IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. EQUITYBUILD, INC., et al., Defendants.	Case No. 1:18-cv-5587 Hon. Manish S. Shah Magistrate Judge Young B. Kim

RESPONSIVE STATEMENT OF CLAIMANT MIDLAND LOAN SERVICES (PROPERTIES 50, 51, 53, 54, 55, 56, and 57)

Both the SEC and the Individual Investors contend the Individual Investors should take priority over Midland[1] because the Individual Investors "never released their mortgages and no purported release was ever recorded." (Dkt. 1754 at 1; *see also* Dkt. 1755 at 2.) Midland does not dispute that releases were never provided or recorded. As to unsecured claims, Midland undisputedly holds first priority position over unsecured lenders notwithstanding the lack of releases, even though neither the SEC nor the Individual Investors make a distinction between secured and unsecured claims. (*See* Dkt. 1757 at § I(A).)

As to competing secured claims, however, which this Response focuses on, Midland is still entitled to priority over the prior Individual Investors. Midland, having performed all of its payment obligations under Illinois law, is entitled to valid releases. Indeed, to conclude otherwise runs contrary to Illinois Mortgage Act, as well as well-established principles of Illinois common

[1] Midland refers to Midland Loan Services, a Division of PNC Bank N.A., as servicer for (i) Wilmington Trust, N.A., as Trustee for the Benefit of CoreVest American Finance 2017-1 Mortgage Pass-Through Certificates and (ii) Wilmington Trust, N.A., as Trustee for the Registered Holders of CoreVest American Finance 2017-2 Trust, Mortgage Pass-Through Certificates 2017-2.

law, including foundational principles of agency, and the Illinois Fiduciary Obligations Act. As a result, Midland should take priority over prior the Individual Investors who authorized Equitybuild Finance, LLC ("EBF") (or Hard Money Company LLC, EBF's prior name[2]) to act on their behalf. Each of the SEC and Individual Investors' arguments to the contrary are without merit.

ARGUMENT

I. The Seventh Circuit's Group 1 Decision Does Not Foreclose Midland's Argument.

The SEC and the Individual Investors both suggest the Seventh Circuit's Group 1 decision, *SEC v. Equitybuild, Inc.*, 101 F.4th 526 (7th Cir. 2024), forecloses Midland's priority argument because the Individual Investors' mortgages were not released. (Dkt. 1754 at 1; Dkt. 1755 at 2.) To be sure, the Seventh Circuit rejected Group 1 claimant BC57, LLC's argument that the Illinois common law rule—that payment of a debt underlying a mortgage automatically extinguishes the security interest belonging to the holder of that debt—survived the passage of the Illinois Mortgage Act ("IMA"). *Id*. at 532. Specifically, the Court held "there must be payment *and* delivery of the release to extinguish a mortgage lien." *Id.* (emphasis in original). Midland, however, advances a different argument. As a matter of Illinois law, ***and consistent with the Seventh Circuit's ruling***, having paid the debts underlying the prior liens, Midland is ***entitled to releases*** of the Individual Investors' mortgages. Midland is therefore entitled to priority over the Individual Investors who empowered their agent, EBF, to issue payoff statements and receive payments on their behalf.

II. Midland is Entitled to Valid Releases Under the IMA.

The IMA governs the release of mortgages in Illinois and, as relevant here, requires releases for the benefit of Midland. The IMA states "every mortgagee of real property, his or her assignee

[2] For ease of reference, this brief will refer to the prior Individual Investors' servicer as EBF, though its prior name Hard Money Company, LLC, was the listed servicer in some instances.

of record, or other legal representative, having received full satisfaction and payment of all such sum or sums of money as are really due to him or her . . . shall make, execute and deliver to the mortgagor . . . an instrument in writing releasing such mortgage . . . or shall deliver that release to the recorder or registrar for recording or registering." 765 ILCS 905/2. The IMA further requires that a court order the issuance and delivery of a release when a prior mortgagee fails to deliver a release within 30 days after the payment of the debt secured by such prior mortgage. *See* 765 ILCS 905/4 ("Upon a finding for the party aggrieved, the court **shall** order the mortgagee . . . to make, execute, and deliver the release as provided in Section 2 of [the IMA].") (emphasis added). Finally, the IMA further confirms that "introduction of a loan payment book or receipt which indicates that the obligation has been paid shall be sufficient evidence to raise a presumption that the obligation has been paid." *Id*. The IMA does not require anything further from the "party aggrieved."

Here, Midland has satisfied each element under the IMA entitling it to valid releases. First, Midland issued payoffs to EBF, the Individual Investors' "legal representative" within the meaning of the IMA, authorized to receive such payoffs. (*See* Midland Ex. P (CASA § 2(a)); *see also* Receiver's Ex. 26; Midland Ex. E (EB3); Receiver's Ex. 23, Midland Exs. K, L (EB4).) In fact, the Illinois First District Court of Appeals recognized in *5201 Wash. Investors LLC v. Equitybuild Inc.*, 2024 IL App (1st) 213403-U, that EBF qualifies as a legal representative within the meaning of the IMA, in circumstances arising out of the same Equitybuild scheme, involving the same EBF entity, and the same authorizing agreements (CASAs). *See id*. at ¶ 38. Specifically, in *5201 Wash. Investors*, the Illinois First District Court of Appeals concluded EBF necessarily qualified as a "legal representative" within the meaning of the IMA where the record established EBF was publicly identified as the prior investors' agent via the same "care of" language seen on the

Individual Investors' mortgages here. (*Id*. at ¶ 38; *see also* Receiver's Ex. 8.) As the Seventh Circuit acknowledged, "[w]ithout guidance from the state's highest court, 'decisions of the Illinois Appellate Courts control, unless there are persuasive indications that the Illinois Supreme Court would decide the issue differently.'" *SEC v. Equitybuild, Inc.*, 101 F.4th at 531 (quoting *Nationwide Agribusiness v. Dugan*, 810 F.3d 446, 450 (7th Cir. 2015)). In *5201 Wash. Investors*, the First District's reasoning was sound and, given the nearly identical facts here, applies with equal force:

> Reference to the dictionary reveals that a legal representative is "an agent having legal status." Merriam- Webster.com Legal Dictionary, Merriam-Webster, https://www.merriam-webster.com/legal/legal%20representative. Accessed 2 Aug. 2024. Similarly, Black's Law Dictionary defines "agent" as "someone who is authorized to act for or in place of another; a representative." Black's Law Dictionary (11th ed. 2019). Courts have also recognized that an agent is necessarily a legal representative. *See*, *e.g.*, *Grane v. Grane*, 143 Ill. App. 3d 979, 985 (1986) (describing defendant as "agent/legal representative").

2024 IL App (1st) 213403-U, ¶ 38. Even if EBF were not a "legal representative" under the IMA, payment to EBF is equivalent to payment to the lenders themselves, satisfying the IMA payment criteria, as discussed in greater detail below. *See Rockford Life Ins. Co. v. Rios,* 128 Ill. App. 2d 190, 193 (3d Dist. 1970) ("Under the general rules of agency, if [the agent] had either actual or apparent authority to receive the payment, then payment to him had the same legal effect as payment to [the] principal.").

Second, Midland issued payoffs at closing in amounts consistent with the payoff statements indicating the amounts due under each prior investor mortgage. (*See* Receiver's Ex. 26; Midland Ex. E (EB3); Receiver's Ex. 23, Midland Exs. K, L (EB4).)

Third, Midland has submitted evidence demonstrating that the amounts actually due under the Individual Investors' prior mortgages were paid. (*Id.*)

Fourth, and finally, though the IMA does not require a mortgagor to request a release,[3] Midland, through its agent OS National, nevertheless required releases to waive the exception for the Individual Investors' mortgages. (Receiver's Ex. 23, Midland Ex. J.) Given that Midland satisfied each of its obligations pursuant to the IMA by making its payment to the Individual Investors' legal representative, EBF, for the balance of the existing debts encumbering the properties, the IMA entitles Midland to valid releases.[4]

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[3] For payoffs made *before* September 1973, the IMA indicates a mortgagee shall execute and deliver a release "at the request" of the mortgagor or others. 765 ILCS 905/2. For payoffs made *after* September 1973, like Midland's, the IMA's requirements that a release be issued are automatic, and not triggered by a request. *See id*.; *see also* § 905/4 (confirming mortgagee's obligation to execute and deliver a valid release in compliance with § 905/2 must be completed "within 30 days *after the payment of the debt*. . .") (emphasis added)). While Midland does not suggest or concede that it was required to request releases, Midland nevertheless cannot now request the releases to which it is entitled under the IMA given that the claimants are "restrained and enjoined from directly or indirectly taking any action or causing any action to be taken . . .which would [i]nterfere with the Receiver's efforts" including "interfering with or creating or enforcing a lien upon any Receivership Assets." (Dkt. 16 at 15.)

[4] It is Midland's position that it is entitled to valid releases for each of the Individual Investors' mortgages having paid the amounts due thereunder to the Individual Investors' agent, EBF, authorized to issue payoff statements and receive such loan payments. However, to the extent the Court believes the Illinois Mortgage Certificate of Release Act ("MCRA") applies to the exclusion of the IMA, Midland maintains it similarly would be entitled to issue certificates of release (through its title agent) for the only properties conceivably encompassed by the MCRA. Specifically, if the MCRA is found to apply to 1401 W. 109th or 6807 S. Indiana (the only interests conceivably falling within the definition of "mortgages" under the MCRA, as all of the other Individual Investor mortgages exceed the original principal amount of $500,000 and additionally were for properties exceeding one to four family units (*see* 765 ILCS 935/5; *see also* Receiver's Ex. 8)), Midland would be entitled to issue and deliver (through its title agent), certificates of release (*see id.* at § 935/10), and as such should be awarded priority. Because it is clear the prior Individual Investors "object," Midland cannot proceed under the MCRA, at least absent court order. *See* 765 ILCS 935/20(b) (a certificate of release must contain a statement that there is no objection by the mortgagee). However, following the payoff to the Individual Investors' authorized agent, Midland is entitled to releases and priority, whether under the IMA, as Midland believes is appropriate (the IMA applies because Midland cannot avail itself of the MCRA due to the Individual Investors' objection), the MCRA itself (because the Court must be able to resolve disputes where a payoff was made in conformity with the MCRA but the lender objects to a certificate of release), or under general principles of agency and common law, as discussed herein.

The Seventh Circuit's Group 1 decision supports this conclusion. As noted, the Seventh Circuit held that the IMA abrogated the common law principle that payment of the debt underlying a prior mortgage extinguishes that mortgage. *SEC v. Equitybuild, Inc.*, 101 F.4th at 532. Instead, "the [IMA] obligates a mortgagee to issue a release of the mortgage upon full satisfaction of the debt underlying the lien." *Id*. at 531. That obligation finds support in the IMA's purpose: the IMA was designed "to allow the mortgagor to obtain a release when the terms of the mortgage have been fully satisfied" and to "protect[] the free alienability of land." *In re Gluth Bros. Constr. Inc.*, 451 B.R. 447, 451 (Bankr. N.D. Ill. 2021). Having met the requirements under the IMA—by issuing payment of the amounts due under the prior liens to the Individual Investors' agent authorized (actually and apparently) to receive those payments—Midland is entitled to valid releases under the IMA. *See Franz v. Calaco Dev. Corp.*, 352 Ill. App. 3d 1129, 1150-1152 (2d Dist. 2004) (recognizing "the [IMA] unambiguously requires a mortgagee to release his mortgage upon receiving full payment under the mortgage" and ordering plaintiff to "execute and deliver a release of the mortgage as required by section 2 of the [IMA]."); *In re Estate of Schroeder*, 2022 IL App (5th) 210163-U (ordering bank to execute and deliver a release pursuant to section 2 of the IMA). To conclude otherwise would read a loophole into the IMA, wherein a mortgagor could comply with all of its obligations under the IMA, by submitting payment to a legal representative in satisfaction of the prior lien debt, but receive none of the IMA's protections. Indeed, reading the IMA this way undercuts the very rights the IMA is designed to protect.

Illinois case law supports this conclusion, too. Once payment is made to a legal representative, the burden does not shift back to the payor to confirm that the legal representative remits those funds to its principal. *Rockford Life Ins. Co. v. Rios*, 128 Ill. App. 2d 190 (3d Dist. 1970), in which a legal representative absconded with a subsequent lender's payment, is

particularly instructive in this regard. As the Seventh Circuit explained, "[i]n *Rockford*, the Illinois Appellate Court **ordered the release of a mortgage** after it determined that the note securing the mortgage **had been properly paid** to the mortgagee's authorized **agent**." *SEC v. Equitybuild, Inc*., 101 F.4th at 532 (emphasis added). Having paid the authorized agent in *Rockford*, "the payor [was] not bound to inquire into the application of such payment. The default of such agent is the responsibility of the principal." *Rockford Life Ins Co.*, 128 Ill. App. 2d at 195. The court reasoned "[it] is the principal who in the first instance selects the agent, grants him the authority and enables him to come into possession of the funds which are diverted. It is this conduct which makes the loss possible and the principal **may not shift the burden to the party dealing with his agent.**"[5] *Id*. (emphasis added).

Here, like *Rockford*, the Individual Investors expressly authorized EBF to act as their agent—at a minimum, to "issue payoff demands" and "demand, receive and collect all Loan payments." (Midland Exhibit P, § 9(a).) The Authorization Document also confirmed EBF's authority to receive payoffs as the Individual Investors' agent and trustee. (Midland Ex. Q.) Because the Individual Investors—not Midland, a subsequent assignee with no agency relationship with EBF or Equitybuild—empowered EBF to act as the collateral agent and servicer of their loan, they must bear the responsibility for their agent's wrongful conduct, and the Court must order a release of the mortgage, giving Midland priority. *See Rockford Life Ins. Co.*, 128 Ill. App. 2d at

[5] In its Group 1 ruling, the Court distinguished *Rockford* on the basis that the "contract between Rockford and Roe did not 'include any limitations or exceptions on the authority of the agent' to collect payments," while the "contract here explicitly barred Equitybuild Finance from unilaterally releasing the mortgages." (Dkt. 1386 at 21-22.) As relevant here, however, the contract between EBF and the Institutional Lenders (the CASAs) contains no limitation on EBF's authority to issue payoff statements or receive loan payments. Instead, the CASAs authorized EBF, among other things, to "issue payoff demands" and "demand, receive and collect all Loan payments." (Midland Ex. P at § 9(a).)

193, 195 (affirming trial court holding including that "defendants were entitled to a release of the mortgage" where the "note secured by the mortgage had been paid in full" by payment to the agent); *see also M&T Bank v. Mallinckrodt*, 2015 IL App (2d) 141233, ¶ 52 ("Where one of two innocent persons must suffer by reason of the fraud or wrong conduct of another, the burden must fall upon him who put it in the power of the wrongdoer to commit the fraud or do the wrong.").

Finally, the Illinois Fiduciary Obligations Act,[6] 760 ILCS 65 *et seq.* ("IFOA"), similarly protects Midland in these circumstances, consistent with both the IMA, *Rockford*, and principles of agency. The IFOA is intended to protect payors such as Midland. *See* 760 ILCS 65/1(1). The purpose of the IFOA is "to facilitate the fiduciary's performance of his responsibilities by limiting the liability of those who deal with him." *Praither v. Northbrook Bank & Tr. Co*., 2021 IL App (1st) 201192, ¶ 27 (citations omitted). The IFOA thus serves to "facilitate banking and financial transactions and place[s] on the principal the burden of employing honest fiduciaries." *Cty. of Macon v. Edgcomb*, 274 Ill. App. 3d 432, 435, (4th Dist. 1995).

The IFOA broadly defines "fiduciary" to include an agent, which EBF undoubtedly was on behalf of the Investor-Lenders. *See* 760 ILCS 65/1(1*)* (including "agent" as a "fiduciary" within the meaning of IFOA). The IFOA further defines "fiduciary" to include a trustee, which EBF was by virtue of the Authorization Document. (*See* Midland Ex. Q.) While Midland acknowledges the CASA indicates "neither the Collateral Agent nor the Servicer shall have . . . a fiduciary relationship with any Lender," (*see* Midland Ex. P, § 2(a)), Illinois courts disfavor advance waivers of fiduciary duties. *See Labovitz v. Dolan*, 189 Ill. App. 3d 403 (1st Dist. 1989) ("Defendants cite

[6] Respectfully, the Court's ruling in Group 1 that the IFOA does not apply because the CASAs "expressly disclaimed" a fiduciary relationship between EBF and the Individual Investors (Dkt. 1386 at 20) is not binding on Midland (*see* Dkt. 941 at 7) and, in any event, should be reconsidered by the Court.

no authority, and we find none, for the proposition that there can be an a *priori* waiver of fiduciary duties in a partnership – be it general or limited."). Further, fiduciary relationships are born out of the parties conduct, not labels. *See, e.g.*, *McNerney v. Allamuradov*, 2017 IL App (1st) 153515, ¶ 69.

Here, it is undisputed that EBF was the individual investors' agent (and trustee) (*see* Midland Exs. P, Q), which expressly brings their relationship into the zone of protection provided by the IFOA. EBF and the individual investors did not have the privilege or right of agreeing between themselves to deprive Midland and others of the protections the legislature provided through the IFOA by attempting to voluntarily disclaim EBF was a "fiduciary," particularly where the IFOA's provisions expressly define and establish EBF as a "fiduciary" within the meaning of the act.[7]

Accordingly, having satisfied its obligations under the IMA and Illinois common law, Midland is entitled to valid releases and therefore priority over the Individual Investors who empowered their agent to receive Midland's payoffs. The Court should, therefore, direct the Individual Investors to issue releases to Midland of their respective mortgages on Property Nos. 50, 51, 53, 54, 55, 56, and 57.

III. The Individual Investors are not Entitled to Priority by Virtue of "Equitable Liens."

The Individual Investors alternatively assert that "the Court should hold that the Individual Investors have equitable liens on the properties and in the proceeds of sale of such properties superior to the Institutional Lenders' mortgages." (Dkt. 1755 at 2.) There is no evidentiary basis whatsoever to impress an equitable lien here. Midland does not contest that the Individual

[7] The protections set forth within the IFOA also exist in common law. *See M&T Bank*, 2015 IL App (2d) 141233, *supra*.

Investors had valid mortgage liens—Midland paid the amounts due under those liens to close its loans and is entitled to a release of such liens. In any event, the imposition of equitable liens would not change the foregoing analysis with respect to the operation of the IMA following Midland's payments to the Individual Investors' legal representative. The Individual Investors, in short, simply ask far too much of equitable lien principles. Moreover, the suggestion that the prior Individual Investors have priority because Midland's due diligence efforts were "lax" is totally unfounded. (Dkt. 1755 at 3.)

The Individual Investors concede that "[g]enerally, the holder of an equitable lien cannot take priority over the interest of a party who acquires an interest in a property without notice of the equitable interest." *Id*. at 3 (citing *Stump v. Swanson Development Co., LLC*, 2014 IL App (3d) 110784). The Individual Investors assert, however, that the "Institutional Lenders were making loans to a business that trumpeted its crowdsourced funding and used lenders like them to refinance that funding" and thus "should have been on inquiry to investigate whether there were any existing loans on the properties." *Id*. at 3-4.

Midland, however, did not participate in the origination of the EB3 and EB4 loans. Instead, it received its interests through a series of assignments. (Midland Exs. M, N.) As such, Midland had *no* opportunity to investigate the existence of prior liens on the properties with Equitybuild or its representatives. In any case, Equitybuild represented to Midland's assignors that they would receive a "first-priority security interest" in the properties and that EB3 and EB4 would "take all actions necessary to maintain in favor of [the assignors, CAF or CoreVest], a first priority security interest therein[.]" (Midland Ex. A, §§ 4.5, 5.17; Midland Ex. G §§ 4.5, 5.17.) Accordingly, there was nothing further for Midland, a subsequent assignee, to do. As described, Midland was under no duty to ensure the payments were passed to the Individual Investors themselves. To the

contrary, Illinois law absolves Midland of any such obligation. *See Rockford Life Ins Co.*, 128 Ill. App. 2d at 195; *M&T Bank*, 2015 IL App (2d) 141233 at ¶ 52; *see also* 760 ILCS 65 *et seq*.

CONCLUSION

For the aforementioned reasons, and for the reasons stated in Midland's Position Statement (Dkt. 1757), Midland holds the only secured interest in Properties 50, 51, 53, 54, 55, 56, and 57 and Midland is therefore entitled to priority as a matter of law. Under the IMA, Midland is entitled to releases from the Individual Investors of their prior (and paid off) mortgages, and the Court should direct them to issue such releases. As the secured claimant with priority, Midland is further entitled to receive the entirety of its secured claim up to the amount of the net proceeds from the Receiver's sale of Properties 50, 51, 53, 54, 55, 56, and 57.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 15, 2024, I electronically filed the foregoing **RESPONSIVE POSITION STATEMENT OF CLAIMANT MIDLAND LOAN SERVICES (PROPERTIES 50, 51, 53, 54, 55, 56, and 57)**, with the Clerk of the Court using the CM/ECF system which will send notification of such filing to counsel of record, and further caused the foregoing to be served upon all members of Claims Group 6 by email to the distribution list via equitybuildclaims@rdaplaw.net.

/s/ Andrew R. DeVooght
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