

# Illinois Legislature Overrules Cypress Creek and Resolves Controversial Mechanics' Lien Enhancement Issue In Favor Of Contractors

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On Feb. 11, 2013 the Illinois legislature enacted legislation that overrules the controversial *Cypress Creek* decision and ends the dispute between lenders and contractors regarding proper apportionment of foreclosure proceeds under the Illinois Mechanics' Lien Act (the "Act"). In ***LaSalle Bank National Association v. Cypress Creek*** 1, LP, 242 Ill. 2d 231 (2011), the Illinois Supreme Court held that an individual lien claimant could not assert priority for value added to the property by other contractors' improvements to real property. However, Public Act 97-1165 amends Section 16 of the Act, 770 ILCS 60/16, to make clear that contractors shall be preferred over prior incumbrancers for all improvements made to the land "whether or not provided by the lien creditor." *Id.*

## Summary of the *Cypress Creek* Decision

*Cypress Creek* involved the proper division of \$331,328.40 in foreclosure proceeds attributable to improvements made to create senior-living apartments in Bolingbrook, Illinois (the "Improvement Fund"). LaSalle Bank, Eagle Concrete, Edon Construction, and three unnamed lien claimants all asserted claims to the Improvement Fund. LaSalle Bank argued that it was entitled to credit for the enhancements created by contractors that had been paid for the work performed out of the proceeds of the loan. The contractor claimants asserted that LaSalle Bank was not entitled to receive any of the Improvement Fund because Section 16 "entitles mechanics lien claimants to be preferred to the added value of all lienable improvements on the land made subsequent to the time the mortgage was entered into."

The Illinois Supreme Court rejected the argument that Section 16 permits lien claimants to assert priority to the extent all lienable improvements enhanced the value of the property. The Court held that the Act affords lien claimants priority only to the extent that their work improved the property. The Court found this to be the equitable result, stating: "Were the lien claimants to be preferred to the value of all improvements, the lien claimants would be unjustly enriched, to the detriment of an owner or mortgagee who funded improvements other than those that form the basis for the liens." Accordingly, *Cypress Creek* held that LaSalle Bank was entitled to receive \$256,614 (77%) of the

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\$331,328.40 Improvement Fund, and the other lien claimants were entitled to share only in the \$74,715 remaining in the Improvement Fund in a proportion equal to their particular work on the project.

## **Legislative Attempts to Clarify a Lien Claimants' Priority**

In the months leading up to the *Cypress Creek* decision, interested parties on both sides of the issue pressed for legislation and two competing bills to amend Section 16 of the Act were introduced. On Feb. 9, 2011, Senator Dillard introduced S.B. 1564, which proposed amending Section 16 to codify the result subsequently announced in *Cypress Creek*. On March 11, 2011, the House introduced an amendment to H.B. 3636 to amend Section 16 of the Act such that lien creditors would be preferred to the extent of all improvements made to the property, including improvements made by other contractors.

The bankers lobby and the construction lobby completely disagreed whether *Cypress Creek* created just apportionment of foreclosure proceeds under the Act. Contractors argued that *Cypress Creek* changed existing law and created an inequitable and unjust apportionment that deprived contractors of their fair share of foreclosure proceeds. Conversely, lenders argued *Cypress Creek* applied existing law and the apportionment sought by contractors would enrich them unjustly at the expense of lenders and owners. There was no common ground. In the words of Senator Mulroe: "if you asked a hundred people that were on the banking industry or lending side . . . , they would say that the [*Cypress Creek*] majority had it right; if you asked a hundred people . . . who represented contracts or contractors, they would say the dissenting opinion had it right." S. TR., 97th Gen. Assembly, 99th Legislative Day 56 (Ill. 2012).

## **Effect of P.A. 97–1165**

In the end, after almost two years of debate, the legislature passed H.B. 3636, and the bill was signed into law on February 11, 2013 as P.A. 97–1165. The new statute amends Section 16 of the Act as follows:

No incumbrance upon land, created before or after the making of the contract for improvements under the provisions of this act, shall operate upon the building erected, or materials furnished until a lien in favor of the persons having done work or furnished material (hereinafter "lien creditor") shall have been satisfied, and upon any questions arising between incumbrancers and lien creditors, all previous incumbrances shall be preferred only to the extent of the value of the land at the time of making of the contract for improvements, but shall not be preferred to the value of any subsequent improvements, and each the lien creditor shall be preferred to the value of all the subsequent improvements erected on said premises, whether or not provided by the lien creditor, and the court shall ascertain by jury or otherwise, as the case may require, what proportion of the proceeds of any sale shall be paid to the several parties in interest. All incumbrances, whether by mortgage, judgment or otherwise, charged and shown to be fraudulent, in respect to creditors, may be set aside by the court, and the premises freed and discharged from such fraudulent incumbrance. When the proceeds of a sale are insufficient to satisfy the claims of both previous incumbrancers and lien creditors, the proceeds of the sale shall be distributed as follows: (i) any previous incumbrancers shall have a paramount lien in the portion of the proceeds attributable to the value of the land at the time of making of the contract for improvements; and (ii) any lien creditors shall have a paramount lien in the portion of the proceeds attributable to the value of all subsequent improvements made to the property.

The new statute settles the dispute by requiring contractors to have preference over a prior incumbrancer to the extent of all improvements to the property, including improvements provided by other contractors. The law stands as a legislative determination that, subject to certain exceptions beyond the scope of this article, lenders will not receive any preference based on work performed by non-liening contractors, even if that work was paid for by the lenders asserting a prior lien on the property. While lenders and contractors will never agree what the proper apportionment of foreclosure proceeds should be under Section 16 of the Act, Public Act 97–1165 at least provides clarity and finality to this dispute.

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