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REAL PROPERTY

The newsletter of the Illinois State Bar Association's Section on Real Estate Law

The Harold I. Levine Memorial[1] caselaw update

By Steven B. Bashaw, Steven B. Bashaw, P.C., and Joseph R. Fortunato, Jr., Momkus McCluskey, LLC

MORTGAGE FORECLOSURE

MORTGAGE FORECLOSURE; COMMERCIAL REAL ESTATE AND APPOINTMENT OF RECEIVER:

One of the primary distinctions made between the treatment of residential versus non-residential property in the Illinois Mortgage Foreclosure Law is the differing statutory presumptions relating to possession and the appointment of a receiver or mortgagee in possession during the foreclosure proceeding. The statutory presumption relating to non-residential property is that under 735 ILCS 5/15-1701(b)(2), the lender is to be granted possession or the appointment of a receiver/mortgagee in possession on request if (a) the mortgage documents so provide upon a default and (b) there is a reasonable probability of the lender ultimately prevailing upon a final hearing; i.e., that there is a default. In that event, the burden shifts to the borrower to establish "good cause" why it should remain in possession in an evidentiary hearing. In *Centerpoint Properties Trust v. Olde Prairie Block Owner, LLC* (1st Dist., February, 2010), 398 Ill.App.3d 388, 923 N.E.2d 878, the borrower appealed the trial court's decision to appoint a receiver at the request of the Plaintiff lender. The

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Is there a new tax imposed on the sale of real estate under the 2010 Health Care Reconciliation Act? Not directly.

By Emily R. Vivian

One rumor circulating over the Internet is that the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (the "Act"), commonly known as the health care reform bill, imposes a new tax on real estate sales. The reform bill, however, does not directly impose such a tax. Rather, for certain individuals, it imposes a new 3.8 percent Medicare tax on "net investment income," which might result from a real estate sale. This tax applies to taxable years beginning after December 31, 2012. § 1402(a)(4) of the Act. The Act amends Subtitle A of the Internal Revenue Code of 1986 (the "Code") by inserting Chapter 2A after Chapter 2, and the changes to the Internal Revenue Code can be found in §1411, as added by the reform bill.

Before the reform bill was enacted, no Medicare tax was assessed on unearned income. Generally, unearned income consists of interest, dividends, annuities, royalties, rents and capital gains. While the reform bill will impose a Medicare tax on individuals, estates and trusts for unearned income, the tax will not apply to any distribution from a plan or arrangement described in IRC §401(a), 403(a), 403(b), 408, 408A or 457(b). IRC §1411(c)(5).

For individuals, the Medicare tax will be equal to 3.8 percent of the lesser of (a) net investment income for the taxable year or (b) the excess (if any) of the modified adjusted gross income

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The Harold I. Levine Memorial caselaw update

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mortgage being foreclosed secured a one-year promissory note in excess of $32 million that had matured relating to real estate that was to be developed for retail and hotel use near McCormick Place in Chicago. Upon the filing of the motion to appoint a receiver, the defendant filed a response alleging that the appointment would hamper the Defendant's efforts to refinance and develop the property and would interfere with a pending condemnation suit by the Metropolitan Pier and Exposition Authority that would presumably result in proceeds which would allow the redemption and resolution of the mortgage indebtedness. Additionally, the Defendant filed a counterclaim alleging that the mortgage was entered into under duress and that the lender had violated the Consumer Fraud Act in the inception of the loan. The Appellate Court opinion, in a detailed analysis, rejected each of the borrower's arguments. "First [Plaintiff] is authorized by the terms of the mortgage to take possession of the property in the event of a default…Second, because a proven default establishes a reasonable probability of success in a mortgage foreclosure action (citations), and [Defendant] has admittedly defaulted on its note, there is a 'reasonable probability that [Plaintiff] will prevail on a final hearing in this case. Therefore [Plaintiff] is entitled to possession…unless [Defendant] can establish good cause for permitting it to retain possession." The allegation that the borrower could more efficiently manage the property than the lender was rejected as insufficient "good cause" under the statutory presumption scheme and "such a requirement would be tantamount to shifting the burden of showing good cause onto the mortgagee." Likewise, a plea to weigh the harm caused to the borrower by the appointment of the receiver (due to the impact on the ability to refinance, develop and obtain tenants) against the harm that would inure to the lender if a receiver were not appointed (the property was largely vacant) was not "sufficient to overcome the statutory presumption in favor of placing the mortgagee in possession… If we were to hold that a mortgagor can establish good cause simply by showing that a receiver will make it more difficult to attract investors, lenders or buyers, it is likely that the exception would swallow the rule." The only circumstance the Court could envision which would establish sufficient good cause to overcome the statutory presumption in favor of the lender was if "the mortgagor presents evidence to the trial court that it has a commitment from an investor to provide funds for development of the property or it has obtained a loan from another lender to refinance…the transaction must be imminent and not merely a possibility at some unknown time in the future." The Court's decision also includes a discussion of the rules of interpretation of statutory presumptions and provisions and concludes with a finding that the trial court under these circumstances did not err in denying the borrower's request for an evidentiary hearing relating to the appoint of the receiver.

MORTGAGE FORECLOSURE; DECEASED MORTGAGOR, JURISDICTION AND SPECIAL REPRESENTATIVES

In *ABN AMRO Mortgage Group, Inc. v. McGahan, et al*, (Ill. S. Ct., June 4, 2010), 231 Ill.2d 577, 910 N.E.2d 1126, the Illinois Supreme Court held that a mortgagee must name a personal representative for a deceased mortgagor in a mortgage foreclosure proceeding in order for the trial court to acquire subject matter jurisdiction to enter a judgment in that proceeding. The Court reversed the First District Appellate Court, and upheld the reasoning set forth by Judge Simko in Cook County in two mortgage foreclosure cases, (*ABN AMRO v. McGahan* and *Charter One Bank v. Hunter*), which reasoning was originally espoused in the trial court's decision in the 2006 decision in *Wells Fargo v. McQueen*. The trial court's holding was that a mortgage foreclosure action is not an action *in rem*, in which the action is brought only against "property," but an action *quasi in rem,* in which an action is brought against a defendant personally "…with jurisdiction based upon an interest in property, the objective being to deal with the particular property or to subject the property to the discharge of the claims asserted." One of the pivotal differences between the two actions is whether the "defendant" is the property or a named person. A circuit court has jurisdiction *in rem* against real property by virtue of the location of the property in the county. In mortgage foreclosure cases, however, it is a

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person's rights in the property that are being foreclosed, based upon a default under the mortgage, and a person is the "instrumentality of the wrong…" Accordingly, a foreclosure is a *quasi in rem* proceeding and the trial court must obtain jurisdiction over the mortgagor as a necessary party under the Illinois Mortgage Foreclosure Law (735 ILCS 5/15-1501(a)(1)). Because a mortgagor is a "necessary party," personal service of process is necessary over the mortgagor in order for the court to obtain subject matter jurisdiction. If the mortgagor is deceased, and no jurisdiction is obtained over a representative of the decedent, the court lacks subject matter jurisdiction, and the action is void. (In order to obtain jurisdiction in these circumstances, Judge Simko suggested appointing a "special representative" pursuant to 735 ILCS 5/13-209(c)). The Illinois Supreme Court reviewed the history of *in rem* versus *quasi in rem* proceedings going back to 1886, treatises ranging from 1882 and Black's Law Dictionary to conclude that "Prior decisions from this court have inconsistently characterized a foreclosure as both *in rem* and *quasi in rem actions*." Noting that "None of these cases analyze the rationale for characterizing a foreclosure action as either *in rem* or *quasi in rem*. We do so now. Coming to the conclusion that the action is *quasi in rem,* because "In a foreclosure action, the property is not the defendant. Rather, the mortgagor, the person whose interest in the real estate is the subject of the mortgage, is a necessary party defendant," the Court reversed the decision of the Appellate Court below and specifically overruled the case law it relied upon, *Financial Freedom v. Kirgis*, (2007) 377 Ill.App.3d 107.

The implications of this decision in the current recession and extraordinary volume of pending foreclosure cases, (some of which are certainly involving deceased mortgagors), are dealt with in a forthcoming article by Kevin Hudspeth in the October 2010 *Illinois Bar Journal*, and emphasized by Helen Gunnarsson's sidebar "LawPulse" analysis. The author, a law clerk in the Cook County Chancery Division dealing with mortgage foreclosures on a daily basis, opines that a judgment of foreclosure in a case in which a mortgagor is deceased and a special representative is not appointed is void for lack of subject matter jurisdiction under the *McGahan* decision. The impact on the foreclosure procedure is obvious, but the resulting defect in the title to foreclosed property is potentially devastating. Foreclosed property is often bought at a sale and/or re-sold based on a perhaps mistaken belief that the title has been 'cleared' by the foreclosure. If the title coming out of the foreclosure, however, is void for lack of subject matter jurisdiction, a fatal flaw will result. Coping with the issue of whether there was a decedent mortgagor in the chain of title and lack of subject matter jurisdiction in the foreclosure where the plaintiff was thought to have extinguished liens on the property making it marketable may make many sleepless nights for our friends at the title companies.

MORTGAGE FORECLOSURE; EVIDENCE OF OWNERSHIP OF THE ORIGINAL NOTE

The Internet is awash with commentaries and blogs suggesting that desperate homeowners in foreclosure defend by demanding the Plaintiff be required to admit the original note into evidence at the time of judgment. The Illinois Mortgage Foreclosure Law (735 ILCS 5/15-1506(b) even requires that "In all cases the evidence of the indebtedness and the mortgage foreclosed shall be exhibited to the court and appropriately marked and copies thereof shall be filed with the court." Trial courts throughout the State have routinely ignored or misunderstood this aspect of foreclosure, but the recent Seventh Circuit Court case of *Patrick L. Cogswell v. Citifinancial Mortgage Company* (7th Cir., October 5, 2010), 08-2153, 2008 U.S. Dist. LEXIS 33334, may well change this attitude and should have a significant impact in the world of foreclosure litigation.

The case is not actually a foreclosure proceeding but an action for breach of contract by an investor against a lender to recover damages for breach of contract after an unsuccessful attempt to foreclose a mortgage without a note. Citifinancial began foreclosure proceedings in state court to foreclose a mortgage and note on residential real estate that it had acquired from Home Equity (although there was a gap in the chain of the mortgage assignments that failed to indicate how Home Equity acquired the mortgage). Patrick L. Cogswell, d/b/a The Patrick Group, offered to purchase the mortgage and note from Citifinancial, and an agreement was fashioned. At the closing of the transaction, Citifinancial did not have either the original mortgage or note to tender to The Patrick Group and only provided a copy of the mortgage and assignment of the mortgage. The Patrick Group then took up the foreclosure case in Citifinancial's place as Plaintiff, only to be denied in the state trial court when it could not provide it was the holder of the note. The trial court entered a directed verdict in favor of the borrowers and against The Patrick Group. The Appellate court affirmed noting that "under Illinois law only the holder of a note may foreclose on property; transferring a mortgage is not enough by itself to confer the right to foreclose upon property. See, e.g. *Moore v. Lewis*, 366 N.E.2d 594, 599, (Ill.App.Ct. 1977)." As a result The Patrick Group filed the instant proceeding against Citifinancial for breach of contract and damages. (The case, although initially filed in state court, was transferred to federal court based on diversity jurisdiction). The District Court granted summary judgment in favor of Citifinancial, finding as a matter of law that The Patrick Group failed to prove that the agreement of the parties included the transfer of the original note, and that the fact that the note was not turned over was not the proximate cause of the damages; the District Court held that Illinois law permitted foreclosure regardless of whether the Plaintiff is the holder of the note. The Seventh Circuit Court of Appeals reversed on both grounds.

First, the issue of what the parties intended to have transferred as their agreement that The Patrick Group would purchase the note was a question of fact, not of law, and summary judgment was improper when the issue was whether the parties' agreement required the surrender of the note or a copy of the note. Whether the parties intended the physical transfer of the note was a question of fact, not law, and therefore summary judgment was improper and reversed. The fact that Patrick Cogswell's affidavit stated that he requested the original note on several occasions after the agreement did not permit the Court to necessarily find that there was no agreement the note would be transferred. "Again, this is one possible interpretation of Cogswell's testimony, but it is not the only reasonable one; Cogswell might simply have been reminding Citifinancial of its promise."

The more important (from a practicing attorney's point of view in this area) holding of the Court was that the failure to turn over the original note was, indeed, the cause for The Patrick Group's damages because they were unable to foreclose as a result, leading to the logical conclusion that the case may be cited for the proposition that without the note, or at least a copy supported by a lost note affidavit, a Plaintiff can not foreclose. The Patrick Group argued that the directed verdict in the foreclosure case would not have occurred

had it had the original note or a copy of the note as it believed Citifinancial had agreed to provide to it. "These courts [the state trial and appellate courts] concluded that The Patrick Group failed to make out a prima facia case because it had not shown it was the 'note holder'." Noting that "This question turns on principles of Illinois mortgage foreclosure law. Generally speaking, only a mortgagee can foreclose on property and a mortgagee must be (at a minimum) 'the holder of an indebtedness…secured by a mortgage' 735 ILCS 5/15-1208. Under the Uniform Commercial Code, which Illinois has adopted, 810 ILCS 5/1-101 *et seq*, a key requirement to being a holder is physical possession of the note secured by the mortgage. See id. 5/1-201(b)(21)(a), defining a holder as 'the person in possession of a negotiable instrument that is payable either to bearer or an identified person that is the person in possession'.…It follows, then, that Citifinancial's failure to deliver the note or a copy to The Patrick Group caused the foreclosure action to fail." Additionally, although Citifinancial argued that The Patrick Group failed to mitigate its damages by providing the trial court with a lost note affidavit, the Seventh Circuit noted that "A lost-note affidavit from Citifinancial would not have conclusively established The Patrick Group's ability to foreclose on the mortgage." Rejecting the presumption that a plaintiff can meet its burden of proof as long as it can produce a lost note affidavit, the Court observed that in those cases where a lost note affidavit was accepted, the affidavits attach a copy of the note, something the Patrick Group could not do because Citifinancial did not provide even a copy of the note. "We are not aware of any case in Illinois in which a lost-note affidavit by itself was enough to prove ownership of the underlying debt…Thus, Citifinancial's ability to provide a lost-note affidavit if The Patrick Group had asked is simply a red herring…there remained the possibility that the note was actually held by another who would be entitled to enforce it against the property owners…Illinois law is clear that a mortgage may not be transferred unless the underlying debt is also transferred…and the normal rule under the Uniform Commercial Code is that a party may not enforce a negotiable instrument unless it has physical possession of the note."

Mortgages outside of the chain of Title; Recording in the wrong county

In *In Re Bulgarea*, (N.D. Il. BK, September 9, 2010), 2010 Bankr LEXIS 2811, a trustee's motion to avoid the mortgage of National City Mortgage Company on the debtor Bulgarea's residence provides some excellent analysis of the law that applies where a mortgage is improperly recorded. Here Goldstein, the Trustee, brought a motion for summary judgment on her adversary complaint alleging that because the real estate was located in McHenry County but the mortgage was mistakenly recorded in Lake County, the mortgage did not constitute a lien on the real estate. The Bankruptcy Code provides, importantly, that the Trustee has the status of a bona fide purchaser against all other persons in the situation where the Trustee seeks to avoid a transfer by application of state law. The Court here notes that "Under Illinois law, a mortgage is ineffective against a purchaser or creditor who lacks actual or constructive notice of it." There was no "record" notice here of National City's mortgage under the Illinois Conveyances Act, (765 ILCS 5/30) because the mortgage was recorded in the wrong county; i.e., Lake rather than McHenry County, where the property was located). The other form of notice analyzed, "Inquiry Notice" (which puts the burden of further investigation upon a purchaser or creditor), did not exist here because there was no indication in the correct public records in McHenry County that would suggest the National City Mortgage and even Bulgarea's deed was not recorded in McHenry County. Although an unrecorded deed is effective between the parties to the transaction upon deliver of the deed, other parties are only charged with notice of conveyances in the chain of title. The deed to Bulgarea was not in the chain of title, nor was the National City mortgage (both having been recorded in a different county), and "Because nothing would have put a judicial lien creditor or bona fide purchaser on inquiry notice of National City's mortgage, sections 544(a)(1) and (3) of the Code make Goldstein's interest in the property superior… ." ■

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1. Harold I. Levine was a defender of owners and mortgagors, a prolific writer and continuing education presenter, and, to a few very fortunate lawyers, a mentor and role model who passed away in 2003. He was a long-time volunteer for the Legal Assistance Foundation, the Center for Disability and Elder Law, as well as other legal service providers, and, most importantly, brought others to this important work. On more than one occasion, I had the honor of being on the opposite side of the counsel's table from Harold. He was a formidable opponent, always an advocate for his client, and always a gentleman. On a number of occasions, I had the pleasure of being on the opposite side of a dinner table from Harold. He was always a source of new ideas, a proponent of justice and equity, and…always a gentle friend. His dedication to his clients, worthy causes, and great contribution to the continuing education of attorneys is be sorely missed. He would be so very proud of our Supreme Court and Bar Associations if he had known we would have finally adopted minimum continuing legal education. In some small measure, the work of this man must be undertaken and carried on by those of us in our profession who shared his great caring and love for the law.

Is there a new tax imposed on the sale of real estate under the 2010 Health Care Reconciliation Act? Not directly.

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("MAGI") for the taxable year over the threshold amount. IRC §1411(a)(1). Net investment income is the amount by which gross income from interest, dividends, annuities, royalties, rents (other than such income derived in the ordinary course of a trade or business), other gross income derived from a trade or business described in IRC §1411(c)(2), and net gain attributable to the disposition of property other than property held in a trade or business not described in IRC §1411(c)(2) exceeds deductions properly allocable to the income. IRC § 1411(c)(1). In addition, the Medicare tax applies to a trade or business if it is either (1) a passive activity of the taxpayer (within the meaning of IRC §469), or a trade or business of trading in financial instruments or commodities (as defined in IRC §475(e)(2)). §1411(c)(2).

As used in IRC §1411, "MAGI" means adjusted gross income increased by the excess of (1) the amount excluded from gross income under §911(a)(1), over (2) the amount of any deductions or exclusions disallowed under §911(d)(6) with respect to the amounts described in (1) above. IRC § 1411(d). In addition, the threshold amount is $250,000 for a taxpayer filing a joint return or for a surviving spouse, $125,000 for a married taxpayer filing a separate return and $200,000 in all other cases. IRC §1411(b). If a person has MAGI that does not exceed the threshold amount, he or she will not be subject to the tax.

For example, suppose that in 2013, John, a single taxpayer, has MAGI of $190,000. Suppose further than he sells his principal residence, which results in a profit of $350,000 (after taking into account commissions and fees and the price he paid for the home). Because John is allowed to exclude $250,000 of gain from the sale of his principal residence, his net investment income from the sale of his house is $100,000. If this is the only net investment income John incurs in 2013, he will not be liable for the new tax because his MAGI does not exceed the $200,000 threshold.

If, however, John had MAGI of $250,000, he would be required to pay the Medicare tax on $50,000, because $50,000 is less than his net investment income of $100,000. That is, the Medicare tax would be $1,900 ($50,000 x 3.8 percent).

For estate and trusts, the Medicare tax will be equal to 3.8 percent of the lesser of (a) the undistributed net investment income for the taxable year or (b) the excess (if any) of the adjusted gross income for the taxable year over the dollar amount at which the highest estate and trust income tax bracket begins. IRC §1411(a)(2).

Because this new tax is not scheduled to take effect until January 1, 2013, Congress may make several changes, refinements and "clarifications" to this provision before it actually takes effect, especially in light of the recent elections. ■

ABN AMRO Mortgage Group, Inc. v. Nona L. McGahan, 2010 Ill. LEXIS 959, 2010 WL 2222126 (June 4, 2010)

By Richard F. Bales, Chicago Title Insurance Company, Wheaton, Illinois

Introduction

On June 4, 2010, the Illinois Supreme Court issued its opinion, stating that a mortgagee must name a personal representative for a deceased mortgagor in a mortgage foreclosure proceeding in order for the circuit court to acquire subject matter jurisdiction. This article will discuss the facts and ramifications of this case.

Facts of the Case

This appeal concerned two cases, *ABN AMRO Mortgage Group, Inc. v. McGahan* and *Charter One Bank v. Hunter*. Both cases contained similar fact situations.

ABN AMRO Case

ABN AMRO gave a mortgage to McGahan, who defaulted. ABN AMRO filed foreclosure proceedings and later found out that McGahan had died. Although ABN AMRO was granted leave to file a petition to name a personal representative on behalf of McGahan, ABN AMRO declined to do so. The circuit court then dismissed ABN AMRO's complaint pursuant to its order entered in the circuit court case, *Wells Fargo v. McQueen*, No. 05-CH 12846.

Wells Fargo v. McQueen

The facts of *Wells Fargo v. McQueen* are similar to those of *McGahan*. In *Wells Fargo*, the circuit court noted that generally speaking, a circuit court lacks subject matter jurisdiction when a lawsuit is filed against a deceased person because such a suit is a nullity. To avoid this situation and to confer jurisdiction on the circuit court, a plaintiff may proceed under section 13-209 of the Code of Civil Procedure and substitute the deceased party's personal representative.

This statute (735 ILCS 5/13-209(c)), provides as follows:

> If a party commences an action against a deceased person whose death is unknown to the party before the expiration of the time limited for the commencement thereof, and the cause of action survives, and is not otherwise barred, the action may be commenced against the deceased person's personal representative if all of the following terms and conditions are met:
>
> (1) After learning of the death, the party proceeds with reasonable diligence to move the court for leave to file an amended complaint, substituting the personal representative as defendant.
>
> (2) The party proceeds with reasonable diligence to serve process upon the personal representative.
>
> (3) If process is served more than 6 months after the issuance of letters of office, liability of the estate is limited as to recovery to the extent the estate is protected by liability insurance.
>
> (4) In no event can a party commence an action under this subsection (c) unless a personal representative is appointed and an amended complaint is filed within 2 years of the time limited for the commencement of the original action.

Wells Fargo argued, however, that this rule did not apply because foreclosure proceedings are *in rem* actions and it is unnecessary to name a human defendant, i.e., the mortgagor, in such actions.

The circuit court concluded that mortgage foreclosure proceedings were *quasi in rem* in nature and that thus, pursuant to the Illinois Mortgage Foreclosure Law (735 ILCS 5/15-1501), the mortgagor is a necessary party who has the right to defend against the action. Therefore, the circuit court determined that a lender is required to name a personal representative for a deceased mortgagor.

In light of the *Wells Fargo* ruling, the circuit court held in the *McGahan* case that because ABN AMRO failed to name a personal representative as a substitute for McGahan, the court lacked subject matter jurisdiction. Accordingly, ABN AMRO's complaint was dismissed.

Charter One Bank v. Hunter

The facts in this case are basically the same as those in the *McGahan* case. Again, pursuant to the circuit court's decision in the *Wells Fargo* case, the circuit court dismissed Charter One's complaint for lack of subject matter jurisdiction.

Both Charter One and ABN AMRO appealed and the cases were consolidated. No one appeared on behalf of the deceased mortgagors. However, the appellate court granted leave to the Chicago Volunteer Legal Service Foundation to file an *amicus curiae* brief in support of the trial court's decision.

The appellate court reversed and remanded, finding that this court has consistently labeled foreclosures as *in rem* actions. The Illinois Supreme Court granted the Foundation's petition for leave to appeal instanter as *amicus curiae*. The court later granted the Cook County public defender leave to file an *amicus* brief as well.

The Supreme Court's Discussion of *ABN AMRO Mortgage Group v. McGahan*

As noted above, Section 15-1501 of the IMFL (735 ILCS 5/15-1501(a)) indicates that a mortgagor is a "necessary party" in a mortgage foreclosure case. The IMFL does not suggest a course of action when the mortgagor is deceased. One would then normally look to the rules of civil procedure. However, both Charter One and ABN AMRO contend that this is not necessary, because mortgage foreclosure cases are *in rem* actions and that therefore, neither a deceased mortgagor's estate nor a personal representative needs to be named.

The court noted that the legal fiction underlying an *in rem* proceeding is that the "property" and not the "owner of the property" is liable to the complaining party.

On the other hand, a *quasi in rem* proceeding is an *in rem* action that affects only the interests of particular persons in a certain thing. Unlike an *in rem* action, a *quasi in rem* action operates only as between the parties to the proceedings.

In other words, in an *in rem* proceeding, the court determines rights to the property as against the whole world, but in a*quasi in rem* proceeding, the court determines rights to the property only in respect to specific in-

dividuals.

Prior decisions have characterized a mortgage foreclosure as both *in rem* and *quasi in rem* proceedings. Accordingly, the Illinois Supreme Court analyzed as follows:

One of the differences between *in rem* and *quasi in rem* actions is whether the defendant is the property or a named person. With *in rem* actions, the property is the defendant. In *quasi in rem* actions, a named party is the defendant.

In a mortgage foreclosure case, the property is not the defendant. Rather, the mortgagor is the defendant. The IMFL has deemed the mortgagor to be a necessary party to a mortgage foreclosure case. This means that in a foreclosure action, the proceeding must be brought against a named party. Therefore, a foreclosure action is a *quasi in rem* proceeding.

The court also noted that in a foreclosure case, the property did not cause the wrong, nor is the property responsible for the plaintiff's injury. The mortgagor is the person who caused the wrong. It is the mortgagor who defaulted on the mortgage.

Therefore, because the mortgagor is a necessary party in a foreclosure action, there must be personal service on the mortgagor.

In reaching a conclusion that a foreclosure proceeding is an *in rem* action, the appellate court relied on *Financial Freedom v. Kirgis*, 377 Ill. App. 3d 107, 877 N.E.2d 24, 315 Ill. Dec. 537 (1st Dist. 2007). This case also involved a lender filing a foreclosure case against a deceased mortgagor. In this case the appellate court held that a foreclosure case was an *in rem* action. The Illinois Supreme Court states in *McGahan* that "we reject *Financial Freedom*, and to the extent that decision and any statements in our prior cases are contrary to our holding here, they are hereby overruled."

Accordingly, the supreme court reversed the appellate court's decision and affirmed the judgment of the circuit court. That is, the supreme court stated that a mortgagee must name a personal representative for a deceased mortgagor in a mortgage foreclosure proceeding in order for the circuit court to acquire subject matter jurisdiction.

Analysis of the *ABN AMRO* decision

The court fails to apply existing statutory law in addressing the facts and issues of the case. For example, the court writes in its decision that IMFL does not indicate a course of action when the mortgagor is deceased. But is that really true? The court emphasizes the fact that Section 5/15-1501 of the IMFL indicates that a mortgagor is a "necessary party" in a mortgage foreclosure case. But Section 5/15-1209 of the IMFL defines mortgagor as "the person whose interest in the real estate is the subject of the mortgage and *any person claiming through a mortgagor as successor* [emphasis added]." Thus, one would think that serving the "heirs and legatees" of the deceased mortgagor personally if discovered by diligent inquiry or serving them by publication if not discovered would be a course of action that falls within the IMFL's purview. (In other words, pursuant to the rules of descent and distribution set forth in the Probate Act at 755 ILCS 5/2-1, the heirs or legatees of the decedent would be Section 5-1501's mortgagor).

Rather than insisting on the appointment of a personal representative, the supreme court could have followed the lead of the appellate court in *In Re Application of County Treasurer*, 216 Ill. App. 3d 162, 576 N.E.2d 255 (1st. Dist. 1991). This was a tax deed case. Here the court stated that the tax purchaser has an obligation to make a "diligent inquiry" to find and serve all owners and parties interested in the real estate. This includes naming the beneficiaries of the land trust in title when the recorded deed in trust indicates that the grantors of said deed are very likely the land trust beneficiaries.

The supreme court could have adopted similar logic. For example, the court could have said that when a foreclosing lender discovers that a mortgagor is deceased, it must make a "diligent inquiry" to determine, e.g., if the mortgagor's estate is being probated, and if so, to make the executor or administrator of the estate a necessary party to the foreclosure proceeding. But the court did not do this.

The court could have said that if the deceased mortgagor's estate is not probated, a court could obtain jurisdiction over the unknown heirs and legatees of the mortgagor by affidavit and publication pursuant to 735 ILCS 5/2-413. But the court did not do this.

Ultimately, the logic of the supreme court seems weak. The court goes to great lengths to stress the importance of the mortgagor as a necessary party to the mortgage foreclosure. At one point it opines that "the mortgagor is the instrumentality of the wrong. It was he or she who breached the contract by defaulting on the note secured by the mortgage." But the court's solution to the problem of the demise of the mortgagor—appointing a personal representative--seems to be of little real value in addressing the apparent concerns of this court.

Unanswered Questions

By not discussing the rights of the heirs and legatees of a deceased mortgagor, the supreme court left unaddressed several important questions and issues—questions and issues that title insurance companies will now have to analyze and underwrite. Consider, e.g., the following scenarios. (Note that different title companies may adopt different means of underwriting the issues presented in these examples).

Example 1: A owns the land and executes a mortgage in favor of Bank. Upon default, Bank files its foreclosure proceeding. A cannot be found for personal service, and so Bank cannot determine whether A is dead or alive. Did A simply abandon the property, or is A really deceased? There is no probate for A, and Bank does not know who, if anyone, would be A's heirs.

If it appears that A is indeed deceased, then Bank must obtain the appointment of a personal representative. Note that the *ABN AMRO* decision suggests that if the original mortgagor is deceased, all that the lender has to do is appoint a personal representative in order to go forward with the mortgage foreclosure. Despite this indication, the title company will probably ask that Bank discover A's heirs or legatees and include them in the foreclosure as necessary parties. if Bank cannot discover these parties, title companies will probably require that the foreclosing lender obtain jurisdiction over and publish against the possible heirs and legatees of A pursuant to 735 ILCS 5/2-413 and 735 ILCS 5/2-206 and 5/2-207.

What if the lender fails to obtain jurisdiction over these "unknown owners?" In that event, the title company will probably raise an appropriate title exception on any policy issued to the foreclosing lender. However, unless the public record discloses a probate of A's estate, the title company ought to be able to waive this exception pursuant to 735 ILCS 5/2-1401(e) when this lender sells the property to a purchaser for value.

On the other hand, if Bank, upon diligent inquiry, cannot locate A, but there is no indication that A is deceased, that it appears that A has simply abandoned the property, then it is possible that the title company will assume the risk that A may in fact be dead.

That is, if Bank furnishes the title company a written statement that A is not occupying the land being foreclosed, that it has looked for but cannot find A, that there is no probate of A's estate in the county in which the land is located, and that it has no reason to believe that A is deceased, the title company may agree to insure title through the mortgage foreclosure without requiring the appointment of a personal representative. (However, the title company will probably insist that Bank obtain jurisdiction over A pursuant to 735 ILCS 5/2-206 and 5/2-207). Thus, if A is indeed deceased, the title company will assume the risk of all consequences arising from the failure to appoint the personal representative when insuring the sale of the property to a purchaser for value.

In Bank's attempt to determine whether or not A is deceased, what would constitute a "diligent inquiry?" Bank should consider talking to A's neighbors, conducting an Internet search using such search engines such as Google in an attempt to locate A's online obituary (see also <www.arrangeonline.com>), and completing a Social Security Death Index search. (See <www.socialsecuritydeathindex-search.com>).

Similarly, what would be a "diligent inquiry" as to the possible existence of A's heirs and legatees? Again, Bank should talk to A's neighbors or conduct an Internet search.

Should A's personal representative be someone recommended by Bank or an impartial third party? The *ABN AMRO* decision offers no guidance in this regard. In addition, this opinion is silent as to the duties of this representative.

Example 2: A and B own the land as tenants in common and execute a mortgage in favor of Bank. After A's death, B defaults on the mortgage. Here, Bank must obtain the appointment of a personal representative for A. In addition, the title company will probably ask that Bank discover A's heirs or legatees and include them in the foreclosure as necessary parties. Again, if Bank cannot discover these parties, then the title company will probably insist that service be had by publication pursuant to 735 ILCS 5/2-413.

Example 3: A and B own the land as joint tenants (or tenants by the entirety) and execute a mortgage in favor of Bank. After A's death, B defaults on the mortgage. Here, Bank should not have to obtain the appointment of a personal representative for A. The title company will probably determine that B is the only necessary party.

Example 4: C is a junior secured creditor on land subject to Bank's prior mortgage. Bank initiates foreclosure proceedings and discovers that C died prior to the filing of the foreclosure case. There is no reason for a title company to require that Bank obtain the appointment of a personal representative for C. The *ABN AMRO* case is strictly confined to deceased necessary parties. Junior creditors are merely permissible parties. The title company will probably, however, require that Bank discover C's heirs or legatees and include them in the foreclosure as parties to the proceeding. Again, if Bank cannot discover these parties, then the title company will probably insist that publication be had against the possible heirs and legatees of these creditors.

Example 5: Title to the land is vested in A, as Trustee under the A Living Trust. A, as Trustee, executes a mortgage in favor of Bank. After default, Bank discovers that A died prior to the filing of Bank's foreclosure. Bank should not have to obtain the appointment of a personal representative for A. Instead, Bank should name as a party defendant and serve process on any successor trustee named in the trust agreement. If the trust agreement is silent or ambiguous as to trustee succession, or if neither Bank nor the title company have a copy of the trust agreement, then Bank should consult the title company for guidance. The title company may ask that Bank serve generally all unknown owners by publication.

Example 6: Title to the land is vested in an Illinois land trust. A is the beneficiary of this land trust. The land trust executes a mortgage in favor of Bank. After default, Bank discovers that A died prior to the filing of Bank's foreclosure. Bank should not have to obtain the appointment of a personal representative for A. Instead, Bank should simply name and serve this Illinois land trust.

Example 7: A owns the land and executes a mortgage in favor of Bank. Upon default, Bank files its foreclosure proceeding in federal court. Bank discovers that A is deceased. There is no probate for A, and Bank does not know who, if anyone, would be A's heirs.

Pursuant to *Erie Railroad v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817 (1938), the federal court would apply state substantive law and ask that a personal representative be appointed. However, the title insurance company would probably insist that the heirs and legatees of A be made necessary parties to the mortgage foreclosure. As these parties would be unknown, there would be no diversity jurisdiction under 28 USC Sec. 1332.

It seems clear that in this particular fact situation, Bank would be unable to foreclose its mortgage in federal court. The probable title company requirement of making the unknown heirs and legatees of A necessary parties to the mortgage foreclosure would be fatal to this federal court example.

Conclusion

Because there was no petition for a rehearing of this decision, this case now represents the law in Illinois. A lender must have a personal representative appointed when it discovers that the mortgagor against whom it is foreclosing is deceased. This representative can be appointed in one of two ways: One, the lender can open a probate estate and have a representative appointed; or two, the lender can petition the foreclosure court to have a personal representative appointed pursuant to section 13-209 of the Code of Civil Procedure.

The devil, though, is in the details—the details ignored by the supreme court. It is these details that title companies and real estate attorneys will wrestle with in the coming years. ■

The author acknowledges the assistance of Douglas M. Karlen, Regional Counsel, Chicago Title Insurance Company, in the preparation of this article.

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February

Tuesday, 2/1/11- Teleseminar—2011 Ethics Update, Part 1. 12-1.

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Friday, 2/4/11- Bloomington, Bloomington-Normal Marriott—Hot Topics in Agriculture- 2011. Presented by the ISBA Agriculture Law Section; co-sponsored by the ISBA Mineral Law Section. TBD.

Tuesday, 2/8/11- Teleseminar—Sophisticated Choice of Entity Analysis, Part 1. 12-1.

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Friday, 2/11/11- Chicago, ISBA Regional Office—ADR- Arbitration and Mediation Issues- 2011. Presented by the Civil Practice and Procedure Section. 9-4:15.

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Thursday, 2/24/11- Peoria, Hotel Pere Marquette—Family Law-Nuts & Bolts for Downstate 2011. Presented by the ISBA Family Law Section. TBD.

Friday, 2/25/11- Chicago, ISBA Regional Office—Developments in Wage and Hour Law and Employment of Foreign Workers. Presented by the Labor and Employment Section. 8:55-1:30.

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Monday, 2/28/11- Teleseminar—Family Feuds in Trusts REPLAY. 12-1.

March

Friday, 3/4/11 – Chicago, ISBA Regional Office—Dynamic Presentation Skills For Lawyers. Master Series Presented by the Illinois State Bar Association. 12:30-5.

Saturday, 3/5/11- Downer's Grove, Double Tree—DUI, Traffic and Secretary of State Related Issues. Presented by the Traffic Laws/Courts Section. 8:55-4:00.

Monday, 3/7/11-Friday, 3/11/11- Chicago, ISBA Regional Office—40 Hour Mediation/ Arbitration Training. Master Series Presented by the Illinois State Bar Association and the ISBA Alternative Dispute Resolution Section. 8:30-5:45 each day.

Wednesday, 3/30/11- Chicago, ISBA Regional Office—Why International Treaties Matter to Illinois Lawyers. Presented by the International and Immigration Committee. 12-2.

April

Friday, 4/1/11- Chicago, ISBA Regional Office—Military family Law Issues. Presented by the ISBA Family Law Section and the ISBA Military Affairs Section. TBD.

Friday, 4/8/11- Bloomington, Holiday Inn and Suites—DUI, Traffic and Secretary of State Related Issues. Presented by the Traffic Laws/Courts Section. 8:55-4:00. ■

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