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The newsletter of the Illinois State Bar Association's Section on Commercial Banking, Collections and Bankruptcy

Now Comes the Cold

BY JUDGE MICHAEL CHMIEL

We are now in the winter. Hopefully, this is the last winter of the pandemic! Chance are, however, we have merely slipped into a new world order, with this one involving things like healthier habits—habits that help us prevent the spread of germs, through things like masks, hand sanitizer, and distancing. Last week, as an attorney for a large insurance company said he actually preferred an in-person hearing on a motion for partial summary judgment in a coverage case. Why? Because as a trained attorney, he was constituted for personal interaction, including the give-and-take of the courtroom.

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Using 'Non-Lienability' as a First Tranche Attack to Defeat a Mechanic's Lien Case

BY ADAM WHITEMAN

The Illinois Mechanic's Lien Act grants to a contractor the right to place a lien on property in order to secure that contractor's right to obtain fair compensation for the value of services and materials that have been provided. There are times, however, when this process is abused or misapplied. For example, a contractor might record a lien knowing that it lacks a good faith factual basis, or a contractor might mistakenly place a lien on the wrong property.

It is incumbent upon the owner's attorney to attack an invalid lien at the earliest stages of the litigation. Ordinarily, the attorney will initially evaluate the lien in light of the pleadings and try

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Now Comes the Cold

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In this edition, we welcome back two long-time contributors, Adam Whiteman and Michael Weissman, with two commercial law offerings. We thank each for their contributions to our efforts.

As before and always, questions or comments on any of this, along with other relevant items for publication, are welcomed at mjchmiel@22ndcircuit.illinoiscourts.gov. Happy new year!■

Using 'Non-Lienability' as a First Tranche Attack to Defeat a Mechanic's Lien Case

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to determine if the foreclosure case can be dismissed on a 2-615 motion due to defects such as untimeliness or a failure to properly identify the contractor or owner. Sometimes, however, the defect of the claim does not immediately appear on the face of the complaint. Rather, some additional information must be provided that will reveal the truth of the matter. The problem is, one is not permitted to discuss additional facts in a 2-615 motion to dismiss. In this situation, an attorney should consider submitting the necessary facts by way of affidavits and filing a 2-619(a)(9) motion to dismiss asserting "non-lienability" as an affirmative matter barring relief. If the lien was filed for purposes of harassment, the motion will essentially call the contractor's "bluff." If the lien was filed incorrectly, then the motion will quickly make the relevant facts known permitting the case to be dismissed at an early stage of litigation.

The 2-619 Standard

The purpose of Section 2–619(a) "is to provide litigants with a method of disposing of issues of law and easily proved issues of fact— relating to the affirmative matter—early in the litigation. (citations) ...A motion for involuntary dismissal under section 2–619(a)(9) of the Code admits the legal sufficiency of the complaint, admits all well-pleaded facts and all reasonable inferences therefrom, and asserts an affirmative matter outside the complaint bars or defeats the cause of action. (citations)" *Reynolds v. Jimmy John's Enters, LLC*, 2013 IL App (4th) 120139, 988 N.E.2d 984, 370 Ill.Dec. 628 (Ill. App., 2013) ¶ 30.

As it happens, the question of "non-lienability" is an "affirmative matter" that may be raised in a 2-619 motion. The reason for this is that "[i]f successful, the defense of non-lienability raised in a motion to defeat a claim for foreclosure of a mechanic's lien would act to negate the cause of action completely. This result is clearly within the parameters of the statutory definition of 'affirmative matter.'" *Consumer Elec. Co. v. Cobelcomex, Inc.*, 501 N.E.2d 156, 159 (1st. Dist. 1986)

In Practice

Examples of fact patterns that may result in immediate dismissal could be (1) the failure of a lien claimant to provide a timely 90 day notice of lien or (2) attempts to lien work that was never completed or that relates to the wrong property.

Failure to Send a Timely 90 Day Notice

Section 24(a) of the Illinois Mechanic's Lien Act provides in relevant part:

> "Sub-contractors *** shall within 90 days after the completion thereof *** cause a written notice of his or her claim and the amount due or to become due thereunder, to be sent by registered or certified mail, with return receipt requested, and delivery limited to addressee only, to or personally served on the owner of record *** For purposes of this Section, notice by registered or certified mail is considered served at the time of its mailing."

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Thus, under Illinois law, "[t]o perfect a mechanic's lien claim, section 24 of the Act requires a subcontractor to "file a notice of lien claim within 90 days after `completion' of his work in order for the claim to be enforceable." *** Compliance with section 24's notice requirement is a "condition precedent to the cause of action." *Cordeck Sales v. Construction Systems*, 887 N.E.2d 474, 525 (1st Dist. 2008) (See also 770 ILCS 60/24(a) of the Illinois Mechanic's Lien Act (the "Act")) "Because the rights under the Act are in derogation of the common law, the steps necessary to invoke those rights must be strictly construed." (*Crawford Supply Co., v. Schwartz*, 919 N.E.2d 5, 12 (1st, Dist. 2009). "A mechanic's lien is valid only if each of the statutory requirements is scrupulously observed by the party invoking the benefits of the Act." *Pyramid Dev., LLC v. Dukane Precast, Inc.*, 40 N.E.3d 1185, 1191 (2nd Dist. 2014).

Look carefully at the complaint to see what facts the contractor plead to show timely notice. The mere assertion that the notice was "timely served" is a conclusion, not a fact. In Illinois, "It is axiomatic that when considering a motion to dismiss, all well-pleaded facts are admitted as true and all surplusage and conclusory allegations are disregarded *** Pleadings which state mere conclusions and characterize acts rather than set forth facts are insufficient to state a cause of action." *People ex rel. Roseman by Roseman v. Trachtman*, 487 N.E.2d 77, 80 (1st Dist. 1985) The assertion that a legally critical document was "timely served" without the pleading of facts proving timely service is a mere conclusion and is not a fact sufficient to support a cause of action based on timely service.

In practice, you can obtain an affidavit from your client in order to provide the facts showing, as an affirmative matter, that the contractor failed to comply with Section 24. Check to see if your client still has the envelope in which the lien was served. It may be stamped with a date showing when it was mailed. If that date stamp proves the lien was untimely, you will be well on your way to having established an affirmative matter that may defeat the lien claim.

Asserting a Lien for Work Not Done

A subcontractor can only have a lien for material and services it actually furnished to improve the real estate. (See 770 ILCS 60/1(a),(b)) Section 770 ILCS 60/7(a) of the Illinois Mechanic's Lien Act provides that labor and materials must "actually be used in the construction" and be "delivered" to the "owner." If you can prove, as an affirmative matter, that the work described on the lien claim was never provided, then you may be able to defeat the lien claim on a 2-619 motion. This could be as simple as an affidavit from the home owner which contains photographs showing that the work claimed to have been done was never actually completed.

In *Fedco Elec. Co., Inc. v. Stunkel.*, 395 N.E.2d 1116, 1118 (4th Dist. 1979), the court found a lien to be constructive fraud where the lien included charges for work for someone other than the property owner and where "[t]he effect of the overcharge was to give the appearance of greater encumbrance existing…than was actually the case." The "evidence required to establish constructive fraud may *** come in the form of an affidavit, signed by an agent of a contractor's company, which is attached to the mechanic's lien claim, and which falsely attests to the truth of overstatements and overcharges made by the contractor." *Father & Sons Home Improvement II, Inc. v. Stuart*, 52 N.E.3d 581, 592-593 (1st Dist. 2016) In *Father & Sons Home Improvement II, Inc.*, the court determined that there can be no lien when the allegations of fraud "are not merely based on overstatements or overcharges, but rather on patently false statements that plaintiff used to establish its right to a mechanic's lien in the first place." *Father & Sons Home Improvement II, Inc. v. Stuart*, 52 N.E.3d 581, 594 (1st Dist. 2016)

By way of example, if you can show that the contractor did not install a sink but has filed a lien for the installation of a sink, then you are well on your way to defeating the lien claim and even proving constructive fraud. The type of proof you can submit could be as simple as a photograph of a bathroom without a sink accompanied by the homeowner's affidavit attesting to the absence of a sink.

This scenario can also happen when a contractor has been hired to perform work on individual units as well as common elements of condominium property. According to The Illinois Condominium Property Act, "[n]o labor performed or materials furnished with the consent or at the request of a particular unit owner shall be the basis for the filing of a mechanics' lien claim against any other unit." (765 ILCS 605/9.1) Additionally, as regards liens arising out of construction on the common elements, each unit owner "shall be liable for the payment of his unit's proportionate share…" *Id.* In sum, a unit owner is only liable for lien relating to their own unit or as regards their percentage share of the common elements. Unscrupulous contractors or inattentive attorneys filing a mechanic's lien against a condominium unit may attempt to lien one unit for work done on another units or they may attempt to lien a single unit for a disproportionate share of work on the common elements. In such a case the attorney attacking the lien could gather proofs establishing that the work which is the subject of the lien was not performed in their client's unit and thereby have the lien dismissed on a 2-619 motion.

The Practical Effect of an Accurate 2-619

A well-drafted 2-619 motion attacking a contractor's lien can make opposing counsel realize that filing the foreclosure complaint was a huge mistake. If it is shown that the lien claim is bereft of any factual basis, the contractor's attorney will understand that they relied too much on what their client told them and too little on their own independent investigation. In the mechanic's lien world, this is a serious matter that could lead to sanctions.

"The duty imposed upon counsel is to make a reasonable inquiry into the facts to support a legal claim before pleadings are filed, not after." *Liddle v. Cepeda*, 623 N.E.2d 849, 852 (3rd Dist. 1993). In Illinois, "as a general rule, an attorney cannot simply rely on the client's verbal representations when the client has in his possession additional information bearing on the facts, or when the additional information is readily ascertainable from third parties." *Chicago*

Title & Trust Co. v. Anderson, 532 N.E.2d 595, 601 (1st Dist. 1988) Thus, "the attorney has an obligation to objectively review all information and if any discrepancies, inconsistencies or gaps appear, he must investigate further before filing…This duty to investigate does not stop at the filing stage. An attorney has a continuing professional duty to promptly dismiss a baseless lawsuit, even over his client's objections, when he learns he no longer has grounds for a case." *A & A Acoustics, Inc. v. Valinsky*, 559 N.E.2d 1180, 1185 (1st Dist. Ill.1982) "If a reasonable inquiry into the facts to support the pleading has not been made to ensure that facts are well-grounded, the party, the party's attorney, or both are subject to an appropriate sanction, including payment of the other party's attorney fees and costs." *A & A Acoustics, Inc. v. Valinsky*, 559 N.E.2d at 1184.

The mechanic's lien act itself permits the recovery of attorney fees when a lien claim is brought without just cause or right. Specifically, Section 770 ILCS 60/17(c) and (d) of the Illinois Mechanic's Lien Act provides that:

> "(c) If the court specifically finds that a lien claimant has brought an action under this Act without just cause or right, the court may tax the claimant the reasonable attorney's fees of the owner who contracted to have the improvements made and defended the action, but not those of any other party.
>
> (d) "Without just cause or right", as used in this Section, means a claim asserted by a lien claimant or a defense asserted by the owner who contracted to have the improvements made, which is not well grounded in fact and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law."

A successful 2-619 motion showing the absence of a factual basis for the underlying lien could, pave the way to an award of attorney fees under 77 ILCS 60/17 of the Mechanic's Lien Act.

A well-drafted 2-619 motion can help to make opposing counsel the strongest advocate for your attack of the lien claim. Opposing counsel might come to realize that their own client was not truthful about the facts underlying the claim. Most attorneys, recognizing their duty to speak truth to the court, will then want to bring the matter to a swift and certain resolution. ■

Adam Whiteman is an attorney maintaining a real estate and commercial litigation practice in Chicago Illinois. He is currently serving as the pier appointed secretary of the Illinois State Bar Association Construction Law Section Council. Adam@WhitemanBorden.com.

Allonge Enables Bank to Enforce Note

BY MICHAEL WEISSMAN

What is an allonge? The definition: An allonge is a slip of paper affixed to a negotiable instrument for the purpose of receiving additional endorsements for which there may not be sufficient space on the instrument itself. An endorsement written on the allonge is deemed to be written on the instrument itself. The allonge must be firmly affixed to the instrument in order to become part of the instrument.

In *Hood v. CIT Bank, N.A.*,2021 Tex. App. Lexis 1218, 104 U.C.C. Rep. Serv. 2d 141, 2021 WL 629751(February 18, 2021), CIT was able to establish its right to enforce a note by reference to an endorsement on an attached allonge.

CIT sued Hood because he failed to turn over insurance proceeds he received as a result of the destruction of a condominium by a casualty. That was a violation of the reverse mortgage the note secured.

The background of the case was that Rita Hackett executed a home-equity conversion ("reverse") mortgage in 2006 encumbering her condominium. She also signed an adjustable rate note in favor of Financial Freedom Senior Funding Corporation ("FF"). A rider to the mortgage stipulated that if there were any insurance proceeds received due to damage to the condominium, those proceeds would be paid to the lender as a paydown on the mortgage.

Rita Hackett passed away. Eric Hood, her son, was her sole beneficiary and he received $39,800 in insurance proceeds as compensation for damage sustained in 2008 and 2010. Hood did not deliver those monies to CIT so CIT sued him for breach of contract. And won.

Hood's primary defense to enforcement of the note was that there was a bona fide issue as to the ownership of the note. In 2011, FF's assets were sold to Financial Freedom Acquisition, LLC, a subsidiary of OneWest Bank. In 2015, OneWest Bank changed its name to CIT Bank. The note was negotiated by Financial Freedom endorsing the note in blank on an allonge. At the time of the lawsuit, CIT was in possession of the note, with the allonge, although Federal National Mortgage Association was the owner of the note.

The first issue was whether, pursuant to the UCC, CIT had the right to enforce the note. Hood's first argument was that by asserting possession of the note CIT was also asserting ownership of the note. The court, citing Article 3 of the UCC, easily dismissed that argument saying, "The right to enforce an instrument and ownership of an instrument are two different concepts." It also said," The fact that CIT Bank is asserting status as a holder does not require that CIT must be the owner." And that, "CIT's possession of the note, indorsed in blank on the allonge to the note, established conclusively that it was the holder of the instrument and entitled to enforce the note."

Hood's next argument was that the

blank endorsement on the allonge created a fact question as to the timing of the endorsement. Once again, he lost. "… the lack of a date on the indorsement is immaterial", said the court. And the court concluded, "The allonge corresponding to the note at issue specifically references the loan number, the original loan amount, the date of the note, and the borrower's last name and address. The evidence makes abundantly clear that the allonge belongs with the note…"

What's the point? When all or a portion of a bank's loan portfolio is transferred, it is not uncommon to use allonges as instruments of transfer. Although transfer in blank is permissible, it is advisable that the allonge refer to as many of the terms of the note as possible. ■

Michael Weissman practices with Levin Ginsburg in Chicago. He is a member of the Commercial Banking, Collections & Bankruptcy Section Council, and chairs its UCC/Commercial Banking Committee.

IRA Accounts Can Stand as Collateral, Cannot Be Liquidated Without Recourse

BY MICHAEL WEISSMAN

In *Cassidy v. Signature Bank*, 2021 IL App. (1st) 19178-U, the use and availability of IRA accounts to satisfy a debt was at issue. A guarantor challenged the action of the bank in setting off his pledged IRA accounts against a third-party's business loan in default. The guarantor succeeded.

James M. Cassidy owned a corporation known as Cassidy Brothers, Inc.("CBI"). CBI was indebted to Signature Bank as a result of a business loan agreement it signed, and a series of promissory notes executed in 2012 aggregating $3,473,000.

In 2013 Cassidy opened a $150,000 IRA deposit account with the Bank with a rollover from another bank. Shortly thereafter, the Bank issued an irrevocable letter of credit with CBI as applicant and Allegheny Casualty Company as beneficiary providing for draws of up to $126,000. The draws were to be deemed advances under CBI's loan agreement. Mr. Cassidy guarantied CBI's indebtedness. Concurrently, the Bank required that he execute an "assignment of deposit account" agreement in which the Bank was granted a security interest in his IRA deposit account.

One month later, again using funds rolled over from an IRA account at another bank, Cassidy opened a second IRA account at Signature Bank. The initial deposit was $150,000. And, at the same time, the Bank issued a second irrevocable letter of credit with CBI as applicant and Allegheny as beneficiary providing for draws of up to $150,000. The draws were to be deemed advances under the business loan agreement between CBI and the Bank. Once again, Mr. Cassidy signed a guarantee along with a promissory note. And, once again, he was required to execute an "assignment of deposit account" agreement.

Fate was not kind to Mr. Cassidy's drywall contracting business as it went into default on the notes in September 2013. The Bank proceeded to set off the funds in the two IRA deposit accounts against the debt owed by CBI. CBI filed for bankruptcy relief and was discharged in a Chapter 7 proceeding. But that was not the end of the story.

In August 2018 Cassidy sued Signature Bank in the Circuit Court of Cook County seeking damages for breach of contract contending that the Bank had improperly setoff the funds in his two IRA deposit accounts against CBI's indebtedness.

The Bank's response was that when the IRA deposit accounts were pledged, they lost whatever exemption they had under Illinois law and that permitted the setoff.

The court began its opinion by pointing out that under Illinois law IRA accounts are considered "special accounts" that create a trust relationship between the depositor and the bank. And quoting from earlier decisions, it also directed attention to the fact that the relationship is protected in Illinois and cannot be reached in satisfaction of a depositor's general indebtedness.

Furthermore, it focused on section 12-1006(a) of the Illinois Code of Civil Procedure adopted in 1989 that states a debtor's interest in a retirement plan is exempt "from judgment, attachment, execution, distress for rent, and seizure for satisfaction of debts" as long as the plan "is intended in good faith to qualify as a retirement plan under applicable provisions of the Internal Revenue Code of 1986, as now or hereafter amended." And that the term "retirement plan" expressly includes an "individual retirement account."

Signature argued that the exemption did not apply because nothing was "taken" from Cassidy. That is, when the Bank setoff the IRA accounts against CBI's debt, it was simply exercising its contractual rights under the assignment agreements. The court disagreed saying it was, indeed, a setoff: "Signature Bank applied the IRA funds to setoff CBI's debt."

All of the documents in evidence showed that the IRA accounts were established and treated as bona fide IRA accounts. Even the Bank officer who managed the CBI portfolio testified at a deposition that the accounts were maintained by the bank as retirement accounts.

Then the court turned to the question whether the funds in the accounts lost their exempt status when they were pledged as collateral. That called for a reference to

section 408(e)(4) of the Internal Revenue Code. The Code states that if "during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual."

Citing an opinion of the Sixth Circuit Court of Appeals, the Illinois court followed the reasoning of that decision that the protection of section 408 was not lost because Cassidy did not directly withdraw funds from the IRA accounts and the bank did not extend credit to him based on his IRA accounts. That was because CBI never made a draw on the letters of credit and "therefore the IRA funds were never used in a (prohibited) transaction."

And continuing, the court said in order to escape the prophylactic provisions of Illinois law and the restrictions of the Internal Revenue Code, "…the party holding the security interest in pledged property must have some recourse against the property in the event of a default." Recourse means, said the court, "[t]he right to repayment of a loan from the borrower's personal assets, not just from the collateral that secured the loan." That requirement was not satisfied in this case because Mr. Cassidy was not personally indebted to Signature.

The final commentary by the court was that because there were no draws on the two letters of credit "…the IRA funds were never used in a (prohibited) transaction."

What's the point? Merely accepting a pledge of an IRA deposit account as security for a loan does not, per se, cause the funds in the account to lose exempted status. The loss will only occur when the funds exit from their protective cocoon. Nevertheless, it is good practice to avoid any documentation of IRA deposit accounts as collateral since, faced with a loan default and the accompanying search for recoverable funds, an error can be made and an improper exercise of the right of setoff against the IRA funds may occur.■

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