

MORTGAGE FORECLOSURES

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PREFACE

This manual is to acquaint the general practitioner who is representing the mortgagor with an overview of the real estate foreclosure law.

Mortgage law in Alabama has both statutory requirements and the enforceability of the mortgage contract. One should always begin with a review of the documents signed by the mortgagor.

We have not compiled a definitive treatise on the law but only to provide a quick reference for the busy practitioner. We have not attempted to identify all avenues of legal relief but only the most common. For a more in depth decisions of any issue one should consult the treaties listed in the bibliography, or research the cases and statutes.

Claude M. Burns, Jr., Esq., Editor

MORTGAGE FORECLOSURES

I. PRELIMINARY CONCERNS

A. Mortgagee's Collection Attempts

Review all relevant documents and information from the mortgagor. Obtain copies of the documents, (loan closing documents, letters and notices from mortgagee).

1. Determine if mortgage documents are complete and in proper form.
2. What was the reason for default? Was the default debt or non-debt related?
3. Review mortgagee's attempts to have mortgagor cure default. Determine if a controversy exists as to whether a default has occurred.
4. Generally a commercial lending institution will likely work out some kind of settlement, provided that the mortgagor has financial resources with which to reestablish making loan payments or cure non-debt default.
5. Determine whether notice of default has been given to the mortgagor.

B. General Overview of Mortgage Law.

1. After execution of the mortgage, Alabama law vests title in the mortgagee subject to the mortgagor's equitable right of redemption. Once the debt is satisfied, legal title reverts with the mortgagor. The equitable right of redemption allows the debtor to pay the debt even when the mortgagor is in default. This equitable right continues until foreclosure. After the sale the mortgagor has a one year right of redemption from the date of the foreclosure sale.
2. Mortgage law is statutorily defined. See Ala. Code § 35-10-1, et seq. The mortgage and foreclosure procedure must meet the statutory minimum requirements. Additional provisions may be added in the mortgage and note.
3. Because of the secondary mortgage market, whereby mortgages are often sold to a third party and collection is made through servicing agents, the standard Federal National Mortgage Association Uniform Mortgage instrument form is frequently used. This instrument requires notice be given to the mortgagor and the mortgagor has a time to cure the default.

4. The foreclosure procedure will depend on the method used. A foreclosure may be held either under the power of sale provisions in a mortgage or by filing a suit in circuit court through a judicial foreclosure. A mortgage executed after January 1, 1989 which does not contain a power of sale provision must be judicially foreclosed. Section 35-10-12.
5. Although foreclosure terminates the equity of redemption, the mortgagor and others holding an interest in the property (subordinate to the foreclosing mortgagee) have a one year statutory right of redemption from the date of foreclosure sale. Section 6-5-248.

C. Reinstatement

1. There is not a statutory requirement to allow a mortgagor to cure a default and be reinstated under the mortgage.
2. The Federal National Mortgage Association Uniform Mortgage provides that if a borrower meets certain conditions 5 days before the sale of property, such as curing any default and paying all expenses, the foreclosure will be discontinued.
3. Generally, reasons used to enjoin and set aside foreclosures are procedural in nature. See paragraph I.B.
4. Determining your client's needs is very critical. For instance, if your client has no prospect of paying his debt, then actions brought on procedural issues which merely create delay may not be desirable. The client is only increasing the indebtedness and possibly a larger deficiency judgment.
5. If the client is temporarily out of work, but prospects for employment look better in the future (i.e., construction worker), the mortgagee may permit a partial payment and allow the mortgagor to keep the house.
6. Further legal grounds to enjoin the foreclosure involve filing for suit against the mortgagee for wrongful foreclosure, fraud, escrow misuse, and over charging costs such as insurance may be an option if evidence so warrants the action. The attorney may not file a previous action merely to delay a foreclosure. See Ala Code §12-19-270.

II. POWER OF SALE FORECLOSURE.

- A. Statutory Foreclosure Provisions. Ala. Code § 35-10-1, et seq.

1. Notice must be published in a newspaper for three consecutive weeks. Section 35-10-13. If power of sale notice is not enumerated in the mortgage and the mortgage executed before January 1, 1989 notice must be given for four weeks. Section 35-10-2.
2. If the property is in more than one county, then publication notice must be published in all counties. Section 35-10-13.
3. The newspaper must be one of general circulation in the county. Section 6-8-60.
4. The publication notice must give time, place and terms of sale, together with an accurate description of the property. Section 35-10-13.
5. Special notice must be given the IRS when the IRS has a lien on the property. This notice must be given 25 days before sale. 26 U.S.C. 7425
6. No personal notice is required by Alabama statute but mortgage forms generally require some notice. It is the better practice to give the mortgagor written notice of intent to foreclose. See Mennonite Board of Missions v. Adams, 462 U.S. 791 (1983). Standard federal mortgage forms all provide for notice to be given. If the mortgagee is a federal government agency, due process would require notice.
7. Although junior lien holders are not required by statute to be notified, good practice would be to notify all parties who are affected by the foreclosure. A party may buy the mortgage to keep their interest from being extinguished by the foreclosure.
8. If the mortgage does not contain a power of sale clause, and if the mortgage was executed after January 1, 1989, then judicial foreclosure must be used. Power of sale is not an option. Section 35-10-16; 35-10-12.

B. Injunctive Relief

Preventing a power of sale foreclosure requires the grant of an injunction in an independent proceeding. The procedure to prevent a judicial foreclosure requires raising one or more of the defenses explained infra in the same action as the foreclosure. In order to acquire a T.R.O. or preliminary injunction, a surety bond must be posted. A.R.C.P. 65(c).

III. JUDICIAL FORECLOSURE

- A. All parties holding an interest inferior to the mortgagor and not having**

priority over the foreclosing mortgagee are indispensable parties and must be notified. See McGowan v. Williams, 241 Ala. 588, 4 So.2d 164, 166 (1941).

- B. The Alabama Rules of Civil Procedure apply to actions in circuit court. Failure to acquire jurisdiction over indispensable parties may serve as grounds for dismissal of the foreclosure action. A.R.C.P. 12(b)(7). Parties not included and served are unaffected by the foreclosure, however, those defendants served may have their rights terminated by the court.
- C. The complaint must allege sufficient facts to substantiate the parties mortgage, description, and right to foreclose to enable the plaintiff relief. A.R.C.P. 12(b)(6); Scott v. Jackson Securities and Investment Co., 225 Ala. 90, 142 So. 76, 79 (1932).
- D. The mortgagee must properly serve the mortgagor with any action. A.R.C.P. 4.
- E. The complaint must correctly describe the property. But see Frazier v. Malone, 387 So.2d 145 (Ala. 1980); Mid-State Homes, Inc. v. Brown, 294 Ala. 242, 245, 314 So.2d 836, 838 (1975)(mortgage enforceable where intent of the parties is ascertainable).
- F. The court may order a foreclosure of the property and determine the amount of the debt in the same action.
- G. Court ordered foreclosure must be advertised for four weeks (Ala. Code § 35-10-3) and sale conducted at the court house at the prescribed time, place and under conditions required in the mortgage.

IV. MORTGAGE FORECLOSURE PROBLEMS

- A. Non-enforceability: Problems with the Mortgage Documents.
 - 1. If the mortgage was not properly notarized or witnessed, then it may not be enforceable. If the debt is not properly secured (by a valid mortgage), and homestead waived in the note or mortgage, then homestead exemptions may be claimed. See Smothers v. Fulton Federal, 653 F.2d 977, 979 (5th Cir. 1981); Frazier v. Malone, 387 So.2d 145, 149 (Ala. 1980).
 - 2. The description in the mortgage may be inaccurate. Nevertheless, a court in equity may reform the description in the mortgage to conform to the intent of the parties.
 - 3. If the foreclosing party is not the original mortgagee the assignment of the mortgage must be recorded or proof of assignment given.

B. Government Insured Mortgages.

Relief may be available to the mortgagor for defaults beyond his control in the form of Temporary Mortgage Assistance Payments, Moratoriums, and Reamortizations. See 24 CFR § 203.500, §§ 203.640-660 (HUD); 7 CFR § 1951.301 (FHA); 38 CFR §§ 36.4314-4318 (VA).

C. Soldiers' and Sailors' Civil Relief Act. 50 U.S.C. § 501, et seq.

If the mortgagor is in the armed forces, and at the time of foreclosure is on active duty, then the foreclosure may be enjoined. 50 U.S.C. § 532.

D. Violations of Truth-In-Lending Requirements. 15 U.S.C. § 1601, et seq.; 12 CFR § 226, et seq.

1. If the lender failed to make the required material disclosures and give "Notice of Right to Cancel," the borrower (mortgagor) may rescind up to three years after execution. 12 CFR §§ 226.15; 226.23.
2. Furthermore, if the foreclosure has already occurred, rescission is available during the one year of redemption. 12 CFR §§ 226.23 (a)(3)-3 (commentary).
3. A consumer may seek damages against the lender for violations of the Truth in Lending Act. 15 U.S.C. § 1601, et seq.; § 1640(a)(1) and (2)(A)(i); In re Smith, 737 F.2d 1549, 1551-1554 (11th Cir. 1984).
4. Attorney's fees are recoverable for violations of the Act. James v. Home Construction Co. of Mobile, 689 F.2d 1357 (11th Cir. 1982).

E. General Defenses.

1. No default has occurred.
2. A foreclosure may be enjoined due to waiver, estoppel, unconscionability, duress and lack of capacity. See generally Bell v. Coots, 451 So.2d 268 (Ala. 1984) (waiver); Saucer v. Pilgrim, 553 So.2d 609 (Ala. Civ. App. 1989)(equitable estoppel); Ala. Code § 8-8-5; § 5-19-16; § 8-1-40.
3. Fraud may be a ground to enjoin foreclosure and seek damages where the facts warrant such action. See Schoen v. Gullege, 481 So.2d 1094 (Ala. 1989) (Fraudulent loan miscalculation.)

F. Bankruptcy Filing. 11 U.S.C. § 101, et seq.

1. Chapter 7 Filing.

- (a) Filing a pre-foreclosure Chapter 7 petition automatically stays foreclosure. 11 U.S.C. § 362(a)(3) and (a)(5).
- (b) Violations of the automatic stay subject the mortgagee to fines, contempt of court and liability for the mortgagor's attorney's fees. See In re Kuck, 116 B.R. 821 (S.D. Ala. 1990); Borg-Warner Corp. v. Hall, 685 F.2d 1306 (11th Cir. 1982); In re Schwartz, 954 F.2d 569 (9th Cir. 1992)(collecting cases).
- (c) Nevertheless, the mortgagee may petition the court for relief from the automatic stay. Frank A. St. Claire, "Bankruptcy Issues and Real Property Foreclosures," 8 The Practical Real Estate Lawyer 31 (1992)(single asset bad faith filings). See also Brown, "Automatic Stay Litigation," 47 Ala. Lawyer 319 (Nov. 1986).

2. Chapter 13 Filing.

- (a) A pre-foreclosure Chapter 13 filing stays a pending foreclosure. 11 U.S.C. § 362(a)(3) and (a)(5).
- (b) A Chapter 13 debtor may deaccelerate the debt, allowing the debtor to cure the default and reinstate the mortgage. See 11 U.S.C. § 1322(b); In re Dettler, 141 B.R. 221 (Bkrtcy. M.D. Ala. 1991); In re Read, 131 B.R. 188 (Bkrtcy. M.D. Ala. 1991); In re Thompson, 894 F.2d 1227 (10th Cir. 1990).

V. AFTER-FORECLOSURE

A. Reasons to Set Aside Foreclosure.

1. Failure to comply with statutory requirements:
 - (a) The sale must be at the main courthouse door. Section 35-10-14.
 - (b) The sale must be held between 11:00 a.m. and 4:00 p.m. Section 35-10-14.
 - (c) The sale must be on the prescribed day.
 - (d) Foreclosure advertised for sufficient number of weeks. Ala. Code § 35-10-8.
2. Failure to follow procedures for foreclosure in the mortgage, such as a requirement for personal notice.
3. Common law reasons to set aside the sale.
 - (a) Inadequacy of price. Morris v. Indian Hills, Inc., 282 Ala. 443, 212 So.2d 831 (1968); George v. Cone, 91 S.W. 557 (Ark. 1905) (judicial sale, citing cases).
 - (b) Sale of the property en masse rather than in separate parcels. Rogers v. Dixon, 239 Ala. 72, 193 So. 741 (1940).
 - (c) Advertising in newspaper of limited circulation. Bon v. Graves, 103 N.E. 1023 (Mass. 1914).
 - (d) Bad faith use of power of sale, fraud, etc. Bon v. Graves, supra; Mosely v. Ritter, 226 Ala. 673, 148 So. 139, 142 (1933); Marsh v. Elba Bank & Trust, 207 Ala. 553, 93 So. 604, 606 (1922)(oppression).

B. Bankruptcy.

1. In the past, bankruptcy courts have set aside foreclosure sales at prices grossly inadequate with relation to the fair market value. See 11 U.S.C. § 548(a)(2); Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980). This rule was subsequently rejected by the United States Supreme Court where the sale occurred in compliance with state law. B.F.P. v. Resolution Trust Corp., 62 U.S.L.W. 4359 (May 24, 1994). (Alternative cite: 511 U.S. 531)
2. In a Chapter 13 post-foreclosure petition, some courts have held the

sale may be voidable where the price was grossly inadequate. In re Carr, 34 B.R. 653 (Bkrtcy. D.Conn. 1983).

C. One Year Right of Redemption. Ala. Code § 6-5-247, et seq.

1. The debtor, mortgagor, junior mortgagor, judgment creditors, transferee, spouse and children, etc., may redeem from the sale purchaser at the sale. Section 6-5-248.
2. If the purchaser at the sale gives the mortgagor 10 days personal notice to deliver possession, and the mortgagor fails to vacate the premises, the mortgagor loses his right of redemption. Section 6-5-251. In order to redeem, the redemption must tender the sale price and all lawful charges. See §§ 6-5-252 through 254.
3. Section 6-5-253 defines lawful charges, inter alia
 - (a) purchase price at sale
 - (b) lawful interest
 - (c) permanent improvements
 - (d) taxes paid
 - (e) insurance premiums paid
 - (f) any other valid liens paid
 - (g) if redemption is by the debtor, the balance of the debt.

VI. POTENTIAL LENDER LIABILITY PROBLEMS

A. Mortgagee Overcharged for Insurance.

1. Usually the mortgagee will require that insurance be procured by the mortgagor to protect the mortgagee's security interest. The mortgagee may acquire the insurance and charge the mortgagor premiums.
2. If the mortgagee procures coverage that is in excess of the insurable interest in the property, the mortgagee will be subject to liability to the mortgagor for the excess. Evidence of the fact of over insurance is that the premium is too high for the insurable interest. Of course, the mortgagee has an incentive for procuring as much insurance as possible because of its role as "broker." Rarely will a standard institutional lender over insure. However, this issue should be

considered.

B. Mortgagee Charges.

Another problem is the billing for unspecified "mortgagee charges." The mortgagee may only charge for those items defined by the loan agreement.

C. Excessive Escrow Charges.

A related issue to the two prior issues is excessive escrow holdings. Normally, the mortgagee pays the taxes, insurance, etc. for the benefit of the mortgagor as they come due by using an escrow account. Lenders might keep too much money in escrow. Unless otherwise agreed, the escrow should not contain more money than necessary to pay the third party. If escrow is excessive, the mortgagee may be liable to the mortgagor for interest in the added funds. See, e.g., 24 CFR § 203.550.

D. Fair Debt Collection Process.

Furthermore, a consumer may have a cause of action against creditors and their attorneys when they violate the Fair Debt Collection Practices Act. 15 U.S.C. § 1692, et seq.; § 1692(d); Jeter v. Credit Bureau, Inc., 760 F.2d 1168 (11th Cir. 1988); Shulman, "Attorney Liability Under the Fair Debt Collection Practices Act," Alabama Layer, 134 (May 1987).

E. Unconscionability.

Engaging in any other unconscionable, false, misleading or deceptive act by the mortgagee may violate the Deceptive Trade Practices Act. Ala. Code § 8-19-1, et seq.; § 8-19-5(23).

ANNOTATED BIBLIOGRAPHY

1. Alabama Mortgage Law. Harry Cohen. Agora Publishing Company, 1989.

This book is an invaluable resource in understanding foreclosure law in Alabama. Statutes and cases are collected. Nearly all state law issues are presented in a brief and concise manner. Federal issues are, for the most part, not addressed. This book is available in the law school libraries in Alabama. Because Professor Cohen was the Alabama Law Institute Reporter for many of the recent mortgage foreclosure statutes, this book is an outstanding resource in understanding statutory mechanics.

2. Real Estate Handbook; Land Laws in Alabama. Robert L. McCurley, Jr. and Penny A. Davis. The Michie Company, 2000, (Seventh Ed.).

This is an excellent resource found in most county law libraries and law schools. This book collects case citations on select mortgage law issues. Several forms are collected, including "Legal Notice Under Power of Sale" form.

3. Mortgage Foreclosures Seminar. Alabama Bar Institute, Continuing Legal Education (CLE). 1993.

This material is available in both a booklet form and on audio cassette. Both may be found in the law school library. Further, this material may be purchased through the CLE offices in Tuscaloosa.

Included in this seminar: the basics of foreclosure law, specialized tax issues, lender liability issues - Environmental Protection concerns, and bankruptcy strategy (Chapter 13).

4. Mortgage Foreclosure Seminar. Alabama Bar Institute, Continuing Legal Education (CLE). 1992.

As with the 1993 Seminar, this information is in both textual and audio form. Topics included: basic foreclosure law, comparison between residential and commercial foreclosures, liability for wrongful foreclosure, rights of redemption, environmental issues.

5. Mortgage Foreclosures Seminar. Alabama Bar Institute, Continuing Legal Education (CLE). 1991.

Topics included: basic foreclosure law, statutory liens, post-foreclosure issues, commercial foreclosures.

6. Treatise, Real Estate Finance Law. Grant S. Nelson, Dale A. Whitman. West, 1994 (3rd ed.).

This is an excellent resource for federal and constitutional issues such as bankruptcy

(Chapter 7 and 13), Soldiers' and Sailors' Relief Act, federal housing issues and due process concerns. Of course the treatise does not address particular Alabama laws and procedures.

The treatise is widely available in county law libraries. Osborne on Mortgages was this treatise's forerunner. This book also collects cases.

7. Consumer Law Manual. Legal Services Corp. ACLSP, 1992.

This booklet provides some helpful guidance in the protection of consumer's rights generally. Chapter 15 of the booklet describes various theories used to prevent foreclosure.

8. Frank A. St. Claire, "Bankruptcy Issues in Real Property Foreclosures," 8 The Practical Real Estate Lawyer 31, (Jan. 1992).

This law review article provides a good analysis of bankruptcy issues pertaining to foreclosure. The law here is still in a state of flux, especially concerning post-foreclosure filings.

9. Real Estate Finance: In a Nutshell. Jon W. Bruce. West, 1985 (2nd ed.).

This handbook provides the reader who is generally unfamiliar with mortgage law with an excellent, brief introduction to the topic in an understandable manner. However, the reader should be cautioned that mortgage law varies highly from state to state; therefore, Alabama statutory law and case interpretation should be consulted.

IN THE CIRCUIT COURT OF BALDWIN COUNTY, ALABAMA

(MORTGAGOR),

Plaintiff,

vs

(MORTGAGEE),

Defendant.

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CIVIL ACTION NO.

A COMPLAINT TO ENJOIN A FORECLOSURE

COMES NOW PLAINTIFF and brings this complaint against Defendant and respectfully shows unto the Court as follows:

1. Plaintiff is a citizen of the State of Alabama and is at least 19 years of age.
2. Defendant is a corporation doing business in the State of Alabama having its principal place of business at _____.
3. Plaintiff executed a mortgage and promissory note on _____, 19__, to Defendant, _____. The indebtedness was secured to real property found in Baldwin County, Alabama to wit:

(DESCRIBE PROPERTY).

4. Attached hereto is a copy of aforesaid mortgage and promissory note and marked as Exhibit 1 and 2, respectively. Aforesaid exhibits are incorporated into this Complaint.
5. Plaintiff avers that on _____, 19__, Defendant published notice of foreclosure in the Baldwin People, a newspaper insert found in the Mobile Press Register.
6. Plaintiff further avers that the Baldwin People is not a newspaper of general circulation in Baldwin County as required by the Code pre-foreclosure requirements.

WHEREFORE, Plaintiff prays that this Honorable Court Order a Temporary Restraint and Injunction on said foreclosure sale because Defendant has failed to follow statutory requirements of a power of sale foreclosure. Plaintiff further prays for such other relief, including reasonable attorney's fees, as this Honorable Court deems appropriate and proper.

IN THE CIRCUIT COURT OF _____ COUNTY, ALABAMA

(MORTGAGOR),
Plaintiff,

vs.

(MORTGAGEE)
Defendant.

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CIVIL ACTION NO.

COMPLAINT

COMES NOW PLAINTIFF and brings this complaint against Defendant and respectfully shows unto the Court as follows:

- 1. Plaintiff is a citizen of the State of Alabama and is at least 19 years of age.**
- 2. Defendant is a corporation doing business in the State of Alabama having its principal place of business at _____.**
- 3. Plaintiff executed a mortgage and promissory note on _____, 19__, to Defendant, _____. The indebtedness was secured to real property found in ____ County, Alabama to wit:**

(DESCRIBE PROPERTY).

- 4. Attached hereto is a copy of aforesaid mortgage and promissory note and marked as Exhibit 1 and 2 respectively. Aforesaid exhibits are incorporated into this Complaint.**
- 5. Plaintiff avers that Defendant, _____, failed to make material disclosures as required by the Federal Truth-in-Lending Act. More particularly, Defendant failed to disclose to Plaintiff the total amount of interest due under the mortgage and promissory note. Defendant has not cured the non-disclosure at this time.**
- 6. Plaintiff avers that this action is commenced within three years of execution of the said promissory note and mortgage.**
- 7. Plaintiff avers that the Defendant's failure to disclose entitles Plaintiff to rescind the promissory note and mortgage.**

WHEREFORE, Plaintiff prays that this Honorable Court grant, declare and award Plaintiff damages in the amount of _____, including reasonable attorney's fee; the aforesaid promissory note and mortgage null and void; and such other relief the Honorable Court deems just and proper.

Attorney for Plaintiff