

WHEN THE GAVEL FALLS AFTER FORECLOSURE SALES

In October 2019, default service attorneys throughout the Eleventh Circuit breathed a collective sigh of relief when the Hon. Jerry C. Oldshue, presiding over the Southern District of Alabama, issued an opinion in *In re Russell*, No. 19-11514-JCO (Bankr. S.D. Ala 2019) that upheld the long-standing “gavel rule.” In *Russell*, the court determined whether, during the period of time between a foreclosure sale and the execution and delivery of the foreclosure deed from that sale, a debtor can cure his mortgage arrears through a bankruptcy plan. The court held that the “gavel rule”—which states that a debtor’s right to cure and maintain no longer exists after the foreclosure sale—remains the correct legal standard for determining a debtor’s interest in a foreclosed property. Moreover, the court clarified, the “gavel rule” earns its name: the debtor’s right to cure ends with the literal fall of the gavel at the time of the foreclosure sale, not any point afterward.

The facts in *Russell*, while straightforward, presented an opportunity to clarify an area of Alabama law that had become murky in recent years. In *Russell*, after a debtor defaulted on his mortgage, the bank conducted a valid foreclosure sale. Four days after the sale, the debtor filed a Chapter 13 bankruptcy petition in which he attempted to cure his mortgage arrears through the plan. Thereafter, the foreclosure deed was executed and recorded. Because the debtor had filed for bankruptcy after the sale but before the deed was executed and recorded, the bank filed a motion to confirm the validity of the foreclosure sale and sought relief to proceed with an ejectment action. The *Russell* court granted the motion, issuing a 14-page opinion holding that (1) the foreclosed property was not part of the bankruptcy estate, and therefore (2) the debtor could thus not cure his mortgage arrears through the plan.

Judge Oldshue’s opinion began with a historical review of the relevant case law that has “[run] the gamut of outcomes from pre-foreclosure sale acceleration to post-foreclosure redemption.” *Id.* at 5. The leading case is *In re McKinney*, in which the court held that the “fall of the gavel” at the foreclosure sale is the time at which the debtor’s interest in the property is determined. 174 B.R. 330 (Bankr. S.D. Ala 1994). Judge Oldshue then turns to the 1994 amendment to 11 U.S.C. §1322, which he refers to as the “Codification of the Gavel Rule.” *In re Russell* at 8. This subsection of the Bankruptcy Code provides, in relevant part, “a default with respect to, or that gave rise to a lien on the debtor’s principal residence may be cured ... until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law[.]” 11 U.S.C. §1322(c)(1). This subsection was intended to clarify the rule that even if state law divests a debtor of an interest in his residence prior to the actual foreclosure sale, federal law will

permit a cure and maintain plan at least until the sale takes place. Interpreting this provision in conjunction with the rule established in *In re McKinney*, Judge Oldshue ruled that the debtor's right to cure and maintain no longer exists after the foreclosure sale.

The opinion goes further than merely upholding the “gavel rule,” however. Judge Oldshue continued his analysis by resolving a question that has created significant confusion within the Alabama default servicing industry in recent years: in the context of a bankruptcy filing, when does the foreclosure “gavel” truly fall? In 2013, the Supreme Court of Alabama held that the validity of a foreclosure sale turns on whether the foreclosing party holds the mortgage and the power of sale *at the time that the foreclosure deed is executed*: “... it is the act of executing and delivering the deed that completes the foreclosure.” *Ex Parte GMAC* at 850. After that ruling, any bankruptcy case filed between a foreclosure sale and the execution of the foreclosure deed created a question as to the validity of the sale.

It is far from unusual for a Chapter 13 debtor to file bankruptcy petition after his property has been sold on the courthouse steps but before the foreclosure deed has been executed and delivered. Due to the surprising number of cases in which this occurs, requiring a foreclosure deed to be “executed and delivered” before the sale is considered complete had begun to wreak havoc on Alabama bankruptcy courts.

In *Russell*, Judge Oldshue clarified that the *GMAC* decision had no effect on the “gavel rule,” going as far as pointing out that the *GMAC* court even cited *In re McKinney* without making any mention of challenging its “gavel rule” holding. *In re Russell* at 11. Thus, Judge Oldshue reasoned, the *GMAC* holding should be strictly limited to its core issue—standing regarding foreclosures—and should not be construed as an attack on the gavel rule. *Id.* at 12. Additionally, Judge Oldshue noted, the “gavel rule” is preferable as a matter of public policy: “[R]eliance on the fall of the gavel as the bright line cutoff for determining a debtor’s ability to include property in a subsequently filed bankruptcy estate fosters predictability and uniformity and accordingly is the logical choice.” *Id.* at 13.

The *Russell* opinion not only confirmed for the Eleventh Circuit that the gavel rule is still alive and well; it also put to rest any unease regarding the foreclosure timeline mentioned in *GMAC*. Further, the opinion provided useful guidance in an area of law that has historically lacked a meaningful consensus. Most bankruptcy courts, when interpreting subsection 1322(c)(1), look to state law as the starting point to determine when a debtor’s right to cure expires. Of course, foreclosure

laws vary from state to state, and as such, they will inevitably produce varying results. However, *Russell* now joins a small body of case law that has interpreted the addition of subsection (c)(1) to establish a uniform time—**the moment of sale—for the expiration of a debtor’s right to cure his mortgage arrears through a Chapter 13 plan.**