ALABAMA LEGISLATORS AND ADJUDICATORS FINALLY MAKING SENSE OF EXCESS FUNDS

By: John McClurkin

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When an owner of real estate becomes delinquent on property taxes, the Alabama probate court will sell the property at a public tax sale auction to recover backed-taxes owed to the county. [1] Commonly, the tax sale purchaser's bid far exceeds the amount of taxes owed. These "excess funds" are then held by the county treasury for a period of three (3) years before they are deposited to the general fund of the county. Much controversy has arisen over the past decade as to who is entitled to recover the excess funds during this three-year period.

Before 2013, the Alabama statute governing disposition of the excess simply read that the funds were to be paid over to "the owner, or his agent or the person legally representing such owner." Ala. Code 1975 § 40-10-28. This seemingly innocuous language unexpectedly fueled turmoil within the Alabama county court systems as to who was the "owner" within the meaning of the statute. The problem with the language was that it did not define "owner" nor did it provide any temporal guidance as to the *vested* owner entitled to the funds.

Questions quickly began to rumble within the courts and county revenue office: Which "owner"? The person who owned the property immediately before the tax sale? Does it matter that the delinquent owner who is making a claim for excess funds does not intend to redeem the property? Does a transferee who purchased the original owner's interest in the land without knowledge of the tax sale obtain a vested interest in the funds? Can a title company who missed the tax sale when insuring the transferee's interest in the property claim a right to the funds when paying off the tax sale purchaser? Does a mortgagee who redeems the property to protect its collateral qualify as an "owner" entitled to a credit for the excess? Does the lender have to foreclose on the property before the tax sale occurs?

I. Alabama Supreme Court's 2011 Decision

The uncertainty and conflicting decisions among the courts when addressing these questions created angst within the county revenue offices for fear of turning the funds over to the improper party and facing future challenges and litigation from competing interests in the property. In 2011, the Alabama Supreme Court, in its ill-fated decision of *First Union Nat. Bank of Florida v. Lee County Commission*,[2] attempted to provide clarity to the madness by setting forth a narrow definition of "owner" within the meaning of § 40-10-28. The Court held that "owner" under this statute meant the "person against whom taxes on the property are assessed."[3]

In that ruling, the Court held that the bank, as the mortgagee who redeemed property at tax sale, *was not* considered the owner of property for purposes of receiving excess funds arising from the sale. It rejected the bank's argument that a mortgagee is an "owner" by virtue of the fact that Alabama is a "title theory" state in which the mortgagee holds legal title to the property. The Court concluded that the bank would first need to foreclose on the defaulted mortgagor to transfer ownership status and entitlement to the excess funds.[4] It believed that by narrowing the definition of "owner" to a specifically defined person -- i.e. that against whom taxes on the property are assessed -- would reduce the burden on county revenue commissioners in deciding whether to disburse the excess funds to a particular claimant.

The Court's ruling, however, did not reduce the burden upon the counties as it failed to address a key issue; namely, the point in time at which the commissioner is to look when determining the qualified "person against whom taxes are assessed" within the Court's definition. This failure lead to inequitable consequences and further conflicting rulings of the lower courts, many of which interpreted the Court's definition to mean the taxed-assessed person at the time of the tax sale. Consequently, they provided precedent for

1 These County Tax Sales occur during the month of May each year.

2 75 So. 3d 105 (Ala. 2011).

3 Id. at 117.

4 Id. at 116.

county commissioner's to deny a bank's request for excess funds when redeeming the property if the bank foreclosed on its mortgage *after* the tax sale occurred.

As such, often a mortgagor who failed to pay property taxes and defaulted on his mortgage was nonetheless permitted to recover excess funds from a tax sale as long as the bank failed to foreclose on the mortgage prior to the tax sale occurrence. These lower court holdings lead to the onset of widespread fly-by-night enterprises seeking to profit from this inequity. They sought to track down the abandoners of real property (and those against whom property taxes were wrongfully still assessed) and inform them of the opportunity to snatch up the excess funds, leaving the lenders holding the "empty" bag.

II. New Legislation in 2013 and 2014

The Court's 2011 holding addressed only one of the questions noted above. In doing so, it created more confusion and led to other systemic problems including inequities with permitting a delinquent land owner from seizing excess funds without any intention of redeeming the property or paying his mortgage.

Meanwhile, the county commissioners continued to struggle with the exposure of improper payouts and the constant challenges to payouts raised by competing interests. This exposure and sustained burden spawned proposed legislation in 2012, driven primarily by the Association of County Commissioners of Alabama. Eventually, the State legislatures passed and Governor Bentley approved amendments to § 40-10-28 such that the word "owner" is no longer even used. Instead, the amended statute in 2013 provides that the excess funds "*shall be paid over to a person or entity who has redeemed the property* as authorized in Section 40-10-120 or any other provisions of Alabama law authorizing redemption of tax sale…"[5]

As such, this revised version no longer accounts for who should be deemed an "owner" for purposes of entitlement to tax sale overtures. Rather, only that person or entity, whether it be a borrower, lender, mortgagee, or title insurer, with a legal or equitable interest in the property who is willing to pay the cost to redeem the property is entitled to the excess funds. The county revenue commissioner no longer has no decision to make, as the funds are automatically paid over to the party redeeming the property. The tax sale purchaser is reimbursed in full, along with a 12% interest per annum on the excess portion of his bid (up to 15% of the value of the property) as an investment incentive to purchase at tax sale.

This 2013 bill, however, was not retroactive and applied only to those tax sales occurring after August 1, 2013. Given the number of outstanding pre-2013 tax sale purchases still at issue and faced with the above-noted concerns, in 2014 the Alabama legislature amended § 40-10-28 again to remove the date of enation and apply the changes to all pending tax sale overages.[6]

III. Alabama Supreme Court's Recent Clarification of 2011 Decision

After three long years of confusion, litigation, and inequitable results, the Alabama Supreme Court on September 26, 2014 finally granted certiorari review of a pending lawsuit to clarify its decision in First Union and to further address the temporal issue of who is the "owner." In Ex parte First United Security Bank and Paty Holdings, LLC, the Court reversed the Court of Civil Appeals' holding that because the bank foreclosed on the mortgage after the tax sale, it was not the "owner" within the meaning of the statute and therefore was not entitled to receive the funds.[7] This common interpretation of the lower courts deemed the person entitled to the excess funds as being and always will be the owner at the time of the tax sale. That is, they viewed the right to excess funds as being a personal interest remaining with the owner, as opposed to a right that is incident of real property ownership and "runs with the land."

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5 2013 Alabama Laws Act 2013-370 (H.B. 47) (emphasis added)

6 2014 Alabama Laws Act 2014-442 (H.B. 349)

7 2014 WL 4798927 (Ala. 2014).

The Court rejected this interpretation, instructing that its definition of "owner" set forth in First Union was not intended to impose any temporal limitation on when a person must become an "owner" in order to be entitled to the excess funds. "Nor was it intended to limit "owner" to the person or entity listed on the tax assessment, whether or not that person or entity is the actual owner at the time of the tax sale (and whether or not the owner was correctly listed on the assessment)."[8] Instead, the Court ruled that the right to excess funds "runs with the land" and transfers with the conveyance of real property.[9] The banks, then, did not lose out on the right to excess funds simply because they did not foreclose prior to the tax sale.

IV. Conclusion

Real estate law can often be a complex web of variables which must be fully unraveled to achieve the desired end result. Fortunately, Alabama lawmakers and judges have finally reached this result after first witnessing the raucous outcry and undesirable consequences of the marketplace following the initial rollout of the bill governing payouts of tax sale overages. Thankfully, lenders and title insurers of mortgages may rest easy knowing that if their borrower bellies-up and the property is sold at a tax sale, their collateral is now more fully protected under Alabama law. ⚖

8 Id. at *4.
9 Id.

THE COMPLETE DEFENSE…

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expenses incurred in defense of the title or the lien of the insured mortgage, as insured, but only to the extent provided in the Conditions and Stipulations" and even though Condition 4 (a) of the policy specifically limited the insurer's duty to defend claims falling within the policy's coverage as follows:

> **DEFENSE AND PROSECUTION OF ACTIONS:**
>
> Upon written request by the insured …, the Company [Chicago Title], at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interest as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy. … The Company will not pay any fees, costs, or expenses incurred by the insured in the defense of those causes of action which allege matters not insured against by this policy.

Chicago Title appealed the District Court's decision and the ILTA retained Stahl Cowen Crowley Addis LLC to file an *amicus curie* (friend of the court) brief based on its long-standing leadership role in the land-title-evidencing industry. Through its brief, the ILTA sought to provide the Court with the public and industry perspectives on the issues before it and the ramifications of the appeal.

The ILTA explained the differences between the GCL carriers to whom the complete defense rule had been applied previously and title insurers. Most notably, title insurers are governed by different statutes and regulatory bodies in Illinois, have clearly defined insurance coverage limitations, underwrite risks based upon the existing public record in exchange for one-time nominal premiums (rather than based on models of potential exposure for future unknown risks for which GCL carriers receive much more significant recurring premiums), and contractually define their exposure to covered causes of action.

The ILTA also provided the Court with an industry perspective, explaining the use of American Land Title Association ("ALTA") forms that had been adopted by the title industry to limit the insurers' risk to their statutorily defined authority, while at the same time providing the public with substantial amounts of title insurance coverage for economic premiums. After describing a series of Illinois and Seventh Circuit cases that upheld the freedom of contracting parties to allocate risk of loss as had been done by insurers who adopted the 1992 ALTA loan policy, the ILTA concluded that the complete defense rule is based in contract and cannot be used judicially to vary the terms of that contract.