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TODAY’S PREDATORY LENDING TACTICS REQUIRE NEW STRATEGIES — AND NEW LAWS: HOW A CASE FROM CHICAGO HELPED CHANGE ILLINOIS LAW

by Daniel P. Lindsey and Lea A. Weems

Two years ago, Effie Knight changed everything.

Before Effie, our project attorneys spent most of their time representing homeowners in foreclosure. Most of our clients had been caught up in predatory loans: (too) easily available subprime loans whose terms our clients did
not understand and which they could not afford. These clients were in over their heads and facing foreclosure. We filed claims on their behalf under the Truth in Lending Act, the Illinois Interest Act, the Illinois Consumer Fraud and Deceptive Business Practices Act, and other state and federal laws. These were our classic “predatory lending” cases. The goal was to reduce our clients’ mortgage debt and refinance them into smaller, affordable loans.

Oh, for those simpler times.

Two years ago, Effie Knight walked into our office and presented us with a new, more complex type of predatory lending. Effie wasn’t facing foreclosure: she was being evicted. If we didn’t do anything, she would lose her home in weeks, not months. She would have no chance to refinance her mortgage debt, no chance to sell her home, no chance to receive a surplus at judicial sale. Instead, she would be evicted, lose all of her equity and walk away with nothing.

Effie was just the beginning. We began getting more and more calls from people who were being evicted from the homes they had owned and lived in for 10, 20, 30 years. While there are variations on the theme, the pattern is the same. Foreclosure rescuers buy lists of homeowners being sued in foreclosure. The rescuers send out mass solicitations to these homeowners promising to save their homes. Enticed by this promise, the homeowner meets with the rescuer and enters the rescuer’s “program.” Invariably, the program involves some form of sale-leaseback with an option to repurchase. The homeowner conveys title to a third-party investor (or “straw buyer”), makes monthly payments and retains the option to buy the property back after a set period of time (usually one or two years).

In the vast majority of cases these deals fail because the homeowner never reacquires title. This is not surprising, given the homeowners’ initial financial distress, the fact that the new monthly payments are often unaffordable and the fact that the repurchase price is almost always unaffordable.

It is also common that the deal is greased with vague promises of credit repair. The result is almost inevitable – the homeowner defaults on the monthly payments or on the agreement to repurchase and faces eviction (or foreclosure on the new mortgage loan taken out by the investor to “buy” the property).
As a result, the rescuer and investor end up with the homeowner's equity, either taken out of the property at the time of the investor's new loan, or through resale of the property. That is why this phenomenon is often called "foreclosure equity-stripping."

In short, the rescuers do not do any real underwriting to make sure that the deal is financially sound. They simply offer the deal and play on the hopes and fears of desperate homeowners while knowing they will profit greatly if the deal fails.

Sometimes it is even worse. Homeowners are misled as to the nature of the program and do not even realize they are conveying title. Documents are forged or signed in blank and filled in later. False statements are made as to the amount of the monthly payments or repurchase price. Material facts are omitted; for instance, that the investor is going to encumber the property with a new, higher mortgage, or resell the property to someone else. This is why, though the term "foreclosure equity-stripping" is apt, we use the term "foreclosure rescue fraud."

Whatever the variation on the theme, the clients we see are losing both their home and their remaining home equity—typically between $50,000 and $100,000.

EFFIE WAS ONLY THE TIP OF THE ICEBERG

Since Effie, we have screened and consulted with private attorneys on hundreds of these cases, and this is clearly the tip of the iceberg. Chicago is among those cities where the conditions have been ideal in creating a market for foreclosure rescue fraud. Three interrelated factors have combined to create a "perfect storm" in this area.

First, in the past 10 years, foreclosure rates have skyrocketed. In Cook County, the number of foreclosures increased from just a few thousand in the early 1990's to more than 20,000 in 2006. This year, foreclosures are projected to rise higher still, to an all-time high of more than 30,000. New court calls and new judges have been added to the county foreclosure division as the court system struggles to keep up with the numbers.
Second, until recently, property values have continued to rise in the Chicago area. Thus, even though the past decade has seen a phenomenal growth in loan flipping and other practices depleting homeowners’ equity, a great deal of additional equity has been built up by rising land values.

What this means is that many of the thousands of foreclosures cases filed in Cook County involve properties where the value is significantly greater than the debt. This distinguishes Chicago from certain other markets where a much larger percentage of homeowners are “underwater” (i.e. the debt on the home exceeds its value). Thus, in the greater Chicago area, many homes in foreclosure are ripe targets for rescuers.

Third, and finally, foreclosure rescue deals have been made easy to finance – through the straw buyer’s new, higher loan – because of the boom in the subprime mortgage market.

Not coincidentally, during the same 15-year period during which foreclosure rates took off in Cook County, the national rate of subprime lending did as well. In the early 1990’s, the (too) easy credit known as subprime lending made up only 5 percent of the mortgage market, and the volume of subprime loans measured in the tens of billions of dollars.5

By 2006, subprime market share was more than 20 percent, and the volume of subprime loans exceeded $600 billion. This boom (now becoming a bust) had a lot to do with rising foreclosure rates; ironically, it was also of great help to foreclosure rescuers, whose straw buyers had no problem getting easy-access loans to fund rescue deals.

FIGHTING RESCUE FRAUD

As Effie and our many other rescue fraud clients have taught us, these cases are often three (or more) cases in one. We often have to: (1) defend the eviction case filed against our client, (2) defend the foreclosure case filed against the straw buyer when it defaults on its loan, and (3) file our own quiet title action. Sometimes there is also a bankruptcy or building court case involved. Motions to consolidate are common.
Our quiet title actions raise a number of common law and statutory claims that we use to challenge these transactions. At the core of our complaints is our claim that the “rescue transaction” is not a true sale, but rather an equitable mortgage.

The doctrine of equitable mortgage states that a “deed which on its face appears to be an absolute conveyance is to be considered a mortgage if it appears that the parties intended it to serve only as a security.” The intent of the parties is to be determined by consideration of any and all objective factors in order to do equity. Relevant factors include “[t]he relation of the parties, the circumstances surrounding the transaction, the appearance of the transaction, the adequacy of consideration and the situation of the parties after the transaction.”

The court properly considers the conveyance to be an equitable mortgage rather than an absolute conveyance when a desperate homeowner “sells” her home for half of its value to a rescuer, whose pitch from the beginning is to help the homeowner save her home from foreclosure. In order to avoid foreclosure, she remains in her home making monthly payments—all with the expectation that she will improve her credit and “buy” back her home in 12 months.

Courts in Illinois and elsewhere are upholding this claim of equitable mortgage. The result is that title is restored to the homeowner, who owes the straw buyer an equitable mortgage debt (i.e., the true monetary benefit conferred to the homeowner).

Our cases begin with the equitable mortgage claim, but they do not end there. If the transaction is an equitable mortgage, then it is covered by the Truth in Lending Act, 15 U.S.C. §1501, et seq (“TILA”). TILA requires numerous disclosures (annual percentage rate, finance charge, amount financed, total of payments and payment schedule), as well as notice of a three-day right to cancel.

If such terms are not properly disclosed and such notice is not given (as they never are in foreclosure rescue cases), the equitable mortgage can be rescinded, creating a reduced debt amount owed by the homeowner to the straw buyer.
Other applicable claims include statutory and common law fraud, based upon fraudulent misrepresentations or omissions of material fact.\textsuperscript{14}

Sometimes rescuers prevent homeowners from realizing they are conveying title. Sometimes homeowners realize, but only at the last minute, when they reasonably feel they have no alternative but to go forward. Or, homeowners are led into the deal based upon false representations as to the monthly payments or buyback terms. And, in almost every case, there is a good argument that the rescue deal violates the Illinois Consumer Fraud and Deceptive Practices Act because it is inherently doomed to fail (i.e. re-conveyance of title to the homeowner is little more than a pipe dream).\textsuperscript{15}

Finally, other common law claims may apply, such as unconscionability, breach of fiduciary duty and unjust enrichment.

We have brought the above claims in a number of foreclosure rescue fraud cases. Some cases are still in litigation. In others, we have survived motions to dismiss and were able to settle. Clients have sometimes been able to stay in their homes by paying the straw buyer or rescuer an agreed upon equitable mortgage debt, in return for reconveyance of title. Other clients have not been able to keep their homes but have settled for some or all of the home equity they otherwise would have lost. In sum, we have been able to achieve good results for our clients based upon available theories of recovery.

And yet, as in many areas of the law, there are serious obstacles to recovery. Even when legal claims are available, not every victim of rescue fraud will find an attorney in time or find one she can afford. Because these are very complex and time-consuming cases, resources are a serious issue.

For these and other reasons, we began collaborating with the Office of Illinois Attorney General more than two years ago. We knew there was a need for state legislation to address this problem – not just to provide legal redress for victimized homeowners, but, even more important, to prevent fraudulent or unconscionable deals from occurring in the first place.

As the official enforcer of state consumer fraud statutes, the Attorney General’s Office had, predictably, begun to receive numerous complaints of foreclosure rescue fraud. These complaints became a clear priority for the Attorney General’s Office for several reasons, according to Tom James, Senior Assistant At-
torney General and Consumer Counsel with the Consumer Fraud Bureau of the Attorney General’s Office.¹⁶

Like us, the Attorney General’s Office saw an increase in the proliferation of rescue fraud as well as the push marketing targeting vulnerable homeowners. Second, foreclosure rescue fraud transactions are so complex that they are indecipherable to unsophisticated consumers who are desperate and would do almost anything to save their homes. Third, the subprime loan market fueling the foreclosure rescue industry was basically unregulated, with little to no underwriting. And finally, James said the Attorney General’s Office saw multiple victims in foreclosure rescue scams: (1) the homeowner, (2) the investor or straw buyer, who may have been told s/he was helping the homeowner by letting the program use her credit to get the rescue loan, and (3) the financial institutions that made the loans.

Seeing the need for a legislative response, the Attorney General’s Office began drafting proposed legislation using other states’ legislative efforts as a touchstone.¹⁷ Because foreclosure rescue fraud transactions are so complex, individual cases involving different victims and different rescuers are highly fact intensive, and the Attorney General’s Office did not believe that litigation solely under the Illinois Consumer Fraud and Deceptive Business Practices Act was adequate.

According to James, legislation to regulate rescue fraud was necessary because “you could chase individual rescuers until doomsday and never adequately address the flood of activity.”¹十八

In December 2005, Chicago Tribune reporter David Jackson shined welcome light on a host of interrelated mortgage fraud schemes in his ongoing series, “Mortgage Fraud: The New Street Hustle.”¹⁹ This series helped to galvanize the interest of state policymakers. Early in 2006, the Attorney General filed the first of several lawsuits against mortgage foreclosure rescuers.

Legislation was finally introduced in 2006 with input from many advocates, including the Attorney General and our office. The legislation, known as the Mortgage Rescue Fraud Act (“Act”), was introduced by Illinois State Senator Jackie Collins.
According to James, Senator Collins was a natural sponsor for the legislation because she has long been an anti-predatory lending advocate and because her district and those surrounding it have been heavily impacted by rising foreclosures and foreclosure rescue fraud. The legislation passed both houses and was signed into law by the Governor in June 2006.

The Act, which became effective on January 1, 2007, includes several protections. Among the key provisions are protection for residential property owners who are at risk of losing their homes because of foreclosure or nonpayment of taxes (or who are more than 90 days delinquent on any loan that is secured by the property) from the potentially unscrupulous behavior of “distressed property consultants” and “distressed property purchasers.” The Act also establishes contractual requirements for both distressed property consultants and distressed property purchasers to protect homeowners in these difficult financial situations. And the Act provides for both civil and criminal penalties for any party that violates the Act.

THE MORTGAGE RESCUE FRAUD ACT

A distressed property consultant is any person who solicits a homeowner, and in exchange for payment of a fee, offers to perform services to save the home, including stopping or postponing the foreclosure or tax sale; obtaining a forbearance agreement from the mortgagee; assisting the homeowner with reinstatement or redemption of the mortgage; obtaining an extension of time within which the homeowner may reinstate the mortgage; obtaining a waiver of the acceleration clause in a promissory note secured by a mortgage on the home; assisting the homeowner to obtain a loan or advance of funds; or avoiding or ameliorating the impairment of the homeowner’s credit resulting from the recording of a notice of default or the foreclosure or tax sale.

The Act requires that distressed property consultants use written contracts with homeowners that state the exact nature of the services to be provided along with the name, address and total compensation to be paid to the consultant. The contract also must include two form notices: (1) a notice that the consultant may not receive any money or ask for money until the services are completely performed and may not ask the homeowner to sign any lien, mortgage or deed; and (2) a notice that the homeowner has the right to cancel the consultant contract at any time until the consultant has performed every ser-
vice in the contract along with an address that the homeowner may mail the cancellation notice.\textsuperscript{27}

The Act also prohibits distressed property consultants from collecting or demanding any fee until all of the consultant’s promised services are fully performed; collecting or demanding any fee that exceeds two monthly mortgage payments or the most recent tax installment on the property, whichever is less; personally or through a subsidiary or affiliate, taking any sort of lien or other security interest in the property; taking any compensation from a third party unless it is first fully disclosed to the homeowner; taking any power of attorney from the homeowner for any purpose; and inducing or attempting to induce a homeowner to enter a contract that does not comply with the requirements of the Act.\textsuperscript{28}

The portion of the act that drew the most opposition, however, was the effort to regulate “distressed property purchasers” and “distressed property conveyances.” A distressed property consultant may charge an up-front fee of \$1,000 to offer bogus help arranging a workout with a lender. Paying such a consultant \$1,000 is usually tantamount to flushing it down the toilet, something a distressed homeowner can ill afford to do. Nonetheless, losing a bogus \$1,000 fee pales in comparison to loss of one’s home and \$50,000 to \$100,000 of home equity. That is the scale of harm resulting from the unregulated activities of distressed property purchasers.

**DISTRESSED PROPERTY PURCHASERS**

The Act defines a distressed property purchaser as “any person who acquires any interest in fee in a distressed property while allowing the owner to possess, occupy or retain any present or future interest in fee in the property, or any person who participates in a joint venture or joint enterprise involving a distressed property conveyance.”\textsuperscript{29}

A “distressed property conveyance” is defined by the Act as “a transaction in which an owner of a distressed property transfers an interest in fee in the distressed property; the acquirer of the property allows the owner of the distressed property to occupy the property; and the acquirer of the property or a person acting in participation with the acquirer of the property conveys or promises to
convey an interest in fee back to the owner or gives the owner an option to
purchase the property at a later date.\textsuperscript{30}

The Act requires that contracts with distressed property purchasers be in writ-
ing and be executed before the execution of any instrument conveying the
property.\textsuperscript{31} Contracts with distressed property purchasers also must include a
wide-ranging number of requirements, including:

- signatures of both the homeowner and the purchaser, dated, witnessed
  and notarized on a document containing every term negotiated be-
  tween the homeowner and the purchaser,\textsuperscript{32}
- a provision that the homeowner may terminate any lease back agree-
  ment at any time without liability;\textsuperscript{33} and
- a complete description of the terms of payment or other
  consideration.\textsuperscript{34}

In addition, contracts with distressed property purchasers must include certain
form notices such as a homeowner's five-day right to cancel the contract,\textsuperscript{35} and
a form notice explaining that the purchaser may not ask the homeowner to
sign any deed or other document until the right to cancel the contract has ended.\textsuperscript{36}

If title to the distressed property will be transferred as part of the transaction,
the contract must also include a form notice stating: "As part of this transac-
tion, you are giving up title to your home."\textsuperscript{37} Finally, the purchaser must
record the contract with the recorder of deeds within ten days of the contract
execution,\textsuperscript{38} and any lease entered into pursuant to the contract with the pur-
chaser is terminable at will by the homeowner without liability.\textsuperscript{39}

In addition to these contractual requirements, the Act imposes certain require-
ments on purchasers at two different stages of a rescue transaction: first, at the
inception of the transaction, when a homeowner and a purchaser enter a con-
veyance contract, and then, at the conclusion of the transaction, when a home-
owner repurchases the property.

When a homeowner and a purchaser enter a conveyance contract, the pur-
chaser must verify that the homeowner has the ability to pay for the monthly
lease payments and future re-purchase of the property before purchasing the
property.\textsuperscript{40} The purchaser must also purchase the property for at least 82
percent of the property’s fair market value or, in the alternative, pay off all existing obligations on the property and establish the cost of re-purchase at no greater than 125 percent of the amount of these payoffs.41

At the conclusion of the rescue transaction, if a homeowner is unable to repurchase the property, the Act requires a purchaser to make a payment to the homeowner so that the homeowner has received consideration in an amount equal to at least 82 percent of the property’s fair market value.42

VIOLATIONS AND REMEDIES

A violation of the Act constitutes an unlawful practice under the Illinois Consumer Fraud and Deceptive Business Practices Act ("CFA").43 A homeowner or consumer who suffers any loss by reason of a violation of the Act may bring a civil action under the CFA to enforce the Act.44 The remedies and rights provided under the Act are not exclusive and all other applicable claims, such as for equitable mortgage, are reserved under the Act.45

The Act also explicitly provides for criminal penalties for any violations of the Act. Any person who intentionally violates the Act commits the offense of criminal mortgage rescue fraud, a class 2 felony.46

WHAT DOES THE FUTURE HOLD?

No one is happier to see this law take effect than Presiding Judge Dorothy Kirie Kinnaird of the Chancery Division of the Circuit Court of Cook County who has presided over the Chancery Division during this recent period when foreclosure rates have skyrocketed.

Judge Kinnaird has done much to ensure that foreclosure defendants and victims of mortgage fraud are treated fairly in the court process, including being able to raise valid legal claims that would save their homes and home equity.

"We are seeing an increasing number of separate cases to quiet title or counterclaims to quiet title involving alleged mortgage rescue fraud," said Kinnaird. "We estimate that there are at least 150 such cases currently pending in the Chancery Division of the Circuit Court of Cook County. The Illinois Mort-
gage Rescue Fraud Act is important in assisting the Court in filling the heretofore legislative vacuum in resolving cases involving alleged rescue fraud.\textsuperscript{47}

It has now been about a year since the Act went into effect. At this point, most of the foreclosure rescue fraud clients contacting our office closed their deals back in 2004, 2005 or 2006. Thus, it is still too early to measure the full effect of the new law.

However, we have heard reports that several of our repeat defendants have stopped transacting these deals. This is probably attributable to a combination of factors: the Act, suits brought by the Attorney General and suits we and other attorneys have filed on behalf of individual homeowners. Nonetheless, the new statute appears to be one of the principal reasons—and perhaps the main reason—why some rescuers are no longer doing business.

At the same time, we know of at least a couple of rescuers who are still at work. If new rescue deals are closing in which the rescuers are complying with the law, then the law has achieved its purpose in protecting the affected homeowners.

However, we have seen several cases come through our doors where the rescue transaction closed in 2007, and where the deals do not comply with the new law. In one instance, the rescuer did not give any of the required procedural protections (e.g., required notices), nor did it comply with any of the substantive protections (e.g., ensuring that the monthly payments and repurchase price are reasonably affordable to the homeowner).

Indeed, one of the written disclosures provided by the rescuer indicates its knowledge that the homeowner probably could \textit{not} afford to buy the home back—good evidence for a summary judgment motion.

Since the Act preserves other claims, we will be filing our typical set of claims (including equitable mortgage), but we will also be suing to enforce the new law. As far as we know, this will be the first such lawsuit to do so.

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Home Ownership Preservation Project of the Legal Assistance Foundation of Metropolitan Chicago.

NOTES

1 Our client's name has been changed to protect her privacy.
3 Letter from Judge Clifford Meacham, Supervising Judge, State of Illinois Circuit Court of Cook County, Chancery Division, Chicago, IL (Apr. 6, 2007).
4 Id.
5 CBA Record, supra Note 2.
6 765 ILCS 905/5.
10 Aurora Loan Serv. v. Craddieth, 442 F.3d 1018, 1021, 1026 (7th Cir. 2006) (referring to homeowners' sale-leaseback transaction as 'alternative financing that would have enabled them to retain their home,' as a 'loan in the form of a sale,' and as 'the faux sale—really a loan—involved in this case.'); Moore v. Cycon Enter., No. 1:04-CV-800, 2007 WL 2375477 (W.D. Mich. Aug. 16, 2006) (entering summary judgment in favor of homeowner on equitable mortgage and Truth in Lending Act claims); Perry v. Queen, No. Civ. 3:05-0599, 2006 WL 481666 (M.D. Tenn. Feb. 27, 2006) (finding homeowner's sale-leaseback to be an equitable mortgage covered by the Truth in Lending Act); Rowland v. Haven Prop., No. 05-C-1957, 2005 WL 1528264 (N.D. Ill. June 24, 2005) (sustaining homeowner's claims that sale-leaseback was an equitable mortgage subject to the Truth in Lending Act); Hruby v. Larsen, No. Civ. 05-894, WL 1540130 (D. Minn. June 30, 2005) (injunctive relief granted based on homeowner's likelihood of success on merits of equitable mortgage and Truth in Lending claims); Hedges v. Swafford, 863 N.E.2d 881 (1nd. App. 2007) (affirming judgment, after trial, that sale-leaseback was equitable mortgage subject to rescission under the Truth in Lending Act).
12 12 C.F.R. §§ 226.18 and 226.23.
13 12 C.F.R. § 226.23.
14 Statutory fraud is alleged under the Illinois Consumer Fraud and Deceptive Business Practices Act, 810 ILCS 505/1 et seq.
15 In addition to prohibiting commercial deception, the Consumer Fraud Act prohibits commercial practices which are so inherently "unfair" as to be against public policy. Robinson v. Toyota Motor Credit Corp., 201 Ill. 2d. 403, 417-18 (2002).
16 Interview with Tom James, Senior Assistant Attorney General, Consumer Counsel, Consumer Fraud Bureau, Office of the Illinois Attorney General, Chicago, IL (Oct. 22, 2007) [hereinafter James interview].


James Interview, supra note 16.


James Interview, supra note 16.

There was little opposition to the law. One foreclosure rescuer testified against the law and managed to rally some opposition from “short sale” purchasers, but that opposition was blunted by adding language to the bill making explicit that which was already implicit, namely, that the law does not cover short sale purchasers (who negotiate a price less than what is owed on the outstanding mortgage, but who do not offer to sell the home back). There was a large amount of support for the bill—not just from consumer groups, but also from the industry (e.g., realtors, lenders), testimony to the fact that the bill regulates a particularly unscrupulous niche of the real estate industry.

765 ILCS 940/5.

765 ILCS 940/10, 765 ILCS 940/30.

765 ILCS 940/55, 765 ILCS 940/60.

765 ILCS 940/5.

765 ILCS 940/10.

Id.

765 ILCS 940/50(a).

Supra note 22.

Id.

765 ILCS 940/25.

Id.

765 ILCS 940/30.

765 ILCS 940/30(4).

765 ILCS 940/30(6), 940/40(a)-(b).

765 ILCS 940/30(7).

765 ILCS 940/30(8).

765 ILCS 940/40.

Supra note 31.

An evaluation of “reasonable ability to pay” under the Act must include debt to income ratio, fair market value of the distressed property, and the distressed property owner’s payment history. 765 ILCS 940/50(e). The Act establishes a rebuttable presumption that the distressed property purchaser has not verified reasonable payment ability if the distressed property purchaser has not obtained documents of assets, liabilities, and income, other than a statement by the owner of the distressed property. 765 ILCS 940/50(e).

765 ILCS 940/50(b)(2).

In addition, see 765 ILCS 940/50(b), the Act prohibits distressed property purchasers from representing to the homeowner that the purchaser is acting on behalf of the homeowner, acting as a consultant for the homeowner, or assisting the homeowner to “save the house” or “buy time,” 765 ILCS 940/50(b)(4); from accepting or recording title to the property until after the expiration of the homeowner’s right to cancel the purchase contract, 765 ILCS 940/50(b)(6); from failing to give the title back to the homeowner after the homeowner has fulfilled all the requirements for re-purchase of the property, 765 ILCS 940/50(b)(7); from entering into a conveyance contract with the homeowner where any party to the transaction is represented by power of attorney, 765 ILCS 940/50(b)(9); from failing to assume or pay off all liens or interests on the property immediately after the conveyance of the property, 765 ILCS 940/50(b)(10); and from causing the property to be conveyed or encumbered without the knowledge or permission
of the homeowner, or in any way frustrating the ability of the homeowner to complete the
conveyance back to the distressed property owner, 765 ILCS 940/50(b)(12).
43 815 ILCS 505/1 et seq., 765 ILCS 940/55(a).
44 765 ILCS 940/55(b).
45 Id.
46 765 ILCS 940/60, 940/65.
47 Interview with Judge Dorothy Kinnaird, Presiding Judge, State of Illinois Circuit Court of
Cook County, Chancery Division, Chicago, IL (Oct. 19, 2007).