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Avoidance of Foreclosure Sales as Fraudulent Transfers under Section 548(a) of the Bankruptcy Code: An Impetus to Changing State Foreclosure Procedures

Michael L. Walcott
University of Nebraska College of Law

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Comment

Avoidance of Foreclosure Sales As Fraudulent Transfers Under Section 548(a) of the Bankruptcy Code: An Impetus To Changing State Foreclosure Procedures

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I. INTRODUCTION

Today the economy throughout the Midwestern states is generally very depressed. Not only is the situation headlined by farm failures, but a large percentage of non-farm businesses are also faced with severe financial difficulties. Unfortunately, during these times lenders are often forced to resort to foreclosing upon the property of delinquent debtors. Many debtors, on the other hand, in order to avoid complete financial obliteration are forced to seek relief under the

1. See Baily & Hill, As Many Farms Fail, More Rural Banks are at Risk of Dying, Too, Wall St. J., Jan. 24, 1985, at 1, col. 6; see also Farnsworth, U.S. Farm Debt Report Disputes Reagan Figures, N.Y. Times, March 11, 1985, at A15, col. 1 (highlighting a recent study by the U.S. Agricultural Department which shows one-third of family farms face financial difficulty, 13.7% of such farms being close to insolvent).
2. See Wall St. J., Nov. 21, 1985, at 1, col. 5 (highlighting a study of rural banks which predicted that 20 to 25% of “Main Street” businesses could close in the next two years because of the domino effect of the poor agricultural economy).
3. See Wall St. J., Feb. 18, 1986, at 29, col. 3 (claims paid by private mortgage insurers

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The Nebraska Legislature has statutorily provided lenders two common devices for securing real estate loans, the mortgage and the deed of trust. These security devices and the corresponding procedures used to foreclose the interests of the debtor are by no means new to the lending industry or the real estate practice. However, the usual foreclosure sale, which is typically conducted on the courthouse steps, very seldom attracts attention from sincerely interested purchasers. Instead the sale sports an entourage of curious bystanders and onlookers as well as one bidder, that bidder usually being the lender that initiated the action to foreclose the debtor’s interest. It is usually under these circumstances that the property is sold for the amount of a single bid, that bid being submitted by the foreclosing lender.

The debtor, if in attendance, is usually resigned to watching as the property is sold for a price he may consider to be well below the fair

4. The Office of the Clerk of the U.S. Bankruptcy Court of the District of Nebraska, indicates that the filing of bankruptcy petitions has increased substantially the past two years; 2,205 petitions were filed in 1983, as compared with 2,547 petitions in 1984, and 3,016 petitions in 1985. Telephone interview with the Office of the Clerk of the U.S. Bankruptcy Court of the District of Nebraska (Feb. 8, 1986).

5. The statutory provisions relating to deeds of trust are found at NEB. REV. STAT. §§ 76-1001 to 76-1018 (1981). The general provisions relating to recordation of mortgages are found at NEB. REV. STAT. §§ 76-238.01 to 76-239.01 (1981). General provisions relating to judicial foreclosure of mortgages and deeds of trust can be found at NEB. REV. STAT. §§ 25-2137 to 25-2155 (1985).

A real estate mortgage can be defined as a transfer by a debtor of an interest in real property to a creditor for purposes of providing security for the performance of an obligation, usually the payment of a note. G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 1 (2d ed. 1985). A deed of trust involves the debtor’s conveyance of the real estate to a third person (trustee) who holds the property as security for the payment of a debt to a lender. Id. at 11-12. An indepth analysis of these two common forms of security devices and the associated procedures for foreclosure is beyond the scope of this Article.


It should be noted that under Nebraska law, other forms of remedies may be available to a lender having a secured interest in real property of the debtor. These remedies may include an action in ejectment, an action in strict foreclosure, or an action to quiet title. These remedies, however, are very limited. For a brief discussion of these actions, see Tye, Creditor Remedies Under Land Contracts and Mortgages, NEB. CONTINUING LEGAL EDUC. SEMINAR ON REAL ESTATE LAW (1983).

6. In most cases, the bid price submitted by a foreclosing lender will be equivalent to the exact amount necessary to liquidate the indebtedness secured by the mort-
market value of the property. Usually the debtor’s attempts to salvage
the property by refinancing or seeking new credit sources will have
failed. In a non-judicial foreclosure, such as a trustee’s sale, the suc-
cessful purchaser will immediately receive title to the subject property
upon payment of the sale price. In a judicially supervised sale, the sale
may have to be confirmed by the court. Even this is not significant
solace to the debtor, since the sale will usually be confirmed as a mat-
ter of course, without a full evidentiary hearing.

In light of this scenario, which is in no respect limited to the Mid-
western states, but is repeatedly seen nationwide, some federal courts
have applied principles developed in bankruptcy law concerning
fraudulent conveyances to invalidate and avoid certain foreclosure
sales conducted within one year of the date of the debtor’s subsequent
filing of a petition in bankruptcy. In so doing, these decisions have
ignited a raging controversy regarding the application of fraudulent
conveyance law to the foreclosure process. While the courts wrestle
with the problems of statutory interpretation, other policy considera-
tions abound. These include the desire to have certainty in real estate
titles, the resulting effects on the cost and availability of credit secured
by real estate loans, as well as the principles of equitable distribution
found in the bankruptcy laws.

This Article reviews the applicable federal bankruptcy statutes

gage or deed of trust. This is usually the situation if the property’s fair market
value equals or exceeds the outstanding indebtedness.

There are other situations in which the lender may submit a lower bid, so as to
retain the right to seek a deficiency judgment against the debtor. Under Ne-
braska law regarding deeds of trust, a lender may never acquire a deficiency judg-
ment for greater than the difference between the outstanding indebtedness under
the deed of trust and the fair market value, regardless of a bid price which may be

7. For purposes of this discussion, it will be assumed that the debtor has not filed a
petition in bankruptcy prior to the foreclosure sale. A debtor may be able to
obtain a stay of the foreclosure sale under 11 U.S.C. § 362(a) (Supp. II 1984), by
filing a petition in bankruptcy prior to the sale.

The issue considered in this Article arises when the debtor has allowed a fore-
closure sale to be completed, and has subsequently filed a petition in bankruptcy.
The argument will then be raised as to whether the “pre-petition foreclosure
sale” should be avoided under fraudulent transfer provisions of the bankruptcy
laws.

There are potentially two reasons why a debtor in possession or a trustee in
bankruptcy may attempt to avoid a foreclosure sale. First, in a reorganization
case, the debtor may regain some equity which was lost through the foreclosure
sale, thereby increasing the possibility of a successful workout. Secondly, even in
a liquidation case, a bankruptcy sale may achieve a higher sale price than would a
foreclosure sale. See LaPucki, A General Theory of the Dynamics of the State
citing empirical studies the commentator reaches this conclusion, based on the
fact that under the Bankruptcy Act § 110(f) (1976), the sale of property for less
than 75% of value was prohibited).
pertinent to this controversy, and examines the development of case law and the historical evolution of fraudulent conveyance law. Secondly, this Article explores the policy implications involved in avoiding foreclosure sales and demonstrates the ease with which certain foreclosure procedures might be reformed.

II. FRAUDULENT TRANSFER PROVISIONS OF THE BANKRUPTCY CODE

The Bankruptcy Code,8 like its predecessor, the Bankruptcy Act9 contains two provisions regarding fraudulent conveyances.10 The first provision, section 544(b)11 provides the trustee the power to avoid any transfer by the debtor which would be voidable for any reason, including fraud, under applicable state or federal law.12 While section 544(b) is an important provision, the discussion and controversy reflected in this Article focuses on the second provision, section 548.13

Section 548 is the focal point of recent controversy regarding the use of the Bankruptcy Code to avoid certain pre-petition foreclosures sales. Section 548(a) provides:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily —

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or


10. For purposes of this Article, the terms “fraudulent conveyance” and “fraudulent transfer” will be equated. Historically and up until the mid-1900s, the term “fraudulent conveyance” was standardly used. However, more recently the term “fraudulent transfer” has been preferred.


12. 4 COLLIER ON BANKRUPTCY § 544.03 (15th ed. 1985). In order to assert such a claim, the trustee is compelled to stand on the rights of actual unsecured creditor of the debtor, against whom the transfer was voidable. Id.

such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.14

Some of the early decisions which invalidated certain pre-petition foreclosure sales on fraudulent transfer grounds were decided under section 67(d) of the Chandler Act.15 Although the drafters of the Code made stylistic changes to the Chandler Act, few substantive changes were made with respect to fraudulent conveyances.16

Legislative history reveals that the commission created by Congress to recommend changes in the bankruptcy law, recommended no substantial changes to section 67(d) of the Chandler Act except to simplify the provision's language.17 Since few substantive changes occurred with respect to the fraudulent conveyance provisions, the analysis employed by the courts in invalidating pre-petition foreclosure sales under section 67(d) of the Chandler Act would be compara-

14. Id. § 548(a).
15. Section 67(d)(2) of the Chandler Act provides:

Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition in bankruptcy or of an original petition under chapter X, XI, XII, or XIII of this Act by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or (b) as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital, without regard to his actual intent; or (c) as to then existing and future creditors, if made or incurred without fair consideration by a debtor who intends to incur or believes that he will incur debts beyond his ability to pay as they mature; or (d) as to then existing and future creditors, if made or incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay or defraud either existing or future creditors.


16. H. MILLER & M. COOK, A PRACTICAL GUIDE TO THE BANKRUPTCY REFORM ACT, 340 (Supp. 1985). One change pertinent to this discussion is the Code's elimination of the "good faith" requirement with respect to transferees. See infra notes 135-37 and accompanying text.

17. The Commission on the Bankruptcy Laws of the United States was established by Congress to recommend changes in the bankruptcy laws. The Commission reported that "Section 67d is modeled upon the Uniform Fraudulent Conveyances Act. The Commission believes that it has worked satisfactorily and it does not recommend any substantive changes therein, except a simplification of its extremely complex language." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137, 93rd Cong., 1st Sess. 20 (1973).
Courts which have invalidated pre-petition foreclosure sales have utilized the language contained specifically in section 548(a)(2)(A) and (B)(1), which provides for avoidance of a transfer if the transfer was "constructively" fraudulent. Section 548(a)(1) provides for the avoidance of any transfer which the debtor made with "actual intent to hinder, delay or defraud" a creditor. In most cases where a foreclosing creditor seeks to enforce its rights under a mortgage or deed of trust, the debtor has no actual intent to defraud other creditors because of the foreclosing creditor's actions. Therefore, actions by trustees to avoid pre-petition foreclosure sales have been brought under section 548(a)(2)(A) and (B)(1), where the transfer is considered "constructively fraudulent," without regard to any intent on the part of the debtor.

The elements of a fraudulent transfer are set out in section 548(a)(2)(A) and (B)(i) of the Code. Those elements include:

1. a transfer by the debtor,
2. within one year prior to the debtor filing a petition in bankruptcy,
3. for less than reasonably equivalent value,
4. while the debtor was insolvent, or became insolvent due to the said transfer.

Two of these four elements have created the controversy in court decisions. The concepts of "transfer" and "reasonably equivalent value" have been interpreted and applied in different ways by the courts, ultimately leading to conflicting conclusions as to whether the fraudulent transfer provisions of the Bankruptcy Code can be used as a tool to invalidate pre-petition foreclosure sales.

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18. See infra notes 133-37 and accompanying text.
20. For a fuller discussion see infra notes 51-53 and accompanying text.
21. Normally the creditor-debtor relationship in the foreclosure process will be an adversarial one. While the debtor will be struggling to salvage his interest in the real property, the creditor will be attempting to foreclose and terminate the debtor's interests. Only in a rare case when the debtor and creditor would act collusively would there by any possible way for the trustee to argue that the pre-petition foreclosure should be avoided under Code § 548(a)(1). For additional discussion concerning actual intent see infra notes 51-53 and accompanying text.
23. Id.
24. Id. § 548(a)(2)(A).
25. Id. § 548(a)(2)(B)(i).
26. The other two elements listed, the debtor's insolvency and the one year avoidance period, have not been at the heart of the dispute. This Article, therefore, devotes little discussion to these two elements.
III. THE HISTORY OF FRAUDULENT TRANSFERS

Fraudulent conveyance laws have been in existence for several centuries, and apparently have been traced back at least two thousand years to the Roman Empire. Throughout the centuries, several decisions at common law and codifications thereof have emphasized the same principle—protection of the creditor defrauded by a debtor. While its history can be traced back to antiquity, the most important codification with respect to the formulation of American fraudulent conveyance laws was the Statute of Elizabeth, enacted by the English Parliament in 1571. It is in this English codification that the modern day American law of fraudulent conveyances finds a solid foundation.

Fraudulent conveyance laws developed in England in an attempt to curb the abuses by debtors of certain "sanctuary laws." A deceitful debtor, upon realizing the hopelessness of his particular predicament, would transfer property to friends and relatives, and take refuge in a sanctuary which was outside the reach of creditors, while still en-

27. One commentator surmises that defaulting debtors are probably as old as the institution of property, that institution being almost as old as human society itself. Radin, Fraudulent Conveyances in California and the Uniform Fraudulent Conveyance Act, 27 CALIF. L. REV. 1, 1 (1938).

28. The fraudulent debtor was evidently present in early Roman Law, since a tort action, known as a "Paulian action" was available to a creditor who had been defrauded by an insolvent debtor. The underlying theory of the right of the creditor to recover was not on any interest the creditor had, but rather the public's benefit by facilitating the payment of debts. M. Radin, HANDBOOK OF ROMAN LAW 15 (1923); Radin, supra note 27, at 1.

29. One general codification of Roman law regarding fraudulent conveyance can be found in the INSTITUTES OF JUSTINIAN, 284, Bk. 4, tit. 6, no. 6 (J. Thomas trans. 1975).

Then again, if someone deliver his property to another in fraud of his creditors, the latter, on taking possession of his estate by the decision of the provincial governor, can claim the thing, the delivery being nullified; i.e., they are allowed to say that the thing was not delivered and, consequently, remained the property of the debtor.

Id. This statement, however, was probably one of the later statements about Roman law. Radin, Fraudulent Conveyances at Roman Law, 18 VA. L. REV. 109, 109 (1931). The Institutes of Justinian were published with the force of law and became effective at the end of December, 553 A.D. J. Thomas, TEXTBOOK OF ROMAN LAW 57 (1976).

30. It seems quite apparent that Roman terminology regarding fraudulent conveyances was regularly used by the English draftsmen. 1 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES § 58 (1940).

31. 13 Eliz., ch. 5 (1570) (repealed by the Law of Property Act, 1925, 15 Geo. 5 ch. 20, § 172).

32. O. Bump, FRAUDULENT CONVEYANCES 10 (1882); 1 G. Glenn, supra note 30, at § 58.

33. 1 G. Glenn, supra note 30, at § 61.
joying a fairly comfortable lifestyle. Statutes passed in 1376 and 1487, respectively, allowed creditors to execute upon property collusively conveyed by the debtor and to avoid fraudulent gifts of personal property made in trust by the debtor. The enactment of the Statute of Elizabeth has been described by some to have been merely a codification of the common law at that time.

Aided by judicial interpretation, the Statute of Elizabeth became a powerful piece of legislation in the protection of creditors who had been defrauded by debtors. Within only a few decades, the English Parliament incorporated fraudulent conveyance provisions, as set out in the Statute Elizabeth, into England's bankruptcy laws.

In the United States, Congress was not oblivious to the plight of the defrauded creditor. In 1800, upon adoption of the first bankruptcy laws for the new nation, a fraudulent conveyance provision was included within the law. Since that time, every subsequent bankruptcy law enacted by Congress has contained some form of fraudulent conveyance provision. In 1898, upon adoption of the Bankruptcy Act, the Congress continued to retain the principles and much of the language set out in the Statute of Elizabeth.

During the 1800s and early 1900s, the courts faced problems in applying fraudulent conveyance law to particular sets of circum-

34. Treman, Escaping the Creditor in the Middle Ages, 43 LAW Q. REV. 230, 235-36 (1927).
35. 50 Edw. 3, ch. 6 (1376).
36. 3 Hen. 7, ch. 4 (1487).
38. In one of the most famous cases regarding the Statute of Elizabeth, Twynes Case, 3 Co. Rep. 80b, 76 Eng. Rep. 809 (1601), Coke showed that the notion of a fraudulent conveyance was not limited to those debtors who sought sanctuary.
39. See 1 Jac., ch. 15 (1603); see also 1 G. Glenn, supra note 30, at § 61(c).
41. During the course of the nation's history, five separate sets of bankruptcy laws have been in force:
(1) Bankruptcy Act of 1800, id.;
(2) Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 (repealed 1843);
(3) Act of March 2, 1867, ch. 176, 14 Stat. 517 (repealed 1878);
(4) Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1978);
42. 4 COLLIER ON BANKRUPTCY, supra note 12, at § 548.01.
stances. One of the most formidable problems implicitly embedded in the law at that time was the difficulty of proving that the actual intent of the debtor was to defraud his creditors. Many times the debtor's intentions could not be clearly ascertained, but instead were veiled in a cloak of darkness. Creditors found it difficult to establish sufficient evidence regarding the debtor's actual intent and accordingly, the courts were forced to rely on instinct. In facing this repetition of particular fact patterns some courts chose to rely on presumptions or "badges of fraud." Certain actions by the debtor were found to be presumptively indicative of fraudulent intent. Under this approach, case decisions were inconsistent, thereby creating pressure for uniformity in fraudulent conveyance law.

In 1915, the National Conference of Commissioners on Uniform State Laws directed its Committee on Commercial Law to draft a uniform act regarding fraudulent conveyance law. The purpose was to rectify the confusion, uncertainties and inconsistencies embodied in existing law. One of the primary tasks to which the Commissioners directed their attention was the elimination of the courts' use of presumptions regarding the debtor's intent. The Commissioners were concerned that in several cases courts may have utilized the presumption to an unwarranted extent.

In 1918, the National Conference of Commissioners on Uniform State Laws approved the Uniform Fraudulent Conveyance Act (UFCA). In light of their concern regarding the courts' use of presumptions of fraudulent intent, the commissioners chose to take a bifurcated approach towards characterizing fraudulent conveyances. Under the first approach, the notion of actual intent was retained within the UFCA, but the Act expressly provided that the debtor's

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44. On certain occasions, it was not only the debtor's intentions that would be veiled in darkness. See Hodges Brothers v. Coleman & Carroll, 76 Ala. 103 (1884) (bargain sale of entire inventory consummated at nightfall).
45. Some courts presumed certain actions by the debtor, such as gifts to friends, establishment of trusts, retention of property allegedly sold to others, and bargain sales to acquaintances, to be fraudulent transfers. See generally M. BIELOW, supra note 37, at 207-430 (1911).
47. Id.
48. The purposes of the UFCA were basically threefold: (1) to provide a definition of insolvency, (2) to clearly ascertain those persons legally injured by fraudulent transfers, and (3) to clear up problems caused by some courts' extensive use of presumptions as to the debtor's intent in a fraudulent transfer. UFCA, supra note 46, at 428 (Prefatory Note).
49. Id.
50. Id. at 427.
51. Compare § 7 of the UFCA, id., with §§ 4 and 5 of the UFCA, id.
actual intent must be shown without the use of any presumption as to that intent. However, in a second approach, the Commissioners set out those transactions which could be held to constitute a fraudulent conveyance, without any requirement of proof of actual intent. It was considered that actions taken under certain conditions and circumstances constituted "constructive" fraudulent transfers, requiring no proof of actual intent.

When the Bankruptcy Act of 1898 was substantially revised by the Chandler Act of 1938, Congress incorporated the constructive fraud provisions of the Uniform Fraudulent Conveyance Act into section 67(d) of the Bankruptcy Act. After the incorporation of these constructive fraud provisions, a trustee in bankruptcy could avoid fraudulent transfers without proving actual fraudulent intent on the part of the debtor.

In 1978, Congress repealed the Bankruptcy Act and replaced it with the Bankruptcy Code. Section 67(d) of the Act was replaced by section 548 of the Code; however, few substantive changes were made in the process.

In 1984, Congress amended the Bankruptcy Code. At first glance, these amendments might seem to have altered the fraudulent transfer provisions of the Code with respect to invalidating pre-petition foreclosure sales. However, the true impact of these amendments is uncertain due to the lack of legislative history regarding the amendments.

52. Section 7 of the UFCA provides:
   Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.

53. Section 4 of the UFCA, which is directly applicable to the discussion, provides:
   Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

55. "We have condensed the provisions of the Uniform Fraudulent Conveyances Act, retaining its substance and, as far as possible, its language. HOUSE COMM. ON THE JUDICIARY, ANALYSIS OF H.R. 12889, 74th Cong., 2d Sess. 214 (Comm. Print 1936).
57. "This section is derived in large part from section 67d of the Bankruptcy Act. It permits the trustee to avoid transfers by the debtor in fraud of his creditors. Its history dates from the statute of 13 Eliz. c.5 (1570)." H.R. REP. NO. 595, 95th Cong., 1st Sess. 375 (1977); S. REP. NO. 989, 95th Cong., 2d Sess. 89-90 (1978).
59. See infra notes 109-11 and accompanying text for a fuller discussion of the 1984
IV. RECENT CASE LAW DEVELOPMENTS

Prior to 1980, case law invalidating a non-collusive, pre-petition foreclosure sale based on a fraudulent transfer was virtually non-existent. In 1980, however, the Fifth Circuit Court of Appeals broke new ground in the seminal case of Durrett v. Washington National Insurance Co., by invalidating a non-collusive, pre-petition foreclosure sale as a fraudulent conveyance. Since the Durrett decision, three other circuits, as well as numerous lower courts, have rendered decisions with respect to this issue. As a result, a wide ranging difference of opinion exists throughout the circuits as to the interpretation and applicability of section 548(a) to pre-petition foreclosure sales. The disagreement focuses mainly on what event constitutes a "transfer" and the characterization of what price constitutes "reasonably equivalent value."

In Durrett, the debtor executed a promissory note secured by a deed of trust. The deed of trust was executed and recorded in 1969. Approximately eight years later the debtor defaulted, and pursuant to amendments and the legislative history and case law surrounding these amendments.

61. 621 F.2d 201 (5th Cir. 1980).
the power of sale clause contained in the deed of trust, the trustee sold the property at a foreclosure sale. The property, worth a fair market value of $200,000, was sold to the sole bidder, a third party purchaser, who offered the exact amount necessary to liquidate the outstanding indebtedness, $115,400.

Nine days later, the debtor filed a petition under Chapter XI of the Bankruptcy Act. Acting in his capacity as debtor in possession, he alleged that the foreclosure sale constituted a fraudulent transfer under section 107(d)(2) of the Bankruptcy Act and should, therefore, be set aside. The U.S. District Court for the Northern District of Texas held that the sale was not a fraudulent transfer.

On appeal, the Fifth Circuit determined that a transfer had occurred within the one year avoidance period of section 67(d) of the Act. The court noted that even though legal title had been transferred via the deed of trust eight years earlier, the debtor remained in possession of the property until the date of the foreclosure sale. Interpreting "transfer" to include the debtor's surrender of possession, the court...

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64. A power of sale clause is basically a "contractual arrangement in a mortgage or a deed of trust... which provides upon default or acceleration the mortgagee or the trustee has the authority to sell the property at public sale." The Real Estate Handbook 106 (M. Seldin ed. 1980). The power of sale foreclosure is basically an alternative to foreclosure through judicial process. This manner of foreclosure reduces the time and expense of judicial procedures. However, the power of sale foreclosure has been labeled as harsh and open to abuse. Jones & Ivens, Power of Sale Foreclosure in Tennessee: A Section 1983 Trap, 51 Tenn. L. Rev. 279, 280 (1984).


68. Id. at 54.

69. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 204 (5th Cir. 1980) (citing 1 Collier on Bankruptcy § 1.30 (14th ed. 1967)). The Durrett court relied on the broad definition of transfer found in section 1(30) of the Bankruptcy Act. That definition provides: "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, volun-
reasoned that the transfer was not finalized until the day of the foreclosure sale.\textsuperscript{70}

The focal issue addressed by the court was whether the sale price constituted a fair equivalent for the property. The court noted that it was not able to locate any decision in which the transfer of real property for less than 70\% of fair market value had weathered attack under section 67(d). Since the sale price represented a mere 57.7\% of the property’s fair market value, the court determined that the sale price was not a fair equivalent for the exchange. Based upon this analysis, the court concluded that the sale constituted a fraudulent transfer which should be set aside.\textsuperscript{71}

A year later, in Abramson v. Lakewood Bank & Trust Co.,\textsuperscript{72} the Fifth Circuit, sitting en banc, reaffirmed the principles set out in Durrett. Judge Clark, in a strong dissent,\textsuperscript{73} argued that a foreclosure sale does not constitute a transfer by the debtor, since in such a sale there is no voluntary conveyance by the debtor.\textsuperscript{74} He contended that the time of the transfer for purposes of fraudulent conveyance law should be determined by the debtor’s action of executing the trust deed or mortgage, whereby the secured party is vested with the right to enforce the security lien. He forecast that under Durrett a cloud would be cast on mortgages and trust deeds further depressing the prices realized at foreclosure sales.\textsuperscript{75}

The Fifth Circuit’s interpretation and application of the fraudulent transfer provisions of the bankruptcy laws has not gone unchallenged. Two decisions, both out of the Ninth Circuit, best represent the major

\textsuperscript{70} Durrett v. Washington Nat’l Ins. Co., 621 F.2d 201, 204 (5th Cir. 1980).
\textsuperscript{71} Id. at 203-04.
\textsuperscript{72} 647 F.2d 547 (5th Cir. 1981).
\textsuperscript{73} Id. at 549 (Clark, J., dissenting).
\textsuperscript{74} Judge Clark’s dissent is based on the literal wording of section 67(d), which refers to “[e]very transfer ... by a debtor.” Id. at 549 (Clark, J., dissenting) (quoting 11 U.S.C. § 107(d)(2)) (emphasis added). One commentator notes that Judge Clark’s argument has been weakened by the Code, since section 548(a) refers to the “transfer of an interest of the debtor.” Henning, \textit{An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications}, 63 N.C. L. Rev. 257, 265 n.47 (1985) (emphasis added).
\textsuperscript{75} Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting).
countervailing views as to the transfer issue and the concept of reasonably equivalent value.

Both of the decisions from the Ninth Circuit involved the same case, Madrid v. Del Mar Commerce Co. (In re Madrid). In the first of these decisions, the Ninth Circuit Bankruptcy Appellate Panel reviewed the concept of reasonably equivalent value (Madrid I). In an appeal from the Bankruptcy Appellate Panel's decision to the Ninth Circuit Court of Appeals, the Ninth Circuit affirmed the Panel's decision. However, it did so on the basis of the Circuit Court's determination as to the transfer issue (Madrid II).

The facts of Madrid are fairly comparable to those of Durrett. Madrid involved a non-judicial foreclosure sale of real estate. The debtor had purchased the property in September, 1979, by borrowing the entire purchase price and executing both a first and a second deed of trust as security for the loans. When the debtor defaulted, the trustee under the second deed of trust sold the property at foreclosure sale. The only bidder at the foreclosure sale, a third party purchaser, purchased the property, subject to the first deed of trust, and an amount necessary to liquidate the indebtedness secured by the second deed of trust.

Seven days after the foreclosure sale, the debtor filed bankruptcy, and as debtor in possession sought to avoid the sale under section 548(a). The bankruptcy court determined that the sale price constituted 64% to 67% of the property's fair market value. The bankruptcy court then followed the Durrett decision and held that the sale was a fraudulent conveyance.

On appeal, in Madrid I, the Bankruptcy Appellate Panel reversed the bankruptcy court's decision. The panel did not discuss the transfer issue, but based its decision on the issue of reasonably equivalent value. The court rejected the Durrett 70% guideline, reasoning that a regularly conducted foreclosure sale, being open to all bidders and creditors, is in itself protection against the evils of private transfers. The court then stated that the "law of foreclosure should be harmo-
nized with the law of fraudulent conveyances.\textsuperscript{82} In an effort to accomplish this goal, the court held that any sale price received at a non-collusive and regularly conducted foreclosure sale should be conclusively presumed to be a reasonably equivalent value for the property sold.\textsuperscript{83}

On appeal, in \textit{Madrid II}, the Ninth Circuit Court of Appeals affirmed the Bankruptcy Appellate Panel's holding; however, it did so without addressing the issue of reasonably equivalent value. Instead, the court focused on the issue of transfer, concluding that the foreclosure sale did not constitute a transfer under Section 548(a).\textsuperscript{84}

The court rejected \textit{Durrett}'s application of the broad definition of transfer to a foreclosure sale. Instead the court focused on a narrower definition of transfer contained in Section 548(d)(1).\textsuperscript{85} Based upon this provision, the court stated that "a foreclosure sale is not a transfer by a debtor, ... but rather is an involuntary conveyance triggered by the debtor's failure to fulfill some obligation ..."\textsuperscript{86} The court concluded that in the case at hand, a transfer occurred when the security interest under the deed of trust was perfected under applicable state law.\textsuperscript{87}

In 1984, the Eighth Circuit had opportunity to address the matter in \textit{First Federal Savings & Loan Association of Bismark v. Hulm (In re Hulm)}.\textsuperscript{88} Not only was this the first time the Eighth Circuit entered the controversy, but it was the first decision by a circuit court involving the attempted avoidance of a judicial foreclosure sale.\textsuperscript{89} The

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{82} Id. at 427.
\item \textsuperscript{83} Id.
\item \textsuperscript{84} Madrid v. Lawyer's Title Ins. Corp., 725 F.2d 1197, 1198 (9th Cir. 1984) (\textit{Madrid II}).
\item \textsuperscript{85} 11 U.S.C. § 548(d)(1) (Supp. II 1984). Section 548(d)(1) provides:
\begin{quote}
For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.
\end{quote}
\textit{Id.}
\item \textsuperscript{86} Madrid v. Lawyer's Title Ins. Corp., 725 F.2d 1197, 1202 (9th Cir. 1984) (\textit{Madrid II}).
\item \textsuperscript{87} Id. at 1199. The \textit{Madrid II} decision has been placed in doubt by certain amendments to the Bankruptcy Code in 1984. For a fuller discussion see \textit{infra} notes 109-111 and accompanying text.
\item \textsuperscript{88} 738 F.2d. 323 (8th Cir.), \textit{cert. denied}, 105 U.S. 398 (1984).
\item \textsuperscript{89} The \textit{Hulm} case resulted from the attempted avoidance of a judicial foreclosure sale. In analyzing the \textit{Hulm} opinion for what it truly represents, it is important to clear up a misconception held by some commentators. While judicial foreclosure sales involve some type of judicial action, in some jurisdictions the judicial foreclosure sale does not necessarily require a judicial confirmation hearing. \textit{Contra} Comment, \textit{supra} note 66, at 196. In the case of North Dakota, the jurisdic-
\end{enumerate}
\end{footnotesize}
Eighth Circuit held that a foreclosure sale constitutes a transfer under the Code. The court, however, refused to adopt a mathematical test for determining the adequacy of the price received at a foreclosure sale.90

In addressing the transfer issue, the court stated that section 548(d)(1) "only determine[s] when a transfer is deemed to occur, not whether a certain occurrence is a transfer of an interest of the debtor in property."91 Based on the broad definition of transfer in section 101,92 the court reasoned that a foreclosure sale constituted a transfer. The court reasoned that there may be distinct and separate transfers of the debtor's interests at different times; therefore, the perfection of a security interest would constitute a transfer, while the termination of the debtor's right to possession through foreclosure sale would constitute another separate transfer of the debtor's interests. The Hulm court indicated that section 548(d)(1) was not inconsistent with its conclusion.93

In addressing the issue of reasonably equivalent value, Hulm's lack of reference to Durrett is obvious. The Hulm court chose only to reject the holding of the Bankruptcy Appellate Panel in Madrid I, where the sale price had been automatically equated with reasonably
equivalent value. The court indicated that only through an evidentiary hearing could a determination be made as to whether the sale price constituted reasonably equivalent value and accordingly, remanded the case to the bankruptcy court for such a hearing.94

In April, 1985, the Sixth Circuit Court of Appeals, in In re Winshall Settlor's Trust,95 joined its sister circuits in ruling on the use of the fraudulent conveyance provisions of the Code to avoid pre-petition foreclosure sales. Although the decision did not bring any new interpretations to the forefront, it is important in one respect. There had been speculation that the 1984 amendments to the Bankruptcy Code legislatively overruled the decision in Madrid II. The Sixth Circuit expressly noted that the amended language of section 548(a) did not weaken or overrule the decision in Madrid II.96 Accordingly, the Sixth Circuit followed Madrid II, as well as Madrid I, stating that a foreclosure sale could not be set aside as a fraudulent conveyance since no transfer would occur at the time of sale and that even if the sale were considered a transfer, the sale price would constitute reasonably equivalent value.97

While the decisions of lower courts have been important in fleshing out this area of the law,98 the opinions at the circuit level have carried the weight in this dispute. Therefore, discussions of lower court cases will be limited to their particular applicability to the issues.

V. THE ISSUES

A. Transfer

As case law indicates, the issue as to whether a foreclosure sale should be characterized as a transfer for purposes of section 548(a) has been and continues to be fiercely contested. Arguments raised by opposing factions focus both on the actual characterization of the event, as well as the timing of the event.99 Case law provides support for at least four fairly distinguishable approaches.

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94. Id. at 327.
95. 758 F.2d 1136 (6th Cir. 1985).
96. Id. at 1138-39 n.3.
97. Id.
98. See supra cases cited in note 63.
99. The timing of the event is a critical issue, since any transfer completed outside of the one-year avoidance period provided for in section 548(a) will be immune from attack by the trustee in bankruptcy. Usually, as the situation unfolds, the perfection of the security lien on the subject property will have occurred beyond the one year avoidance period; therefore, if this date is deemed to be the date of transfer, the transfer will be immune from attack. However, the foreclosure sale will usually have occurred within the one-year period, and accordingly, if this date is considered to be the date of transfer, then the sale may be subject to attack.
The first approach is found in *Durrett*, where the court relied on the broad definition of transfer set out in section 1(30) of the Act to conclude that a foreclosure sale constituted a transfer.\(^{100}\) The *Durrett* court articulated a view that the debtor-creditor relationship, from the execution and perfection of the security device through the termination of the defaulting debtor’s interests in the property, constituted one transfer which was not finalized until the complete termination of the debtor’s interests in the property.\(^{101}\) In light of the *Hulm* decision, it would appear reasonable that the Fifth Circuit might reclassify the entire transaction as two or more separate transfers, a characterization which in no way would disturb the result reached in *Durrett*.

A second approach taken by the bankruptcy court in *In re Alsop*\(^{102}\) provided that while a foreclosure sale might constitute a transfer under section 101(48), section 548(d)(1) sets out special rules which supersede the general definition.\(^{103}\) The *Alsop* court would apply a state law relation-back doctrine to find that the purchaser’s title at a foreclosure sale relates back to the date on which the security lien being enforced is perfected under state law.\(^{104}\)

A third approach, articulated in *Madrid II*, appears to be a hybrid of the *Alsop* reasoning.\(^{105}\) The *Madrid II* court concluded that section 548(d)(1) defined a transfer as that conveyance of rights which was made on the date when the security lien being enforced was perfected under state law.\(^{106}\) The *Madrid II* approach varies from *Alsop* since the *Madrid II* court actually utilized section 548(d)(1) to define the transfer without referring to relation back theories under state law.\(^{107}\)

*In re Hulm* presents a fourth approach. The *Hulm* court focused on the broad definition of transfer found in section 101(48) and concluded that in the life of any debtor-creditor relationship there may be separate and distinct transfers of the debtor’s interests.\(^{108}\) Accordingly, the execution of a mortgage would constitute a transfer, while the foreclosure of the debtor’s interests would constitute yet another transfer. The court’s analysis in *Hulm* seems to approach the transfer issue more realistically since it appears obvious that the debtor’s loss

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101. *Id.*
104. *Id.*
106. *Madrid v. Lawyer’s Title Ins. Corp.*, 725 F.2d 1197, 1199 (9th Cir. 1984) (*Madrid II*).
107. *Id.* at 1199 n.1 (stating that the court did not base its holding on the relation back doctrine).
of the rights to possession should constitute some type of transfer under modern legal principles.

In surveying the four approaches, the conflict seems to center on whether a court chooses to use the literal language and broad definition of transfer found in section 101(48), or to instead rely on section 548(d)(1) to shift the focus of inquiry to the date the security lien was perfected under state law. In order to better analyze the transfer issue, it may be best to consolidate the four approaches into a dichotomy of viewpoints; one best represented by Madrid II, the other by Hulm.

The validity of the Madrid II approach is uncertain because of the 1984 amendments to the Code.\textsuperscript{109} Congress amended sections 101(48) and 548(a) with language which seemed to legislatively overrule Madrid II.\textsuperscript{110} While it appears that there was no intent on the part of Congress to do so,\textsuperscript{111} the language remains and, therefore, presents potential pitfalls to the courts.


\textsuperscript{110} The amendments redesignated section 101(41) as section 101(48), and added to the language of the provision as follows:

"[T]ransfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosures of the debtor's equity of redemption; 11 U.S.C. § 101(48) (1983 & Supp. II 1984) (italicized language added by the 1984 amendments).

Section 548(a) also was amended as follows:

The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—[made the prohibited transfers].


\textsuperscript{111} A discussion on the Senate floor three months after the bill containing the amendments was passed indicates the intent of at least two senators.

\textit{Mr. DeConcini.} Apparently there may have been some misunderstanding regarding the effect of certain technical amendments made by the recently enacted bankruptcy legislation, Public Law 98-353, specifically section 421(i), which amended the definition of transfer in the Bankruptcy Code—11 U.S.C. section 101(48) in the new legislation—to add the phrase "and foreclosure of the debtor's equity of redemption;", and section 467(a)(1), which amended section 548(a) of the Bankruptcy Code to add the phrase "voluntarily or involuntarily." A question has arisen whether these amendments somehow support the position taken by the U.S. Court of Appeals for the Fifth Circuit in Durreet v. Washington National Insurance Co., 621 F.2d 201 (5th Cir. 1980), where the court held that a nonjudicial foreclosure sale could be set aside in bankruptcy if the sale price was not sufficiently high. My understanding is that
Regardless of the 1984 amendments, the general definition of transfer, contained in section 101(41) prior to the amendments, appears to be more than adequate to include a foreclosure sale within its broad definition. Legislative history indicates that the definition was intended to be as broad and expansive as possible. If Congress intended such a broad approach, then it naturally follows that a foreclosure sale should be considered to be a transfer.

Contrasted with this interpretation of transfer, some supporters of the Madrid II decision base their arguments on historical perspective. Two commentators who have reviewed the law of transfers in the early 1900s have concluded that for the purposes of avoidance in bankruptcy, the enforcement of a lien does not constitute a transfer. In analyzing the cases from the Supreme Court during the early 1900s, these commentators, Coppel and Kahn, reviewed the language contained in opinions which held the enforcement of a lien not to be a preference under bankruptcy laws. One case relied upon was Thompson v. Fairbanks, where the Court stated, “It can scarcely be said that the enforcement of a lien by taking possession, with consent of the mortgagor, of after-acquired property covered by a valid mortgage is a conveyance or transfer within the bankrupt act.” Based on statements such as this, usually found in preference cases, Coppel and Kahn have argued that this limiting language should likewise apply to the attempted avoidance of the enforcement of a lien on the basis of a fraudulent transfer.

The arguments raised by Coppel and Kahn have not gone unchallenged. One challenge which seems particularly valid, is that Coppel and Kahn have taken an unduly narrow view of the particular lan-

112. Congressional intent is shown in this statement:

Mr. Dole. The Senator's understanding is indeed correct.

Mr. DeConcini. Then I am correct in concluding that parties in bankruptcy proceedings who seek avoidance of prepetition foreclosure sales would find no support for their arguments in these amendments?

Mr. Dole. The Senator's conclusion is correct.


116. See generally Coppel & Kann, supra note 113.
guage contained within the general discussions of preferences in these opinions.\textsuperscript{117} For instance, in Thompson, language following that relied upon by Coppel and Kahn states, “There is no finding that . . . the mortgagor had any purpose of hindering, delaying or defrauding his creditors . . . . Without a finding to the effect that there was an intent to defraud, there was no invalid transfer of the property within the provisions of section 67(e) of the bankruptcy law.”\textsuperscript{118} This statement indicates that the Supreme Court would have had little difficulty in determining that the enforcement of a lien constituted a fraudulent transfer if the debtor in that case had acted with intent to defraud.\textsuperscript{119}

Another argument which has been raised in support of Madrid II is based on the development of the Uniform Fraudulent Conveyances Act.\textsuperscript{120} In the Prefatory Note, the drafters of the UFCA discussed reasons for its adoption. At one point in the explanation, they state: “There are many transfers which wrong creditors where intent to defraud . . . does not in fact exist. In order to avoid these conveyances, the courts . . . in equity have pushed presumption of fraud as a fact to the unwarranted extent . . . .”\textsuperscript{121} To avoid the use of presumptions, the Note indicates that “[i]n the Act as drafted all possibility of a presumption of law as to intent is avoided,” but those “conveyances which the courts have in practice condemned . . . are declared fraudulent irrespective of intent.”\textsuperscript{122}

It appears that the drafters of the UFCA only intended to codify those common law cases where courts had condemned conveyances through the use of presumptions of fraud. However, courts at that time did not condemn non-collusive foreclosure sales.\textsuperscript{123} Therefore, it is improbable that the drafters of the UFCA, which was later incorporated into the bankruptcy laws without substantial change, intended the “constructive” fraud provisions found in section 4 of the UFCA to apply to non-collusive foreclosure sales.\textsuperscript{124}

While the preceding argument lends support to the Madrid II result, other parts of legislative history tend to support opposing

\textsuperscript{117}. See Davis & Standiford, Foreclosure Sale as Fraudulent Transfer Under the Bankruptcy Code: A Reasonable Approach to Reasonably Equivalent Value, 13 REAL EST. L. J. 203, 222-23 n.75 (1985).
\textsuperscript{118}. Thompson v. Fairbanks, 196 U.S. 516, 523-24 (1905).
\textsuperscript{119}. Davis & Standiford, supra note 117, at 207-10.
\textsuperscript{120}. See Note, Regularly Conducted Non-Collusive Mortgage Foreclosure Sales: Inapplicability of Section 548(a)(2) of the Bankruptcy Code, 52 FORDHAM L. REV. 261, 266 (1983).
\textsuperscript{121}. UFCA, supra note 46, at 428 (Prefatory Note).
\textsuperscript{122}. Id.
\textsuperscript{124}. See Note, supra note 120, at 266.
views. One of the original drafts of section 67(d) contained the following statement: "The provisions of [section 67(d)] ... shall be interpreted and construed so far as possible in uniformity with the law wherever the Uniform Fraudulent Conveyance Act is enacted." This statement was deleted prior to the final passage of the bill in 1938, lending support to the argument that Congress desired that the federal courts have significant leeway in the application of the fraudulent transfer provisions of the bankruptcy laws so that justice might best be served.

One final argument against the Madrid II approach is its reliance on section 548(d)(1). The provision seems designed to solve the problem of fraudulent transfers becoming impregnable to attack by keeping the transfer a secret until the appropriate time limitation period had run. The entire concept incorporated into timing provisions such as a section 548(d)(1), is to postpone the running of the time limitation period, not to accelerate it. Section 548(d)(1) should be strictly applied for the sole purpose of "bringing a transfer ... forward into the avoidance period." While arguments can be made that the decision reached in Madrid II can be supported by historical perspectives, the expansive definition of transfer and the undeniable disposition of some valuable interests of a debtor through a foreclosure sale, which may deprive other creditors of the resources of the debtor's estate, lend support to the decision reached by the Hulm court. The courts and the commentators, however, clearly have not reached any consensus as to whether the foreclosure sale should constitute a transfer.

B. Reasonably Equivalent Value

For the most part, much of the substance contained in section 67(d)
of the Chandler Act, was carried over into section 548 of the Code. In the transition, however, the requirement of "fair consideration" in the Act was switched to "reasonably equivalent value" in the Code. While this change might be considered substantial in some respects, the change really did little to alter the ultimate decisions respecting the avoidance of foreclosure sales as fraudulent transfers. Under the Act, a showing of fair consideration had to include proof that (1) adequate consideration was received in the exchange, and (2) the transferee, the person receiving the debtor's property in exchange for giving value, had acted in good faith. The drafters of the Code chose to omit the sometimes subjective and problematic inquiry into the transferee's good faith, leaving only the requirement that the adequacy of the consideration received in the exchange be reviewed. Since in cases such as Durrett, the parties stipulated to the transferee's good faith, the change from "fair consideration" to "reasonably equivalent value" had little impact on litigation involving non-collusive foreclosure sales.

Case law has spawned at least three distinguishable approaches to ascertaining whether the price received at a foreclosure sale constitutes adequate consideration for the property sold. The first approach, attributed to Durrett, provides a 70% benchmark, whereby a challenged foreclosure sale will not be upheld unless the sale price constitutes at least 70% of the fair market value of the property. A second approach, outlined in Madrid I, holds that any sale price received at a non-collusive foreclosure sale is irrebuttably presumed to be reasonably equivalent value. A third approach, initially expressed in Judge Volinn's dissent to Madrid I, takes the view that the test for reasonably equivalent value should be based on the facts and circumstances surrounding the particular case.

The 70% guideline of Durrett is basically a quantitative ratio for determining the adequacy of the sale price. Under the 70% rule, if the

138. Id. at 203-04.
140. Id. (Volinn, J., dissenting).
141. Id. at 428.
sale price was not equivalent to at least 70% of the fair market value of
the property, the challenged foreclosure sale would be set aside.143

Unfortunately, the Durrett court has been besieged with unfair criticism, since Durrett did not establish a per se rule. Several courts, however, have interpreted the decision in that manner.144

If indeed there is a per se 70% rule in existence, both advantages and disadvantages can be seen. One advantage is that a per se 70% rule may provide bidders at a foreclosure sale more certainty regarding whether a potential bid is likely to be upset in later proceedings. Another consideration resounds in the language of one court. "Despite lip service given to... other factors,... in most of the cases [there are no significant factors] except the price paid at the sale and the fair market value of the property at that time."145 If this is the case, lines must be drawn at some point. Providing an easily identifiable guideline would perhaps lend more uniformity to case decisions then if the determination were left merely to judicial fiat.

The major flaw of a 70% rule is quite self-evident. The inflexibility which is accorded such a standard forecloses judicial consideration of other facts and circumstances relevant to a particular case. As two commentators plainly state the point, "[i]f arithmetic were to supply the answer to the question of whether a transfer is fraudulent, Congress would hardly have asked the courts to determine whether the consideration was... reasonably equivalent...."146

A second approach, outlined in Madrid I, provides that the price received at a regularly conducted, non-collusive foreclosure sale constitutes reasonably equivalent value.147 Only proof of some oppression, unfairness, or fraud would serve to defeat this presumption.148 The justification for such an approach is the desire for harmony between the law of foreclosure and the law of fraudulent transfers.149 This approach has attracted the notice of the National Commissioners on Uniform State Laws, who have incorporated this exact approach into the recently approved Uniform Fraudulent Transfer Act.150


144. One problem inherent in any type of quantitative comparison involving real estate, is that the appraisal of real estate is an inexact science, leading to varied determinations regarding a particular property's actual fair market value.


148. Id.

149. Id.

The approach utilized in Madrid I, however, is subject to criticism. In granting the sale price an irrebuttable presumption of adequacy, the inquiry which section 548(a)(2) is designed to facilitate is all but foreclosed and, therefore, factors which might be important to a court are not considered at all.

The Madrid I rule has also been criticized for giving undue weight to state foreclosure policies which may provide some creditors inadequate protection. When property of the debtor is sold at a foreclosure sale, unsecured creditors of the debtor may be disadvantaged if the sale results in less than adequate consideration for the property being sold. Therefore, federal courts should be able to apply federal bankruptcy law to independently determine the adequacy of the consideration received in order to make available for distribution to creditors the maximum amount of debtor assets.

A third approach to determine reasonably equivalent value, seen by some to be the optimal method, is to test the sale price in view of all of the facts and circumstances surrounding the sale. This approach was initially proposed by Judge Volinn in his dissenting opinion in Madrid I. The Hulm court seemed to take a similar approach in rejecting Madrid I and by making no reference to Durrett. The Hulm court remanded the case to the bankruptcy court for an evidentiary hearing on the issue of reasonably equivalent value—an issue which that court held must be decided on a case by case basis.

Unlike the two approaches previously discussed, the third approach provides a court with the flexibility it may need in particular cases to look to factors other than price. Factors which might be considered include (1) whether the sale resulted from a non-judicial or judicial foreclosure, (2) whether the sale was subject to judicial confirmation, (3) whether the foreclosing lender retained any right to

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152. Id. at 447.
153. Id.
156. In most cases, judicial sales will not present foreclosing creditors with as many opportunities for abusing the system as do nonjudicial foreclosure sales.
157. Certain arguments have been raised that a foreclosure sale which has been subject to a judicial confirmation hearing at the state level should be immune from attack in federal bankruptcy court. See generally Comment, supra note 66. In light of a particular Nebraska statute, NEB. REV. STAT. § 25-1531 (1985), it is interesting to note some of the considerations raised by this contention.

The pertinent part of the Nebraska statute states, "[T]he court may refuse to confirm such sale if, in its opinion, such mortgaged premises have a fair and reasonable value equal to or greater than the amount of the decree ..." Id. Based upon this language in the Nebraska statute, it may appear that the determination of the court at the state level as to the adequacy of the price received at the foreclosure sale, should preclude a trustee or the debtor in possession from challeng-
seek a deficiency judgment against the debtor,\textsuperscript{158} (4) whether there was competitive bidding at the sale, and (5) the actual dollar amount differential between the sale price and the property's fair market

ing the sufficiency of the price received at the foreclosure sale. While an indepth consideration of these issues is beyond the scope of this Article, the issues will briefly be addressed in relation to Nebraska law.

Three courts which have dealt with this subject to a limited extent are \textit{In re Gilmore}, 31 Bankr. 615 (Bankr. E.D. Wash. 1983); \textit{In re Perdido Bay Country Club Estates, Inc.}, 23 Bankr. 36 (Bankr. S.D. Fla. 1982); and \textit{In re Jones}, 20 Bankr. 988 (Bankr. E.D. Pa. 1982). All three cases were conducted in the context of a reorganization in bankruptcy, and not straight liquidation. The court in \textit{Jones} held the foreclosure sale to be a fraudulent transfer but made no reference at all to the judicial aspects of the sale. In the other two cases, both courts held the debtor in possession was collaterally estopped from challenging the adequacy of the price received at foreclosure sale in federal bankruptcy litigation, based upon the opportunity which the debtor had in state court to challenge the sale.

In considering whether a state court's determination as to the adequacy of price received at a foreclosure sale should preclude inquiry into the issue under federal bankruptcy law, several arguments can be made that the issue should still remain open to litigation. One argument which might be made and could be applied with equal force to a debtor in possession or to a trustee, is that the standards by which the sale price is judged may vary from state court to federal court. Nebraska standards for review of a district court's determination of the adequacy of the sale price are stated as follows: "Mere inadequacy of price will not preclude a confirmation of a judicial sale, unless it is so inadequate as to shock the conscience of the court or amount to evidence of fraud." Department of Banking v. Modrow, 134 Neb. 336, 278 N.W. 559 (1938). \textit{Accord Nebraska Fed. Sav. & Loan Ass'n v. Patterson}, 212 Neb. 29, 321 N.W.2d 71 (1982) (order of confirmation will not be reversed unless shocking discrepancy between value and sale price).

Based upon the \textit{Restatement (Second) of Judgments} § 28(4) (1982), it would appear that a party should not be precluded from relitigating an issue if the party had a significantly heavier burden of persuasion in the first action. If a challenging party were to be able to successfully show a variance in the standards, the issue of price adequacy may be reopened in federal court. Unfortunately, it would appear in a review of the cases, that the lowest sale price which was confirmed and subsequently upheld constituted approximately 70% of the property's value. \textit{See E.H. Lougee, Inc. v. Matters}, 124 Neb. 223, 246 N.W. 242 (1933). This leaves in question whether the standards may be so different as to provide this avenue of attack on a judicially confirmed sale in Nebraska. \textit{See Brown v. Felson}, 442 U.S. 127, 139 n.10 (1979) (if a state court uses standards identical to federal standards, then relitigation may be collaterally estopped).

Another argument that a trustee could raise, however, is that he was not a party to the first action, and therefore should not be precluded from challenging the adequacy of the price received at the foreclosure sale. Under the \textit{Restatement (Second) of Judgments} § 28(1) (1982), the trustee would seem to have a good chance of litigating the matter, since he would not have been able to obtain review of the confirmation hearing. The trustee should not be stopped by an argument that he is claiming under the debtor who might be estopped, since the trustee would be able to attack fraudulent conveyances made with actual intent by a debtor even though the debtor could not attack these transfers. The trustee, attacking on behalf of creditors of the debtor's estate, should then have opportunity to reopen the issue of the adequacy of the sale price.

\textsuperscript{158} If a foreclosing creditor is able to obtain a deficiency judgment against the debtor, the debtor's estate will be depleted by even a greater amount.
value.159

In brief, the entire issue narrows down to a choice of (1) holding state foreclosure practices to be immune from scrutiny, or (2) allowing federal courts the flexibility to review particular foreclosure sales to insure that the interests of the creditors of the debtor's estate have not been significantly harmed.

C. Policy Considerations

The controversy which surrounds the concept of avoiding foreclosure sales as fraudulent transfers is not one that will be easily dispelled. Most views regarding either the transfer issue or the issue of price adequacy are supported by meritorious considerations and arguments. Because of the competing arguments, the ultimate resolution of this matter should be based upon the principle which underlies both foreclosure law and bankruptcy law—the principle of equity. Only by evaluating and weighing the fairness of the competing policy considerations will a just resolution be found.

In reviewing the various policy considerations to be addressed in formulating a resolution to this matter, it is insightful to return once again to the scene of a foreclosure sale. The archaic ritual commences once again, never really having proved its ability to achieve the highest sale price possible for any particular parcel of real estate.

On the steps of the courthouse stands the sheriff or a trustee, who has probably never been formally trained in the art of auctioneering. Various spectators and curious onlookers watch as he commences the sale. These onlookers might have been drawn to the sale by a notice posted at the courthouse, a notice posted on the subject property, or a legal notice located within the bowels of a local legal publication of limited circulation. The person conducting the sale describes the property only by legal description, which may constitute little more than gibberish to many laypersons. One spectator who asks whether the property is subject to prior liens, receives only a vague reply. The terms of settlement are simple—cash, a very uncommon and inconvenient form of real estate financing. During the time allocated to the receiving of bids, the person conducting the sale receives only one bid, that of the foreclosing lender. Calling for further bids and receiving no response, the sheriff or trustee, as the case may be, declares the sale closed and the property sold to the only bidder.

In light of this forced-sale environment, federal courts have intervened only in those situations in which the inadequacy of the price

159. If a property's value is only $10,000 and it sells for $6,800, should this be compared with a property having a value of $1,000,000 and selling for only $680,000? Both ratios of sale price to value equal 68%, however, there is a substantial difference in the amount of depletion in the respective debtors' estates.
received at the sale was so low under the circumstances that the sale constituted a constructively fraudulent transfer. The federal courts, under bankruptcy laws, are protecting the interests of the debtor and/or the interests of creditors of the debtor's estate, which otherwise may go unprotected from an estate-depleting transfer.

Opposing policy considerations can be raised, one of which is the concern that in avoiding foreclosure sales, courts will cast a cloud on the title of real estate purchased at foreclosure sales. This is certainly a valid concern. However, it should be noted that in almost one-half of the states, under certain forms of foreclosure, statutory redemption periods already exist which produce the same result.\textsuperscript{160}

Another consideration is that the cloud that may be created on titles will reduce competitive bidding at foreclosure sales. In actuality, under today's present system, the vast majority of foreclosure sales are also provided with certain protections under sections 548(c) and 550 of the Code.\textsuperscript{161}

Concern might also be raised that the avoidance of foreclosure sales would wreak havoc on the credit markets, increasing the cost of credit and reducing the amount of credit available to particular consumers. It would appear true that as financial institutions tailored loans to meet the new risks foreseen, the amount of credit available to real estate purchasers with minimal resources would be reduced, thereby cutting potential purchases out of the real estate market. In fact, however, the amount of equity a purchaser has in any parcel of real estate may very well be correlated to the likelihood of the purchaser's not defaulting in payments on the loan covering the property. The ultimate result would not be a destabilizing result, but instead, a stabilizing outcome.

Ultimately, any proposed solution would seem to require certain tradeoffs. While there is an interest in upholding foreclosure procedures, it appears that most state legislatures have postponed needed reforms. And in light of the Machiavellian foreclosure procedures sanctioned by existing laws, court decisions avoiding foreclosure sales as fraudulent transfers are probably appropriate and probably also serve an important impetus in moving state legislatures toward reforms of state foreclosure procedures.

VI. PROPOSALS FOR REFORMING STATE FORECLOSURE PRACTICES

It is clearly not realistic or practical to require that foreclosure sales realize prices equivalent to those received in lengthy, fully negotiated transactions where both parties are at liberty to terminate the

\textsuperscript{160} G. NELSON \& D. WHITMAN, \textit{supra} note 5, at 616.

\textsuperscript{161} 11 U.S.C. §§ 548(c), 550 (1982).
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negotiations. The distress factor involved in a foreclosure sale undeniably places a certain amount of downward pressure on the ultimate sale price. However, regardless of the inherent downward pressure on the price, certain changes in foreclosure procedures would serve to avoid ridiculously low bargain-sale prices.

Probably one of the two greatest inadequacies of foreclosure procedures is the lack of sufficient advertising reasonably calculated to attract and encourage potential bidders. Generally, statutorily mandated advertising and notice requirements are limited to (1) the posting of the property, (2) a legal notice of the upcoming foreclosure sale posted in the courthouse, and/or (3) a legal notice imbedded in a local publication. Usually the property is described only by legal description, in a very generic legal notice and, consequently, does not serve the function of attracting large numbers of laypeople as potential bidders.

One step in reforming the foreclosure process would be to require foreclosing parties to advertise the property to be sold in a manner comparable to methods employed by other sellers of real estate. Such advertising might include a description of the property in laymen’s terms and possibly a photo of the property if the real estate included a structure. The advertisement might be placed in a weekend edition of a paper of general circulation in order to reach as many people as possible.

A second, and complementary approach toward increasing visibility might include some type of multiple listing arrangement with local realty companies. The property would receive exposure prior to the sale and local realty companies would receive some nominal consideration for the exposure service they provided. If the arrangement was not suitable to realty companies, perhaps simple published brochures describing upcoming foreclosure sales and the properties involved could be placed at strategic locations, such as banks and other financial institutions throughout a county, for distribution to the public.

Probably the second greatest deficiency of the foreclosure process is the terms of payment for purchased properties. Normally, the sale price must be paid in cash very shortly after the completion of the sale. Since realty is seldom transferred without some financing involved, the short-fused payment period very often takes most potential buyers out of the market.

In order to alleviate this problem, several steps should be taken to accommodate those potential buyers who would utilize financing from local financial institutions to complete the deal. To facilitate such financing, the foreclosing entity should be required to prepare a title report and make that report available to potential bidders prior to the sale date. By doing so, potential bidders, and their lenders, are alerted to any liens on the property superior to that of the foreclosing entity.
This would provide the certainty of title necessary to a lender in providing a tailored loan commitment to a potential purchaser prior to the sale.

The arrangements for payment of the sale price should provide the successful bidder with a reasonable period of time to finalize any financing arrangements. The consummation of the deal could then be scheduled at a time and place agreeable to the parties, and conducted in a manner similar to the closings of most real estate transfers.

Other modifications of the foreclosure procedure would be designed to alter the environment of the sale. One recommended change would be to relocate the sale from the courthouse steps to a location such as an assembly room or unoccupied courtroom, providing fewer distractions and less of an air of entertaining spectacle. Another recommended change would be to replace the normally stoic and subdued person conducting the sale with a person having some training in the art of auctioneering, for the purpose of actively soliciting bids.

While these proposals are in no way exhaustive of the potential modifications of foreclosure procedures, they demonstrate the ease with which existing foreclosure procedures can be improved. By attacking the adequacy of prices received under current methods of foreclosure, courts in cases such as Durrett and Hulm have merely reinforced basic instincts as to the overall shortcomings of current foreclosure practices. Only through decisions such as these, will state legislatures be prodded toward reforming current foreclosure procedures.

*Michael L. Walcott '86*