of installment purchasers. The statute leaves room for courts to act, yet fails to provide any governing standards. Judges might be pleased at the willingness of the legislature to defer to their collective judgment, but the task of reconciling these conflicting interests remains a difficult one.

### B. Land Trust Interests

An equally troubling task for courts will lie in determining when a collateral assignment of a land trust beneficial interest should be treated as a mortgage. Vast amounts of Illinois land are held in the peculiar arrangement known nationally as the Illinois land trust. Under this arrangement the trustee holds both legal and equitable title to the real property, and the beneficiary's interest is viewed as personalty.<sup>36</sup> Lenders today often forgo taking mortgages on land trust property and instead secure their loans with Article 9 security interests<sup>37</sup> in the beneficiary's personal property interest in the trust.<sup>38</sup> When this is allowed, the lender has all of the rights of a secured party under Article 9 of the UCC,<sup>39</sup> including the right to take possession of the property promptly upon a default and the

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36. See *In re Estate of Albert*, 95 Ill. 2d 377, 447 N.E.2d 796 (1983). See generally H. KENOE, KENOE ON LAND TRUSTS (1981); Haswell & Levine, *The Illinois Land Trust: A Fictional Best Seller*, 33 DE PAUL L. REV. 277 (1984); Note, *Is the Land Trust Truly a Trust: - Gift Tax and Broader Implications*, 1982 U. ILL. L. REV. 503, 505.

37. Article 9 of the Uniform Commercial Code supplies the rules that apply when an owner of personal property grants to a lender or seller a security interest in the property to secure a debt. U.C.C. § 9-101 Official Comment. The Article describes the relative rights of the debtor and the creditor, including the rights of a creditor to seize and to sell the personal property when the debtor defaults. In general, the debtor's rights under Article 9 are far less than those under mortgage law. See *infra* note 41.

38. When an Illinois land trust is created, the trustee receives both legal and equitable title to the real property, and the beneficiary holds simply a personal property interest. See, e.g., *In re Estate of Albert*, 95 Ill. 2d 377, 447 N.E.2d 796 (1983); *Home Federal Savings & Loan Ass'n. of Chicago v. Zarkin*, 89 Ill. 2d 232, 432 N.E.2d 841 (1982). Because the beneficial interest is viewed as personal property, a security interest in that property would be governed by Article 9 rather than mortgage law. The beneficiary for all intents and purposes is the owner of the real property, and it is a fiction for the law to assume otherwise. If this fiction is ignored and the beneficiary is viewed as the holder of an interest in real property, the security interest granted by the beneficiary would attach to real property, and mortgage law would govern.

39. Those rights are considered in J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE ch. 26 (2d ed. 1980).

right to sell the property at a private sale.<sup>40</sup> The defaulting borrower under Article 9 has far fewer rights than does the defaulting mortgagor.<sup>41</sup>

At first glance, this land trust arrangement would seem to be a prime target for the aged, but still viable, equitable rule that treats as a mortgage any security arrangement that is a mortgage in substance. The Illinois Supreme Court applied this equitable rule in the context of land trusts in *Horney v. Hayes*,<sup>42</sup> a 1957 decision. In that case, the court listed the principal factors that it believed distinguished a legitimate personal property security arrangement from a mortgage.<sup>43</sup> Unfortunately, *Horney* has proven a confusing precedent to follow, and its language for years pushed lower courts in conflicting directions. In the past few years, Illinois courts largely have joined ranks in giving *Horney* a narrow reading. As a consequence, few, if any, land trust security arrangements today are viewed as mortgages.<sup>44</sup>

The new act deals with this issue by requiring that certain land trust arrangements be treated as mortgages. Section 15-1106(a)(3) of the law includes as a mortgage any collateral assignment made on or after July 1, 1987, if several conditions are met: (1) the trust arose contemporaneously with the assignment, (2) the secured creditor required the assignment, and (3) the assignment gives the

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40. See *Horney v. Hayes*, 11 Ill. 2d 178, 142 N.E.2d 94 (1957); Haswell & Levine, *supra* note 36, at 301-04.

41. The rights of a defaulting borrower under Article Nine and Illinois mortgage law are compared in Freyfogle, *Land Trusts and the Decline of Mortgage Law*, 1988 U. ILL. L. REV. —.

42. 11 Ill. 2d 178, 142 N.E.2d 94 (1957). In *Horney*, a party created a land trust with himself as a beneficiary and transferred property to the trust. Some eighteen months later, the beneficiary assigned his beneficial interest to a creditor to secure a short-term loan. The security agreement governing the assignment gave the secured party the right to seize and sell the beneficial interest upon default. On these facts the court concluded that Article 9 applied rather than mortgage law.

43. The court identified four factors: (1) whether the parties intended to create a mortgage; (2) whether the security agreement provided for the sale of the estate (rather than simply the beneficial interest) upon default; (3) whether the trust was created for the purpose of arranging security for the debt; and (4) whether the trust was created at the same time as the security arrangement. *Id.* at 184, 142 N.E.2d at 97; Freyfogle, *supra* note 41.

44. See *Slovick v. All American Bank of Chicago*, 163 Ill. App. 3d 741, 516 N.E.2d 947 (1st Dist. 1987); *Interstate Electric Supply Co. v. Contractors & Engineers, Inc.*, 161 Ill. App. 3d 676, 515 N.E.2d 182 (1st Dist. 1987); *Commercial Nat'l Bank of Chicago v. Hazel Manor Condominiums*, 139 Ill. App. 3d 644, 462 N.E.2d 741 (1st Dist. 1985); *Sheridan v. Park. Nat'l Bank of Chicago*, 97 Ill. App. 3d 589, 422 N.E.2d 1130 (1st. Dist. 1981); *First Federal Savings and Loan v. Pogue*, 72 Ill. App. 3d 54, 389 N.E.2d 652 (2d Dist. 1979); Freyfogle, *supra* note 41.

creditor the right to sell the real estate to satisfy the debt.<sup>45</sup> The language of the statute generally tracks that of *Horney* except that the statute ignores one of the four *Horney* tests—whether the parties intended to create a mortgage relationship.<sup>46</sup> In repeating the *Horney* tests, however, the drafters altered the tests, and did so in a way that virtually eliminates all collateral assignments from the express coverage of the law. The *Horney* court suggested that a collateral assignment amounted to a mortgage if one of the four factors was present.<sup>47</sup> A few intermediate-level decisions subsequent to *Horney* agreed.<sup>48</sup> Some subsequent decisions, on the other hand, concluded that the four factors required examination as a whole, with no single factor determinative.<sup>49</sup> No decision, however, has been so restrictive as to say that all factors must point in the direction of a mortgage before mortgage law will apply. The IMFL, therefore, provides the most restrictive test yet.

In any event, a reexamination of the issue by the Illinois Supreme Court seems likely. The current, rather confused state of the law was recently questioned by Judge Harlington Wood, Jr., of the United States Court of Appeals for the Seventh Circuit, who suspected in a recent case that a lender was out to undercut a debtor's redemption and homestead rights.<sup>50</sup> Wood concluded that Illinois mortgage law did not apply in light of recent Illinois decisions, but he commented gratuitously that "[i]t [would] not be surprising . . . if there continues to be further refinement in the Illinois law of land trusts."<sup>51</sup>

The language of the new statute is particularly restrictive because of the requirement that the secured party have the right upon a default to sell the real estate. This requirement will rarely, if ever, be met. Few assignments, therefore, will satisfy this three-part test. A security arrangement executed under Article 9 of the UCC gives the secured party the right to sell, not the real estate,

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45. Para. 15-1106(a)(3).

46. The intent element, and the inherent difficulties that arise in attempting to apply it, are considered in Freyfogle, *supra* note 41.

47. *Horney*, 11 Ill. 2d at 124, 142 N.E.2d at 97.

48. See *Landino v. American Nat'l Bank of South Chicago Heights*, 120 Ill. App. 3d 740, 458 N.E.2d 1070 (1st Dist. 1983); *Shefner v. University Nat'l Bank*, 40 Ill. App. 3d 978, 353 N.E.2d 126 (1st Dist. 1976); *Quinn v. Pullman Trust & Savings Bank*, 98 Ill. App. 2d 402, 240 N.E.2d 791 (1st Dist. 1968).

49. See *Commercial Nat'l Bank of Chicago v. Hazel Manor Condominiums*, 139 Ill. App. 3d 644, 487 N.E.2d 1145 (1st Dist. 1985); *Melrose Park Nat'l Bank v. Melrose Park Nat'l Bank, as Trustee*, 123 Ill. App. 3d 282, 462 N.E.2d 741 (1st Dist. 1984).

50. *Capitol Bank & Trust v. Fasetta*, 771 F.2d 1077, 1080 (7th Cir. 1985).

51. *Id.*

but the beneficial land trust interest.<sup>52</sup> Once a purchaser buys an entire beneficial interest, he can instruct the trustee to dissolve the trust and thereby take title to the property. But a secured lender cannot seize the real estate directly. Indeed, if a security agreement gave a secured party such a right, the agreement would need to be a true mortgage signed by the trustee. Only the trustee can grant to a lender the power to seize the real estate upon default; a beneficiary signing an Article 9 agreement cannot do so. Read literally, the new statutory language would exclude from the definition of a mortgage any Article 9 security interest that was created in proper form so as to give the secured party simply the right to seize the beneficial interest. In short, the language seems to provide a strong blow to the functional equivalence doctrine<sup>53</sup> in mortgage law, and provides to secured lenders their long-sought-after means to circumvent the heretofore mandatory provisions of mortgage law.

Again, however, it is critical to realize that the new statute maintains the equitable rules on what constitutes a mortgage. In many cases courts can, and probably should, conclude that a land trust arrangement is tantamount to a mortgage and must be foreclosed, even though the arrangement does not fit within the narrow statutory language. Nothing in the language or history of the new act casts any doubt as to the continuing propriety of this judicial role. As with installment land contracts, therefore, courts must resolve the difficult conflict between the interests of the borrowers and the interests of the lenders, with no helpful statutory guidance. *Horney* suggests that the application of mortgage law can be determined only case-by-case after a careful factual inquiry. The burden on the courts, therefore, remains considerable.

A related difficulty that arises under the new act is in determining exactly what is being sold at a foreclosure sale involving land trust property. If a collateral assignment of a beneficial interest is treated as a mortgage, can the mortgagee force a sale of the real estate? The power to do so arguably is supported by the IMFL, which defines a mortgage as a consensual lien that grants an interest in *real estate*.<sup>54</sup> Upon reflection, however, it should seem clear to courts that a mortgagee has no such power. An illuminating example is provided by the case in which there are multiple beneficiaries, only one of whom is in default on a separate note. The

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52. See, e.g., *Shefner v. University Nat'l Bank*, 40 Ill. App. 3d 978, 353 N.E.2d 126 (1st Dist. 1976).

53. See *supra* notes 19-20 and accompanying text.

54. Para. 15-1207.

secured lender should have the right to reach the individual beneficiary's interest, but should have no power to reach the real estate. One of the benefits of a properly drawn land trust arrangement is that it largely eliminates the power of one of several beneficiaries to disrupt title to the real estate to the detriment of the other beneficiaries.<sup>55</sup> One beneficiary should have no power to grant a security interest that gives the secured lender a chance to seize or to sell the real property itself. Thus, when a court decides that foreclosure is required, it should make clear that the item being sold is the beneficial interest rather than the real estate itself, unless all parties otherwise agree.

### C. *Discretionary Application*

Section 15-1106 allows secured parties to seek foreclosure under circumstances in which the new act on its face does not appear to mandate it. Subsection (b) authorizes foreclosure in the case of (1) a collateral assignment of a land trust beneficial interest that is not otherwise covered by the statute, and (2) a security assignment of a buyer's interest in a real estate installment contract, but in each case only if the security interest is created on or after July 1, 1987. Subsection (c) authorizes application of the new act by any installment contract vendor if the contract was entered into on or after July 1, 1987. These provisions should create few problems for courts, at least so long as courts construe them with care.

One misinterpretation of section 15-1106 could bring about a major, unintended change in Illinois law. Under established Illinois law, a buyer's interest under an installment land contract is a real property interest.<sup>56</sup> When a buyer grants a security assignment in that real property interest, he creates a mortgage, not an Article 9 security interest, regardless of the language of the documentation that is used. Courts around the country commonly allow installment purchasers to grant mortgages in their interests, at least when the buyer's interest is not economically insignificant.<sup>57</sup> Thus, a security interest in a buyer's installment contract interest should almost always be viewed as a mortgage, with foreclosure required under the new law. Courts should ignore the implication of the statutory language that application of the new law is somehow discretionary with the secured party.

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55. See H. KENOE, *supra* note 36, at §§ 3.3-3.8.

56. See *e.g.*, *Shay v. Penrose*, 25 Ill. 2d 447, 185 N.E.2d 218 (1962). This law is known as the doctrine of equitable conversion.

57. 7 POWELL *supra* note 21, at ¶ 938.26[2] (1987).

A second possible misinterpretation of section 15-1106 is that it somehow prohibits foreclosure under the act in the case of installment contracts executed before July 1, 1987. Foreclosure is an option that all vendors should possess, and courts have good policy reasons to encourage foreclosure over forfeiture.<sup>58</sup> Illinois courts have never decided expressly whether installment vendors can foreclose. Despite this lack of precedent, there is little reason to think that Illinois vendors lacked the remedy prior to the IMFL. The IMFL expressly authorizes foreclosure only for post-July 1, 1987 contracts. This limit, however, seems insignificant absent either an express ban on foreclosure for earlier contracts or some policy reason to imply a ban. The better interpretation is that the legislature gave no thought to the foreclosure of earlier contracts. When courts do so, they should allow foreclosure.

A final caution on section 15-1106 is that its language on Illinois land trusts could suggest that a secured lender somehow has the option of treating its Article 9 interest as a mortgage on the real property and forcing a foreclosure sale of the realty. As noted above, a beneficiary technically has no power to encumber the title or to transfer an interest in the realty.<sup>59</sup> The beneficiary's only power is to encumber the personal property interest and to grant to a lender the right to seize the personalty. Having agreed to this limited security interest, the lender should not have the power unilaterally to convert the interest into some right to reach the realty.

### III. THREE NEW JUDICIAL ROLES

The most visible new role for foreclosure judges will be in determining the best method of conducting foreclosure sales. That new role and its implications are discussed in the next section of this Article. This section takes up three other, more limited roles that the IMFL places on judges, roles of critical importance to various participants in the foreclosure process. In each case judges must perform the role with no legislative guidance.

#### A. Reinstatement Rights

One new task for judges is to determine when a defaulting mort-

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58. The principal defects of forfeiture, however, are all ones that can be easily remedied. Once reformed, forfeiture law offers many advantages over foreclosure, principally the advantage that it retains the installment land contract as a viable alternative to traditional mortgage financing. See Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. —

59. See *supra* notes 52-55 and accompanying text.

gagor can reuse his statutory reinstatement right.<sup>60</sup> The new law largely continues the prior law on the mortgagor's ability to reinstate a mortgage loan that is in default. But minor particulars have changed, in large part to the benefit of mortgagors.

The old Illinois statute provided a reinstatement period that began upon default and that extended until the *earlier* of (1) ninety days after the commencement of the foreclosure action and (2) entry of a judgment of foreclosure.<sup>61</sup> The new law extends the reinstatement period for ninety days "from the date the court obtains jurisdiction over the mortgagor," without regard to when the foreclosure judgment, or even the foreclosure sale, occurs.<sup>62</sup>

More significantly, the new law provides that the mortgagor cannot again use his reinstatement right for five years "if the court has made an express written finding that the mortgagor has exercised its right to reinstate pursuant to this Section."<sup>63</sup> The language is intriguing. The reference to "the court" presumably means the court that heard the first foreclosure action, which means that a later court cannot reconsider the issue and decide that, in some earlier action, the mortgagor exercised his right to reinstate and therefore cannot use it again. This interpretive conclusion, however, is not free from doubt.

Of greater interest is the fact that the statute provides no guidance on when the court should make such a finding. The mere fact that a court must make a finding suggests quite plainly that a court will have some discretion in the matter.<sup>64</sup> A court, it would seem, need not enter such a finding simply because the mortgagor has reinstated and the mortgagee has asked for the finding. Clearly, something more should be required, something that amounts in substance to a showing of good cause to bar the mortgagor from reinstating again for five years.

One issue a court might consider in deciding to make a requested finding is whether the mortgagor had adequate notice of the possible foreclosure and adequate chance to cure. Mortgage law, even under the new statute, does not require a mortgagee to give notice before starting a foreclosure action (although mortgage documents often do contain such a requirement). Thus, a court

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60. Para. 15-1602.

61. ILL. REV. STAT. ch. 95, para. 57 (1985) (repealed).

62. Para. 15-1602.

63. *Id.*

64. The old law applied mechanically and required no judicial finding. ILL. REV. STAT. ch. 95, para. 57 (1985) (repealed).



might refuse to make a requested finding if, before commencement of the action, the mortgagor did not have a full chance to cure.

A court also might consider how quickly the mortgagor offered to cure, and how much trouble the mortgagee experienced as a result. It also might be relevant for the court to consider the mortgagor's prior payment history and whether the mortgagee had been asked to accept numerous late payments in the past.<sup>65</sup> Finally, a court might show greater solicitude for residential mortgagors over commercial ones.

A court asked to find that reinstatement has occurred might show particular sympathy toward a mortgagor if the default relates, not to a payment of principal and interest, but to some other obligation of the mortgagor, such as the payment of an escrow amount or some obligation relating to the use of the property. In these areas, good faith disputes easily can arise, and the mortgagor should not face a penalty for challenging in good faith some position asserted by the mortgagee. In general, courts should favor a mortgagor acting in good faith and should refuse to issue a requested finding. It is worth remembering that reinstatement typically is not harmful to the mortgagee, particularly because a reinstating mortgagor must pay any reasonable default charges as well as correct the default.<sup>66</sup> In any event, judges have discretion in issuing a finding of reinstatement, whatever standard is used, and can make a finding as equity seems to require.

Courts must be sensitive to the procedures that they employ, as well as to the substantive standards, when they decide whether to enter a requested finding that a mortgagor has reinstated. In many cases the mortgagee will seek a finding when the mortgagor is not represented or even present in the case. The typical request for a finding will come as part of the mortgagee's motion for an entry of dismissal or nonsuit. The mortgagor may not have filed an appearance in the case and may have no lawyer, particularly if he cleared up the default soon after the action began. Is it fair for a court to enter a requested finding with no notice to the mortgagor and no hearing on the issue? An inquiry seems needed before a finding is entered, for a full presentation of relevant equitable considerations is essential. But a hearing requirement would force courts to delay

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65. Courts commonly consider this factor in deciding whether an installment land contract vendor has waived his right to insist on prompt payment by accepting late payments in the past. *See Note, supra* note 26, at 105-06.

66. Para. 15-1602 (requires payment of "all costs and expenses required by the mortgage to be paid in the event of such defaults").

dismissal while examining the equities of the situation. If time is short, it seems, the ruling should favor the mortgagor.

In many instances a mortgagor will have a reinstatement right in his mortgage contract. A question that courts will need to decide is whether a mortgagor who has exercised a reinstatement right under his contract has concurrently exhausted his one reinstatement right under the statute. The statute provides no answer to the question, but the likely answer is that the statutory right will be used only if no contract right exists at the time of reinstatement. Mortgage documents and mortgage laws traditionally are interpreted to favor mortgagors, and this ambiguity probably will be resolved similarly. Only if no contract right exists, will the mortgagor be charged with using his statutory right.

On a final point relating to reinstatement, courts will need to decide whether a mortgagor can reinstate twice within five years if the first reinstatement occurred under the old statute. The old statute, again, required no judicial finding to bar reuse of the reinstatement right within five years.<sup>67</sup> Accordingly, courts had no particular reason to enter a finding that reinstatement had occurred. The new statute is silent on this transition issue. Presumably, courts will interpret the statute as giving rise to a new reinstatement right to all mortgagors, even those who have recently reinstated, if only because of their usual tendency to interpret mortgage laws to favor mortgagors. A liberal reading of this new reinstatement provision is appropriate. As noted below, the new act materially reduces the post-sale redemption rights held by current mortgagors. A pro-mortgagor application of the reinstatement rules would help offset this serious reduction in rights.

### *B. Consent Foreclosure*

A second new role for judges is contained in the provisions governing consent foreclosure. In consent foreclosure, the mortgagee, with the consent of the mortgagor, retains the property with no foreclosure sale.<sup>68</sup> The new statute makes this procedure considerably more attractive for mortgagees. Accordingly, its use could increase appreciably.

Under the old law, the effect of consent foreclosure was simply to reduce the post-foreclosure redemption period from six months to three months for all parties, including judgment creditors of the

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67. See Ill. Rev. Stat. ch. 95, para. 57 (1985) (repealed).

68. Para. 15-1402(a).

mortgagor, that had the right to redeem.<sup>69</sup> Thus, a mortgagee who took the property in lieu of a foreclosure sale could do little with it until the redemption period ended. To achieve this reduction, the mortgagee needed to obtain, after the foreclosure action had begun, the written consent of the mortgagor. The old law was silent as to the mortgagee's ability thereafter to obtain a deficiency. The assumption no doubt was that the mortgagor would consent to the foreclosure only if the mortgagee took the property in full satisfaction of the debt. Other interested parties had no say in the foreclosure; their only recourse was to redeem the property after the foreclosure by paying the full debt and accompanying expenses. For the court, consent foreclosure operated mechanically.

Under the new statute, the process is more complex. Now the mortgagee must expressly waive any right to a deficiency.<sup>70</sup> In addition, the mortgagee must notify the other parties to the action and give them a chance to object. If the parties are notified and do not object, their interests are eliminated and they, like the mortgagor, have no right to redeem after entry of the judgment. If the parties object, the court must conduct a hearing. At the hearing the court has three options. The court can disallow the foreclosure "for good cause shown" by the objecting party. In the absence of good cause, the court can allow the objecting party thirty days to redeem, with the foreclosure to occur after thirty days in the absence of redemption. Finally, the court can allow the foreclosure to take place with no delay if the objecting party fails to show good cause and fails to offer to redeem. The new statute sets forth a process to handle redemptions in the event that two or more interested parties seek to redeem.<sup>71</sup>

The new consent procedure is more attractive than the old principally because it eliminates all redemption rights and thereby allows the mortgagee to take the property free and clear. Compared to a foreclosure sale, the consent method is particularly attractive because the mortgagor loses his six or seven month redemption period that, under the new law, must expire before a foreclosure sale can occur.<sup>72</sup> Under consent foreclosure, therefore, the mortgagee can obtain the property much more quickly and inexpensively.

For the court, however, the new hearing can provide troubles. The new law is silent as to what sort of good cause must be shown

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69. ILL. REV. STAT. ch. 110, paras. 12-127 and 12-132 (1985) (repealed in part).

70. Para. 15-1402(a).

71. Para. 15-1402(b)(3).

72. See *infra* notes 110-13 and accompanying text.

and as to who carries the burden of proof. Typically a protesting third party, such as a junior lienholder or judgment creditor, will oppose the consent foreclosure because of the alleged high value of the property in relation to the senior debt. The junior party will claim that the property, if sold at a foreclosure sale, would bring enough to yield residual proceeds for the junior claimants. The foreclosing mortgagee will claim, to the contrary, that the value is less than the senior lien and that a sale would be wasteful. The court will be called upon to decide the matter.

Because the junior claimant is the one raising an objection to the consent foreclosure, the junior claimant would seem to have the burden of proving good cause. But this allocation of the proof burden seems awkward. The mortgagee and mortgagor, both of whom would favor the consent foreclosure, might be better situated to offer proof about the valuation of the property, particularly in comparison to a judgment creditor who may have no familiarity with the real estate market and the real estate business. Additionally, doubts about the valuation should be resolved in favor of the junior claimant, because a foreclosure sale, the remedy sought by the objector, would eliminate the need to speculate. Perhaps the best approach would be for courts to require the objecting party to carry the burden of coming forward with *prima facie* evidence on the value and then require the mortgagee to prove that the value is less than the mortgage being foreclosed. If the "good cause" objection rests on a different ground, however, and is based on facts known only to the objecting party, then allocating the burden to the objecting party seems more reasonable. In any case, courts should be quick to spot and to dismiss objections by junior claimants who simply seek to delay and harass.

Aside from consent foreclosure, the new act mentions two other ways in which a mortgagee can obtain the property without a foreclosure sale. With the new act, Illinois statutory law for the first time refers to strict foreclosure, the centuries-old method of foreclosure long abolished in virtually all states. The new act states that it leaves undisturbed common law strict foreclosure "as in existence in Illinois on the effective date of this Article."<sup>73</sup> In strict foreclosure, the court sets a date by which the defaulting mortgagor must cure the debt or lose the property to the mortgagee. No sale is needed. By all accounts strict foreclosure is rarely used, despite the existence of a recent appellate decision that expressly sanctions the practice when the mortgagor is insolvent, the prop-

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73. Para. 15-1403.

erty is worth less than the debt, and the mortgagee waives any deficiency.<sup>74</sup> The Illinois Supreme Court has not reassessed strict foreclosure since state statutes first required judicial foreclosure decades ago, and the method's continuing validity remains in doubt. In practice, a court is unlikely to allow strict foreclosure unless the mortgagor has a reasonable chance to redeem. But when a reasonable redemption period is allowed and the above three requirements are satisfied, strict foreclosure seems consistent with the legislatively expressed goal of reducing the costs and delays associated with foreclosure.

The new statute also refers for the first time to the common practice of accepting a deed in lieu of foreclosure.<sup>75</sup> Significantly, the new law provides that the acceptance of a deed relieves the mortgagor and all others, including guarantors, from personal liability on the debt unless a person agrees to remain liable at the time of the deed.<sup>76</sup> As before, a deed in lieu of foreclosure does not affect the rights of other persons who claim interests in the property, including claimants holding interests junior to that of the mortgagee taking the deed. Because of this limit, a deed in lieu of foreclosure usually is attractive only when no junior interests exist. With junior interests present, consent foreclosure is the better approach.

### C. *The Plight of Junior Lessees*

A third new role for judges in the foreclosure process is in deciding whether foreclosure will terminate the rights of parties who hold leases that are junior to the lien being foreclosed. The old equitable rule was that a foreclosure automatically terminated any interest junior to the foreclosing lien, including a lease.<sup>77</sup> The holder of a junior interest was considered a necessary party to the foreclosure proceeding. His joinder was mandatory, and his termination automatic.<sup>78</sup> Equity also provided, however, that a junior party who was omitted from the foreclosure was unaffected by it because he had no chance to protect himself. This meant that a

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74. See *Great Lakes Mortgage Corp. v. Collymore*, 14 Ill. App. 3d 68, 302 N.E.2d 248 (1st Dist. 1973).

75. Para. 15-1401.

76. *Id.*

77. The general rule is discussed in G. NELSON & D. WHITMAN, *supra* note 3, at § 7.12. The confused Illinois law prior to the new Act is considered in Gearen, Vranicar & Becker, *Into Harms' Way: Now that Harms v. Sprague Has Established the Lien Theory of Mortgages in Illinois Does Foreclosure Cut Off Junior Leases or Can a Mortgagee Elect to Preserve Them?*, 34 DE PAUL L. REV. 449 (1985).

78. See G. NELSON & D. WHITMAN, *supra* note 3, at § 7.12.

junior lease survived foreclosure if the lessee was omitted as a party.<sup>79</sup> The question that arose in several states was whether a mortgagee could intentionally omit a junior lessee and thereby achieve the survival of a lease that the mortgagee found advantageous.<sup>80</sup>

Illinois courts never examined the issues surrounding junior leases, and the issues remained open.<sup>81</sup> The new act now resolves them. The act virtually eliminates the concept of necessary parties by requiring the mortgagee to join as defendants only those people who are liable on the debt.<sup>82</sup> Junior claimants of all types can be omitted. At the same time, the mortgagee has broad discretion to join anyone interested in the property or in the debt, including any guarantors on the note.<sup>83</sup> A person who is not joined as a party or as a nonrecord claimant, however, is not bound by the judgment and retains his interest in the property and his equitable redemption rights. Thus, the normal incentive to join all interested parties remains.

The new act expressly allows a mortgagee to omit a junior lease holder and thereby to ensure that the foreclosure has no effect on the lease.<sup>84</sup> By omitting a lessee, the mortgagee can maintain the validity of an advantageous lease. On the other side, however, a junior lessee under the act has the unqualified right to join on its own motion.<sup>85</sup> When this happens, the court's work begins. The IMFL provides that a lessee's appearance in the action "shall not result in the termination of the lessee's interest unless specifically ordered by the court in the judgment of foreclosure."<sup>86</sup> In other words, it is up to the court to decide whether the lease does or does not survive. Unfortunately, the statute says no more. The statute gives no guidance on the factors that courts should consider or the test that they should apply.

In some cases the answer will be clear. The reason for the old rule specifying termination of junior leases was to protect the mortgagee against leases entered into by the mortgagor, subsequent to

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79. See Gearen, Vranicar & Becker, *supra* note 77, at 454.

80. The view of various states on this issue are considered in Gearen, Vranicar & Becker, *supra* note 77, at 452-59.

81. See *id.* at 459-85.

82. Para. 15-1501(a).

83. Para. 15-1501(b).

84. Para. 15-1501(d).

85. *Id.*

86. *Id.* It is not clear from the statute whether this rule applies when the mortgagee joins the junior lessee as well as when the lessee is omitted and joins on his own motion.

the mortgage, at less than fair market value.<sup>87</sup> In such a case, the mortgagee should certainly be able to demand that the lease end. On the other hand, sympathies shift to the lessee if the property has deteriorated in condition or if the lessee has unsatisfied complaints against the lessor. The lessee in these instances perhaps should have the right to terminate. If the mortgagee wants to continue the lease, the mortgagee, as new lessor, should be obligated to respond fairly to past complaints.

Two common junior lease situations will prove difficult for courts to resolve. One situation is when the lease terms are fair when entered but later, because of changed conditions, become clearly favorable to the lessee. The other situation is when the lease terms are fair but the lessee has constructed costly leasehold improvements and faces loss of the improvements if the lease is terminated. In each case the lessee stands to lose, and the party buying at the foreclosure sale is given a strong position to renegotiate a higher rent. If the new owner terminates the lease, the lessee will have a valid claim against the old lessor for breach of its implied covenant of quiet enjoyment.<sup>88</sup> But this claim offers little solace if the old lessor is insolvent. A particularly cautious lessee also might enjoy the protections of leasehold title insurance. But these policies are rarely purchased, particularly by small businesses. In the more common case, leasehold termination will cause the lessee a sizeable loss. The court must decide whether the lessee will bear the loss.

Although both situations involve similar losses for the lessee, it is possible to distinguish them on equitable grounds. In the case of expensive leasehold improvements, the foreclosure sale purchaser (usually the mortgagee) stands to gain a windfall if he can terminate the lease or renegotiate above-market terms. If the lease is already at fair rental value, the new owner should have little cause to complain about the lease, and it seems unfair to empower the lessor to force concessions from a lessee who wants to protect the improvements and to avoid the disruptions of relocation. On the other hand, the new owner has a complaint if the property taken over is saddled with a below-market lease, even if the lease was fair and honest when begun. In that case, the new owner should have the power to terminate.

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87. The competing interest of the mortgagee and lessee are considered in Gearen, Vranicar & Becker, *supra* note 77.

88. See R. CUNNINGHAM, W. STOCKBUCK & D. WHITMAN, *THE LAW OF PROPERTY* § 6.31 (1984).

In these cases, courts should decide based on fairness to the parties. A new owner should have the unqualified option to discontinue a below-market lease, even if the lessee loses because of it. The new owner, however, should not have the power to extract concessions if the lease is fair. A new owner should have the right to terminate a fair junior lease only in the special case in which the owner wants to make use of the property personally. In close cases, courts should favor the new owner over the lessee. After all, the lessee knew or should have known of the mortgage when executing the lease. The mortgagee, on the other hand, likely had no control over the terms of the junior lease. If the mortgagee possessed the contractual right to approve or disapprove the lease when it was executed, a court might rightly be far more sympathetic to the lessee.

Courts should have an easier time dealing with the cases in which the lessee is the one who wants to terminate the lease and the new owner wants its continuance.<sup>89</sup> If the dispute simply is financial, the new owner should be favored. The lessee typically should have no reason to complain about a simple change in the identity of the land owner-lessor, and should have no right to terminate an unfavorable lease simply because the first lessor has lost the property. On the other hand, if the identity of the lessor is important, a more difficult issue is presented. In general, a court should require a lessee to continue a lease only if the new lessor is willing and able to perform the lease fairly and fully. "Fairly and fully" should mean that the lessor abides by all of the lease terms, including purchase options granted to the lessee, and not just those terms that "run with the land" under the old common law rules on running covenants.<sup>90</sup> A new owner, therefore, should either accept a lease entirely or reject it. The old rules on running covenants are confused, dated, and little known today. Courts would do better to ignore them and to fashion some compromise between the new owner and lessee that makes sense on equitable grounds.

This new role for judges can be a burdensome one, with guide-

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89. Some states take the view that foreclosure automatically terminates a junior lease, even if the tenant is not joined, an approach that gives the mortgagee-probable purchaser no options. *See id.* at 455-56. One suggestion has been that the junior lessee should have the option of being bound by the lease or treating it as terminated. This approach, according to its proponents, "would tend to encourage pre-foreclosure settlement of lease problems between the lessee and the mortgagee-probable purchaser and would discourage manipulations of traditional foreclosure concepts." G. NELSON & D. WHITMAN, *supra* note 3, at § 7.12.

90. The rules on running covenants are considered in R. CUNNINGHAM, W. STOEUBUCK & D. WHITMAN, *supra* note 88, §§ 8.13 - 8.33.



lines more or less nonexistent. Most courts, no doubt, will seek to avoid the problem by pressuring the parties to negotiate a settlement. In this setting, modest pressure makes sense. But in the end, courts must stand ready to resolve the dispute and to spend the time necessary to achieve a fair result.

#### IV. THE NEW SALE PROCESS

The centerpiece of the new mortgage foreclosure act is the lengthy new section describing the flexibility that courts now have in setting the terms of the foreclosure sale. The new statute provides that the judgment of foreclosure can include, *without limitation*, the following terms: (1) a manner of sale other than public auction; (2) who shall conduct the sale (if other than a judge or sheriff); (3) provisions for exclusive and nonexclusive broker listings; (4) brokerage fees "to be paid out of the sale proceeds;" (5) matters of exceptions to which title in the real estate may be subject at the sale; (6) a requirement for title insurance; (7) whether bids subject to contingencies will be allowed; and (8) "other matters as approved by the court to ensure sale of the real estate for the most commercially favorable price."<sup>91</sup>

The court's flexibility virtually is unlimited. The introductory language to the section states that these special matters can be included in the judgment "if sought by any party in the complaint or by separate motion."<sup>92</sup> The section also states, however, that it does not limit "the general authority and powers of the court."<sup>93</sup> The latter language suggests that courts have full flexibility in setting sale terms, even in the case of an uncontested foreclosure. A court need not accept sale terms proposed by one party, and can insert sale terms even if the foreclosing mortgagee seeks simply a normal public auction on unconditional, cash terms.

The new law provides for the possibility that the purchaser at the foreclosure sale will pay in installments if so authorized by the judgment of foreclosure.<sup>94</sup> When the first installment is paid, the purchaser receives a receipt, not a certificate of sale.<sup>95</sup> Under section 15-1508, the court can confirm a sale even though the entire purchase price has not yet been paid. At the time of confirmation the purchaser is entitled to a certificate of purchase. Only when all

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91. Para. 15-1506(f).

92. *Id.*

93. *Id.*

94. *See* Para. 15-1507(e) (by implication).

95. *Id.*

of the purchase price has been paid can the purchaser claim a deed.<sup>96</sup>

The possibility of installment payments creates the opportunity for confusion and for possible unfair treatment of mortgagees. Read literally, the statute seems to allow a court to approve a sale on installments, even over the objection of the foreclosing mortgagee. If the price is paid in installments, the mortgagee will be forced to wait for his money. At times the mortgagee might accept this and even desire it, particularly if an installment sale presents the only real opportunity to sell the property at a reasonable price. In other settings, however, the mortgagee might object, especially when the delay is substantial. What should a court do if a mortgagor proposes an installment sale at a high price, a price that will generate some residual money for the mortgagor, and the mortgagee desires a quick cash sale that covers the mortgage debt but returns nothing to the mortgagor? The issue will be a difficult one to resolve, and the statute, as expected, provides no guidance. Fairness, of course, will be the guiding principle, but it is a principle that often points vaguely. In all likelihood, courts will consider seriously only installment options that provide for payment in a year or less, absent the consent of the mortgagee.

Even when an installment period is short there will be tough questions about who really owns the property while the installments are being paid. Three parties have plausible claims to ownership: the mortgagor, the mortgagee, and the purchaser. The mortgagor's claim seems the weakest since a sale logically terminates all rights in the property except in the unusual case in which there is a right to receive some of the future installments. The mortgagee should retain an interest to the extent of the unpaid debt. Illinois mortgage law, however, adheres to the lien theory of mortgages, and never views the mortgagee as the owner of the property.<sup>97</sup> Almost by default, the purchaser's claim is likely to be the strongest, even though the purchaser receives legal title only after all the installments are paid.<sup>98</sup>

Presumably the purchaser will be viewed as the owner, despite the absence of legal title, at least if the purchaser has taken possession. But there must be limits to the purchaser's ownership. If the

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96. Para. 15-1509(a).

97. See *Harms v. Sprague*, 105 Ill. 2d 215, 473 N.E.2d 930 (1984); Gearen, Vranicar & Becker, *supra* note 77, at 485-88.

98. Under the doctrine of equitable conversion, the purchaser is considered the equitable owner of the property as soon as the contract is signed. See *Shay v. Penrose*, 25 Ill. 2d 447, 185 N.E.2d 218 (1962).

purchaser voluntarily or involuntarily transfers any interest in the property before completing payment, that interest should terminate in the event legal title does not transfer to the purchaser. Other problems can also arise if the purchaser defaults on the installment contract, and a court will want to retain jurisdiction over the action so that it easily can enter appropriate orders. Overall, the problems are not insurmountable, but they likely will seem sufficiently imposing to discourage courts from approving contested installment sales except in unusual cases.

One tricky issue that will arise relates to the use of brokers to assist in bringing about a good sale price. Brokers typically want brokerage contracts that guarantee them a commission if they produce a ready, willing, and able buyer, regardless whether the sale is consummated.<sup>99</sup> What happens if, after a broker obtains a desirable bid, the court rejects the bid, or if before the bid is accepted the mortgagor exercises his redemption right? Can the broker demand a commission out of the ultimate sale proceeds, and must the mortgagor pay the commission as part of the expenses of redemption? The statute is unclear, but the language dealing with commissions does refer to payment out of the proceeds of the sale.<sup>100</sup> Courts might want to establish, as a rule, that all brokerage contracts used must provide for payment of the commission only if the bid is accepted and the contract performed, with no commission due in other circumstances.

Courts will also want to look over other terms of the brokerage agreements as well as the process used to select brokers. Mortgagees who propose the use of brokers naturally will want to select brokers they know and trust, but opportunities clearly exist for favoritism and for brokerage terms that unduly favor the broker. After all, the whole purpose of a sale is to provide a chance for the defaulting mortgagor to recoup some of his equity if the sale proceeds exceed the debt. The mortgagee has no incentive to achieve a sale at more than the debt, and might well be encouraged to aid a friendly broker by agreeing to a brokerage commission with slanted terms. Courts, therefore, should use care in approving the use of brokers. They might want to announce, for example, that brokerage contracts must both provide for listing of the property with multiple listing services, if they exist, and allow for splitting the commission fairly with selling brokerage firms.

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99. See, e.g. *United Investors, Inc. v. Tsotsos*, 132 Ill. App. 3d 175, 477 N.E.2d 40 (1st Dist. 1985); *Beider v. Eugene Matanky & Associates, Inc.*, 55 Ill. App. 3d 354, 371 N.E.2d 29 (1st Dist. 1977).

100. Para. 15-1506(f)(5).

This survey of the new sale process only begins to suggest the problems that can arise when courts are vested with complete flexibility in setting the foreclosure sale terms. In reality, courts lack the time to contemplate the best method of selling each parcel. Yet courts cannot in fairness abdicate the task and consent to whatever the mortgagee proposes absent some particularized objection by the mortgagor. The court's primary roles are to supervise the process and to protect the interests of the mortgagor. If that job is not done, the reason for judicial involvement disappears.

As noted above, Illinois could have joined the many states that have chosen to allow private sales under power-of-sale foreclosure clauses.<sup>101</sup> That process saves time before the foreclosure sale, but typically allows mortgagors the chance to complain if a sale is not conducted fairly.<sup>102</sup> Mortgagees who conduct private sales do so as quasi-trustees for the mortgagor, and their efforts are subject to attack on numerous grounds after the sale if the process has turned sour.<sup>103</sup> Under the new Illinois statute, the mortgagor presumably will have no cause to challenge the sale so long as it occurred according to the detailed order of foreclosure. If the process is to work equitably, the court must perceive the problems in the stack of filed papers and tailor a decree that will work. If this is not done, the resulting process will be far worse than the private sale option, upon which the legislature sought to improve.

One option for courts, and indeed for the entire Illinois judicial system, will be to study the problem in general and engage in a bit of *de facto* rulemaking. Courts can fashion standard terms for foreclosure sales, terms that they can follow in routine cases absent some persuasive objection by a party. They can formulate standard sale decrees covering the principal different types of property commonly sold at foreclosure sales, including such terms as acceptable brokerage terms, acceptable listing methods, and acceptable contingencies and financing terms. Standard decrees, formulated in advance, can help handle the routine cases while saving time for those cases requiring greater scrutiny.

A further, more modest problem with the sale process is the apparent conflict between sections 15-1506 and 15-1507 of the new act. The first section grants to courts the flexibility described above. The latter section, however, states plainly that all property shall be sold at a judicial sale (absent a consent foreclosure or strict

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101. See *supra* note 16 and accompanying text.

102. See G. NELSON & D. WHITMAN, *supra* note 3, §§ 7.1 - 7.32.

103. See *id.* §§ 7.21, 7.22.

foreclosure), apparently in a traditional auction format. It seems likely that section 15-1506 will be deemed to override section 15-1507, and that the section 15-1507 judicial auction procedures will be followed only if not inconsistent with the specific sale procedures established by the court in the judgment of foreclosure.

## V. OTHER NEW CONFUSIONS

The new mortgage foreclosure act creates some further difficulties, largely unrelated to the new burdens placed on foreclosure courts. These further difficulties are worthy of brief examination before undertaking an assessment of the wisdom of the general direction that Illinois has taken in the new act.

### A. Redemption Rights and Waivers

Aside from the new rules on foreclosure sales, the IMFL will be noted most for the significant changes it makes in the redemption rights of the various parties who claim interests in the foreclosure property. To appreciate the changes, it is helpful to begin with a review of the old redemption rules. Under the old scheme, the mortgagor, and any other party who stood to lose an interest in the property as a result of the foreclosure, could redeem the property *prior* to the foreclosure sale under the equitable doctrine of redemption.<sup>104</sup> The statute did not regulate or even mention this equitable right and process. *After* the sale, the redemption rules were more complex. Generally, all parties affected by the foreclosure had six months after the sale in which to redeem.<sup>105</sup> In certain rare cases involving successive redemptions, the redemption period could extend even further.<sup>106</sup> In several ways the period could be shortened:

(a) *Waiver*. If the mortgagor was a corporation or a corporate trustee, the mortgagor could waive its redemption rights under two statutory provisions.<sup>107</sup> The effect of the waiver was to bar all statutory redemption rights, except that a judgment creditor had a right to redeem within three months after the sale.

(b) *Deteriorated property*. The mortgagee could shorten the redemption period by proving that the value of the property was less

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104. See, e.g. *First Nat'l Bank v. Hans*, 143 Ill. App. 3d 1033, 493 N.E.2d 1171 (2d Dist. 1986); G. NELSON & D. WHITMAN, *supra* note 3, at § 7.2; Note, *Foreclosures, Redemptions, and Homeowners*, 1975 U. ILL. L. REV. 335, 337-39.

105. ILL. REV. STAT. ch. 110, paras. 12-122 (1985) (repealed in part).

106. ILL. REV. STAT. ch. 110, para. 12-135 (1985).

107. ILL. REV. STAT. ch. 110, paras. 12-124, 12-125 (1985) (repealed).

than ninety percent of the unpaid debt and by agreeing to waive any deficiency.<sup>108</sup> If this occurred, the redemption period for all claimants was reduced to three months, except that judgment creditors still had six months in which to redeem.

(c) *Consent foreclosure.* A special rule applied when the mortgagor agreed to hand the property over to the mortgagee in full satisfaction of the debt. In this case, all parties, including judgment creditors, had three months thereafter in which to redeem.<sup>109</sup>

The new law has a similar scheme but contains shortened periods of redemption. For the most part, redemption periods run before the foreclosure sale, which means that they are concurrent with the old, and continuing, equitable rights of redemption. As importantly, only the mortgagor has the redemption rights set forth in the statute. The statutory rights formerly held by junior lien holders, judgment claimants, and others have all been abolished, and these parties can now redeem only before the foreclosure sale by exercising their equitable redemption rights.

In general, the mortgagor's redemption right under the new law extends until the *later* of (1) six months after commencement of the foreclosure action and (2) three months after the judgment of foreclosure.<sup>110</sup> In the case of a mortgage of property that is residential at the time of the foreclosure, the six-month period is extended to seven months.<sup>111</sup>

These six and seven-month redemption periods, as noted, are designed to run before the sale takes place. Section 15-1507, the principal section dealing with sales, requires that the sale be delayed until that time. The effect of this delay, however, is to render the statutory redemption rights much less meaningful than at first appears. Before the sale, mortgagors, and all other interested parties, have a right to redeem equitably. The statutory right, then, gives them nothing that they did not already possess. Only if the sale is held prematurely will these basic statutory rights give the mortgagor a chance to redeem after the sale. Nonetheless, the statutory rights are helpful in a limited way, for they have the effect of delaying the foreclosure sale, even in uncontested cases. Even if the mortgagor defaults in the action, the sale cannot occur for six or seven months after the action is begun and three months after the foreclosure decree is entered. The mortgagor, therefore,

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108. ILL. REV. STAT. ch. 110, paras. 12-126 (1985) (repealed).

109. ILL. REV. STAT. ch. 110, paras. 12-127 (1985) (repealed).

110. Para. 15-1603(b).

111. *Id.*

has at least that long to redeem, whether the redemption is done under the statute or under the older equitable right.

In two instances the six- or seven-month redemption period can be shortened so that it terminates at the *later* of the end of the reinstatement period and sixty days after the judgment of foreclosure. One instance is when the value of the property is less than ninety percent of the amount required to redeem and the mortgagee waives all right to a deficiency. The other instance is when the court finds that the mortgaged property has been abandoned.

The new law does create one special statutory right of redemption that extends beyond the foreclosure sale. Under section 15-1604, the mortgagor of *residential* real estate can redeem within thirty days after confirmation of the foreclosure sale if (1) the mortgagee bought at the sale, and (2) the sale was for less than the amount needed to redeem.<sup>112</sup>

One possible source of confusion under the new law is created by the old provision in the civil procedure code that gave judgment creditors the right to redeem the property.<sup>113</sup> This provision was modified by the new law but not repealed. As modified, the section states simply that a judgment creditor can redeem within three to six months after a sale. Presumably, based on changes made to other retained portions of the civil procedure code, that section is now meant to have continued application only to sales conducted as a result of judgment liens, and not to foreclosure sales conducted under the new law. If applied literally to foreclosure sales, it seriously would disrupt the new law's aim of minimizing post-sale redemption periods. The language of the section, however, leaves considerable room for confusion.

The new law provides for the first time a procedure for a mortgagor to follow in exercising his right of redemption. Among other steps, the mortgagor must give fifteen business days' notice of an intent to redeem.<sup>114</sup> What is not clear is whether the notice merely need be given within the statutory period or whether the redemption itself must occur within the time period. The statute is silent, but it seems likely that courts will choose the former interpretation. It also is not clear whether the new procedures will apply when a mortgagor or other party exercises an equitable right of redemption. Since the statute almost entirely ignores the equitable

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112. Para. 15-1604(a).

113. ILL. REV. STAT. ch. 110, paras. 12-132 (1987).

114. Para. 15-1603(e).

redemption right in all particulars,<sup>115</sup> it seems proper that this particular section should have no application to equitable redemptions, despite policy grounds that might counsel for an alternative interpretation. Certainly a party should not be penalized for failing to follow the statutory redemption procedures until their applicability to equitable redemptions is established.

One of the most important new rules on redemption is a provision dealing with extensions and stays of the redemption period.<sup>116</sup> The new section states that a court cannot revive a statutory redemption period that has expired. It also states that any stay in the enforcement of a foreclosure judgment or sale will not extend the statutory redemption period. Yet, the section recognizes that a court does have the power to stay the running of the redemption period, and provides that a mortgagor will have at least a thirty day redemption period after the stay ends.<sup>117</sup> The statute is silent as to the grounds upon which a court may rely in issuing a stay. Despite its brevity and superficial complexity, the section conveys a clear meaning: courts can exercise their equitable rights to delay a sale if appropriate, but they cannot interfere with a sale once it has taken place.<sup>118</sup> Clearly the desire of the drafters was to eliminate any chance of post-sale redemptions<sup>119</sup> in hopes that the foreclosure sale then would bring a higher price. With this goal in mind, courts presumably should be reluctant to revive an *equitable* redemption right after a sale has taken place, although the statute does not appear to restrict their ability to do so when equity demands it.

The new law expands considerably the circumstances in which a mortgagor can waive his rights of redemption and reinstatement. The new scheme has differing rules based on whether the property is residential, agricultural or other. In the case of residential property, a mortgagor can waive both his redemption and reinstatement rights if a foreclosure action has begun *and* the mortgagee has

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115. The statute refers to the equitable redemption right only once. See Para. 15-1605 (noting that the equitable right of redemption cannot be enforced *after* the foreclosure takes place).

116. Para. 15-1605(c).

117. Para. 15-1605(c)(2). Under the old law, courts claimed the right to allow redemption after the statutory period expired when equity seemed to require it. See, e.g., *Mutual Life Ins. Co. of New York v. Chambers*, 88 Ill. App. 3d 952, 410 N.E.2d 962 (1st Dist. 1980).

118. A court can interfere by staying the tolling of the special 30-day post-sale redemption period for certain residential mortgagors.

119. The drafters did, as noted, provide for a brief post-sale redemption right for certain residential mortgagors. See *supra* note 112 and accompanying text.



waived all rights to a deficiency.<sup>120</sup> With agricultural property, the mortgagor can waive his redemption rights in the same circumstances as the residential mortgagor; in addition, waiver is permissible if the mortgagor is a corporation or a trust run by a corporate trustee.<sup>121</sup> In all other cases, waiver of redemption rights freely is allowed, either in the mortgage or later.<sup>122</sup> Presumably a waiver is binding on a mortgagor's successors and assigns, although the express language on this point contained in the old law<sup>123</sup> was not reiterated.

The new rules on waiver, although largely clear and understandable, are in two respects beset by serious interpretive difficulties. The first is that the statute is silent on the ability of nonresidential mortgagors to waive their *reinstatement* rights. The absence of express authority to waive suggests that no power to do so exists, at least prior to commencement of the foreclosure action, but this issue is unclear. More importantly, the statute does not seem to have any application to the waiver of *equitable* rights of redemption. On its face, the statute is unclear on whether a valid waiver under the statute operates to release equitable, as well as statutory, rights. The old law expressly stated that the waivers being authorized were waivers of redemption "from sale," meaning that they had no application to equitable rights operating before the foreclosure.<sup>124</sup> The new law deletes the words "from sale," a deletion that arguably should be given meaning. Yet courts so strongly favor redemptions and so jealously guard redemption rights that the statute probably will be given a narrow reading, and only statutory rights will be eliminated.

If this interpretation is correct, the new waiver rules at first glance seem to be surplus, except for the portions dealing with waivers by residential mortgagors and waivers of reinstatement rights. As noted, only certain residential mortgagors have a right to redeem after a foreclosure sale.<sup>125</sup> Thus, nonresidential mortgagors seemingly have given up nothing by waiving the statutory rights of redemption because they still can redeem equitably during the same period. By waiving, that is, the nonresidential mortgagor has simply released one of two concurrent redemption rights. If waivers were indeed this meaningless in such a broad category of

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120. Para. 15-1601(c).

121. Para. 15-1601(b), (c).

122. Para. 15-1601(b).

123. ILL. REV. STAT. ch. 110, paras. 12-124, 12-125 (1985) (repealed).

124. *Id.*

125. See *supra* note 112 and accompanying text.

cases, courts might be prone to reinterpret the statutory section on waivers so that it applies to equitable as well as statutory redemption rights. By doing so, they would be vesting the section with greater meaning.

In fact, however, applying the waiver provision only to statutory redemption rights does not make sense. A waiver of statutory redemption rights does have an effect: It removes the requirement, contained in section 15-1507, that the sale be delayed for at least six or seven months. When statutory redemption rights are waived, the sale can occur more quickly, even though the mortgagor retains full rights to redeem equitably until the sale. In this light, the suggested interpretation makes considerable sense, and courts should feel confident in embracing it.

No similar interpretive difficulties arise in the case of waivers of reinstatement rights, for these waivers do have obvious effects. Reinstatement rights are entirely a product of the statute.<sup>126</sup> When they are waived, no equitable rights exist to fill the gap, and the mortgagor is left only with the right to redeem.

### B. Guarantors

For the first time, mortgagees now can join guarantors of the secured debt in the foreclosure action and obtain deficiency judgments against them.<sup>127</sup> Joinder is optional, and the guarantor must be named in a separate count in the complaint. In most parts of the state, joinder will save time and expense by eliminating any need for the mortgagee to bring a separate action against the guarantor.

One problem that will arise when guarantors are joined stems from the guarantor's right to demand a jury trial on the issue of liability.<sup>128</sup> In foreclosure actions, juries are not used, and many courts in foreclosure actions are not equipped to empanel juries. The problem is particularly clear in Chicago, where law and chancery matters are heard by separate judges and where foreclosure actions frequently are adjudicated in courtrooms that lack the physical space for jurors.

The drafters of the new statute anticipated this difficulty, but concluded that the courts could find solutions. Procedures differ

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126. See G. NELSON & D. WHITMAN, *supra* note 3, at § 7.7.

127. Para. 15-1501(b)(5).

128. See *Abingdon State Bank & Trust Co. of Abingdon v. Bulkeley*, 312 Ill. App. 16, 37 N.E.2d 873 (1941). Under prior law, a personal judgment could not be entered against a guarantor in a foreclosure action. See *Farmer City State Bank v. Champaign Nat'l Bank*, 138 Ill. App. 3d 847, 486 N.E.2d 301 (1st Dist. 1985).

considerably around the state, and the best procedural method for respecting the guarantors' jury trial right could vary. In Chicago, chancery judges likely will sever counts brought against guarantors and refer them to the law courts to adjudicate. Because actions at law in Chicago are far slower in coming to trial, claims against guarantors likely will remain unresolved at the time of the foreclosure sale. Elsewhere, judges might well empanel a jury to resolve the issues on which a jury trial right exists, either before or after the trial on the main foreclosure issues. Whatever procedure is used, judges will need to ensure that they do not resolve issues in chancery in such a way as to deprive the guarantor of his constitutional jury trial right.

### C. *Future Advances Lending*

The new statute also undertakes to resolve some of the complicated issues that are generated when a lender makes future advances on a loan that is secured by a mortgage.<sup>129</sup> The principal question that arises is whether the later advances have a priority as of the date of the mortgage or as of the date that they are made.<sup>130</sup> This question arises often in construction lending, and will arise more frequently in the future given the rising popularity of "home-equity" mortgages that secure revolving credit lines.

The principal pre-existing Illinois statute on the subject provides that a future advance will take priority from the date of the mortgage only if the advance occurs within eighteen months of the mortgage or if the advance is made pursuant to a commitment made by the lender during this period.<sup>131</sup> By enacting this statute, Illinois joined the ranks of the states that distinguish between advances that are optional with the lender and those that are obligatory.<sup>132</sup> The Illinois statute is quite distinct, however, in that it gives an early priority to all advances made during the eighteen month period, even if optional.

The new statute builds on this older statute. The new act states clearly that advances made more than eighteen months after a mortgage is recorded are a lien as to subsequent purchasers and

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129. Para. 15-1302.

130. The date that the advances are made will often be after intervening liens and interest have attained, particularly mechanics' liens.

131. ILL. REV. STAT. ch. 30, para. 37(a) (1985). This statute is ably considered in Benfield, *The Future Advances Lender: Status Under Present Illinois Law and Under ULTA and USOLTA*, 1981 S. ILL. U. L.J. 451, 455-59.

132. See G. NELSON & D. WHITMAN, *supra* note 3, at § 12.7; Benfield, *supra* note 131, at 453-54.

judgment creditors only from the time such monies are advanced and are applied unless made pursuant to a commitment.<sup>133</sup> The eighteen-month general rule of retroactive priority applies only as against "subsequent purchasers and judgment creditors,"<sup>134</sup> which means, apparently, that it provides no priority guidance when the intervening interest is held by a secured lender or a mechanics lien claimant. This omission will continue to trouble lenders. In one respect the act does add a helpful clarification. It states that an advance made after the eighteen-month period will be considered an obligatory advance made pursuant to a commitment only if the commitment is entered into in the mortgage or in a separate instrument contemporaneous with and referred to in the mortgage.<sup>135</sup> Under the old statute, it seemed possible that the commitment to advance more money could be made at any time during the initial eighteen-month period.<sup>136</sup>

The new future advances section specifies several important situations in which optional advances made more than eighteen months after recordation will relate back in priority to the date of original recordation. Monies advanced under a reverse mortgage<sup>137</sup> or under a revolving credit arrangement<sup>138</sup> will be a lien from the date that the mortgage is recorded, even though they occur more than eighteen months after recordation. The statute does not so provide, but presumably the advances will retain this early priority only if the total secured indebtedness remains below the maximum loan amount specified in the recorded mortgage. The recorded mortgage should serve to put later lenders on notice as to the maximum amount of indebtedness secured by the mortgage. In light of this notice rationale, a lender should be unable to increase the maximum amount of a credit line or alter the terms of a reverse mortgage, and then claim that the increased indebtedness should all hold a priority of the original recordation date. If a different rule applied, a mortgagor who executed a revolving credit or reverse mortgage loan would find that no lender was willing to take a junior mortgage on the property, regardless of the apparent

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133. Para. 15-1302(a).

134. *Id.*

135. *Id.*

136. See Benfield, *supra* note 131, at 456-59.

137. Para. 15-1302(b)(2). A reverse mortgage is a mortgage in which the outstanding principal increases for a period of time because the mortgagor during the period pays less than the amount of accruing interest.

138. Para. 15-1302(b)(3). A revolving credit arrangement is a situation in which the mortgage secures a maximum loan amount or line of credit that the borrower typically can draw upon and repay repeatedly during the loan term.

amount of the mortgagor's equity. A prospective lender will view a junior mortgage as worthless so long as the principal amount of the senior mortgage can be increased at will.

As further exceptions to the eighteen-month rule on optional advances, the new act provides that the recordation date is the priority date for all interest that accrues on the loan,<sup>139</sup> as well as for all monies advanced by the mortgagee (1) to preserve or restore the mortgaged real estate, (2) to preserve the lien of the mortgage or the priority of the lien, or (3) to enforce the mortgage.<sup>140</sup>

#### D. Nonrecord Claimants

The new statute largely continues the old procedure by which a mortgagee could bind known holders of unrecorded interests in the mortgaged property.<sup>141</sup> A mortgagee could bind these nonrecord claimants to the results of a foreclosure action simply by sending notice of the action to their last known address. The mortgagee was not required to join them personally as defendants nor was he required to make a diligent search to determine their present locations. Under the new law, the same process can be followed.<sup>142</sup>

The lack of any change in this process is surprising, because the process is now subject to substantial constitutional challenge under the 1983 United States Supreme Court decision, *Mennonite Board of Missions v. Adams*.<sup>143</sup> Due process now requires that a diligent effort be made to send notice to any person whose interest in foreclosed property will be lost as a result of a foreclosure action. In the absence of a diligent search, a nonrecord claimant might well assert successfully that his interest is unaffected by a statutorily correct foreclosure action.

### VI. CONCLUSION: ASSESSING THE NEW JUDICIAL ROLES

On its face, the new Illinois mortgage foreclosure act places important demands on judges handling foreclosure actions. Many of the demands are new; others are held over from the prior statute. Judges must determine when foreclosure under the new law is required, particularly in cases involving installment land contracts

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139. Para. 15-1302(b)(4).

140. Para. 15-1302(b)(5).

141. Paras. 15-1210, 15-1502. The old rules were set forth at ILL. REV. STAT. ch. 110, paras. 15-105 - 15-107 (1985) (repealed).

142. Para. 15-1502.

143. 462 U.S. 791 (1983) (notice by publication and posting fails to provide mortgagee with minimum notice required by the Fourteenth Amendment in a proceeding to sell mortgage real estate for nonpayment of taxes).

and collateral assignments of beneficial interests in Illinois land trusts. They must decide when a mortgagor who has exercised the right to reinstate can reuse that right within the following five-year period. They must decide when consent foreclosure can proceed over the objections of the holder of a junior interest in the property. They must decide when foreclosure will terminate a lease that is junior to the mortgage being foreclosed. They must decide when reinstatement rights can be waived and when reinstatement and redemption periods should be stayed. They must decide how best to protect a guarantor's constitutional right to a jury trial without unduly complicating the foreclosure process. And, they must decide the enigmatic priority issues that arise out of future advances lending. They must do all of these things, and they must do them with essentially no statutory guidance.

Above all else, however, judges now must implement the important new rules that give them flexibility in determining how foreclosure property should be sold. They must determine when property should be listed with a broker and when financing and title contingencies should be accepted. They must decide when a private auctioneer will be helpful, and when an installment sale makes the best sense. They can, of course, sit back and await prompting by mortgagees and the occasional mortgagor. They can insert novel sale terms only when and as proposed by one party or the other. But the act will best serve its function if judges take a more active role. Foreclosure sales will bring the most money only if judges take an active interest in the process and devise sale methods that can achieve that goal.

Realistically, these burdens on judges may be excessive, particularly in counties in which the foreclosure burden is heavy. Judicial time is tight, and the judicial temperament is inclined to resolve only those specific issues presented by the parties. If the parties do not object to a traditional auction, the auction likely will occur. If a parcel is best sold by a broker or subject to a title insurance commitment, perhaps the parties should so determine and advise the court. Judges are not in the real estate marketing business, and, even with strong market knowledge, reasonably cannot examine the attributes of each foreclosed parcel and tailor the sale process accordingly.

Perhaps at bottom the issue raised by the new foreclosure sale rules is whether lending institutions will step forward in foreclosure actions and use the new sale methods in ways that benefit hapless mortgagors. Will mortgagees actually use the new sale

processes to push up sale prices? Evidence will soon provide an answer to these questions, but it is reasonable to assume that some change will occur. Mortgagees are the first to benefit when foreclosure sales approach market prices. Once they gain familiarity with the new range of options, self-interest should motivate them to act flexibly and to tailor sale procedures sensibly. But the self-interest of mortgagees can only move the process so far. Mortgagors are most at risk when their property, if properly sold, could bring them some return of equity. And it is precisely in this situation, however atypical, that a mortgagee will be most content with a traditional auction at which the mortgagee can buy the property at the price of the debt. Property in hand, the foreclosing mortgagee can sell it and retain the profits. Realistically, perhaps, mortgagors will benefit from the new sale methods only if possessed of the savvy and resources needed to look after themselves. They must engage competent legal counsel to push for more vigorous sales methods. In the absence of pushing, judges will be inclined by the rush of business to do little.

As lawyers and mortgage lenders work with the new act, foreclosure sales might yield higher prices, and more foreclosure property might pass directly to buyers other than mortgagees. If evidence of this type accumulates, the legislature presumably will call its experiment in flexibility a success. But it is hard to imagine that mortgagors will benefit except in the unusual case. Deficiency judgments might dwindle a bit, but mortgagors likely will find foreclosure checks in their mailboxes no more often than today. If gain comes from the act, mortgagees can expect to receive the bulk of it.

In the end, mortgagees are unlikely to act unilaterally in a way that merely aids the mortgagor. Mortgagors must protect themselves, and must do so before the foreclosure sale occurs. They must take advantage of the new sale methods, and must push for sale terms and procedures that will enhance recovery. If mortgagors do not do so, they can hope only that judges will find the time to help them. They can hope only that judges will expend the effort to examine generally the foreclosure sale process and to develop sale methods that can increase sale prices. They must hope that judges will act unilaterally and speak out when auctions seem particularly ill-suited to bring a fair yield. If judges can scrape together the time to do this, the new act might achieve the legislature's goals and yield benefits for the many mortgagors unable fairly to defend themselves.