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## Regularly Conducted Non-Collusive Mortgage Foreclosure Sales: Inapplicability of Section 548(a)(2) of the Bankruptcy Code

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## NOTES

### REGULARLY CONDUCTED NON-COLLUSIVE MORTGAGE FORECLOSURE SALES: INAPPLICABILITY OF SECTION 548(a)(2) OF THE BANKRUPTCY CODE

#### INTRODUCTION

The concept of "fraudulent conveyance" traditionally contemplated a debtor who disposed of his property with the intention of defrauding his creditors.<sup>1</sup> To correct the inequities created by such fraudulent conveyances, Congress<sup>2</sup> and state legislatures<sup>3</sup> have enacted statutes designed to protect defrauded creditors. These statutes typically allow the fraudulent conveyance to be voided.<sup>4</sup>

The current federal provision addressing fraudulent transfers is section 548(a)(2) of the Bankruptcy Code of 1978 (Bankruptcy Code),<sup>5</sup> which provides:

The trustee may avoid any transfer of an interest of the debtor in property . . . within one year before the date of the filing of the petition, if the debtor . . . received less than a reasonably equivalent value in exchange for such transfer or obligation; and . . . was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.<sup>6</sup>

Historically, non-collusive mortgage foreclosure sales were virtually never voided as fraudulent conveyances.<sup>7</sup> This remained true even

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1. F. Wait, *A Treatise on Fraudulent Conveyances and Creditors' Bills* § 15, at 34-35 (3d ed. 1897); see D. Moore, *A Treatise on Fraudulent Conveyances and Creditors' Remedies* 3-4 (1908).

2. See Bankruptcy Code of 1978 § 548, Pub. L. No. 95-598, 92 Stat. 2600 (1978) (codified at 11 U.S.C. § 548 (1982)); Chandler Act, ch. 575, § 67(d), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548(a) (1982)).

3. *E.g.*, Cal. Civ. Code §§ 3439-3439.12 (West 1970 & Supp. 1983); Del. Code Ann. tit. 6, §§ 1301-1302 (1974); Idaho Code §§ 55-910 to -922 (1979); Mich. Comp. Laws Ann. §§ 566.11-.23 (1967); N.Y. Debt. & Cred. Law §§ 270-281 (McKinney 1945 & Supp. 1982-1983); N.D. Cent. Code §§ 13-02-01 to -11 (1981).

4. *E.g.*, Cal. Civ. Code §§ 3439.07, .09 (West 1970 & Supp. 1983); Del. Code Ann. tit. 6, §§ 1307, 1310 (1974); Idaho Code §§ 55-916, -918 (1974); Mich. Comp. Laws Ann. §§ 566.17, .20 (1967); N.Y. Debt. & Cred. Law §§ 276, 278 (McKinney 1945); N.D. Cent. Code §§ 13-02-07, -09 (1981).

5. 11 U.S.C. § 548(a)(2) (1982).

6. *Id.*

7. Brief of Amici Curiae for California Bankers Association and California Bank Clearing House Association at 16-18, *Madrid v. Lawyers Title Ins. Corp.*, *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983) [hereinafter cited as *Amici Curiae Brief*]; Sec. Real Prop., Prob. & Trust L., A.B.A., Report to the House of Delegates, No. 106B, at 3 (1983) [hereinafter cited as *A.B.A. Report*]; see, *e.g.*, *Pierce v. Pierce*,

when the property was sold for less than its fair market value.<sup>8</sup> In 1980, however, the Fifth Circuit in *Durrett v. Washington National Insurance Co.*<sup>9</sup> interpreted section 67(d) of the Chandler Act of 1938 (Chandler Act),<sup>10</sup> the predecessor of section 548(a)(2) of the Bankruptcy Code, to mean that a trustee in bankruptcy has the power to avoid a non-collusive mortgage foreclosure sale.<sup>11</sup>

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16 Cal. App. 375, 383, 117 P. 580, 583 (1911); *Harris v. Wagshal*, 343 A.2d 283, 294-95 (D.C. 1975); *Citizens State Bank v. Haworth*, 208 Iowa 1100, 1105, 222 N.W. 428, 430 (1928); *Reeves v. Miller*, 121 Mich. 311, 313, 80 N.W. 19, 19 (1899); *Bourgeois v. Edwards*, 104 A. 447, 449 (N.J. Ch. 1918); *Magruder v. Clayton*, 29 S.C. 407, 413, 7 S.E. 844, 848 (1888); *Brown v. O'Meara*, 193 S.W.2d 715, 720 (Tex. Civ. App. 1946). *But see* *Langan v. First Trust & Deposit Co.*, 277 A.D. 1090, 1091, 101 N.Y.S.2d 36, 37 (4th Dept. 1950) (per curiam), *aff'd*, 302 N.Y. 932, 100 N.E.2d 189 (1951). The *Langan* court held that the sale of a corporation's assets at foreclosure for half of their market value constituted a fraudulent conveyance. *Id.* at 1091, 101 N.Y.S.2d at 37. The dissent argued that "[t]he foreclosure of the mortgage was legal in all respects and there was no duty on the part of the bank . . . to the unsecured creditors to bid in the property for its full market value. . . . The inference is that the defendants were acting in honest defense of their own business interests." *Id.* at 1091, 101 N.Y.S.2d at 37-38 (Kimball & Taylor, JJ., dissenting).

8. *Amici Curiae* Brief, *supra* note 7, at 17; *see, e.g., Harris v. Wagshal*, 343 A.2d 283, 286, 295 (D.C. 1975); *Laflin v. Central Publishing House*, 52 Ill. 432, 434 (1869); *Citizens State Bank v. Haworth*, 208 Iowa 1100, 1101-05, 222 N.W. 428, 429-30 (1928); *Reeves v. Miller*, 121 Mich. 311, 312, 80 N.W. 19, 19 (1899). *But see* *Langan v. First Trust & Deposit Co.*, 277 A.D. 1090, 1091, 101 N.Y.S.2d 36, 37 (4th Dept. 1950) (per curiam) (affirming finding of fraudulent transfer when corporate assets worth over \$50,000 were sold for \$25,000), *aff'd*, 302 N.Y. 932, 100 N.E.2d 189 (1951).

9. 621 F.2d 201 (5th Cir. 1980).

10. Chandler Act, ch. 575, § 67(d), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548(a) (1982)).

11. *See Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 204 (5th Cir. 1980). Other courts have followed *Durrett's* approach and applied § 548(a)(2) to non-collusive mortgage foreclosure sales. *E.g., Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547, 548-49 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982); *Gillman v. Preston Family Inv. Co. (In re Richardson)*, 23 Bankr. 434, 448 (Bankr. D. Utah 1982); *Perdido Bay Country Club Estates, Inc. v. Equitable Trust Co.*, 23 Bankr. 36, 39 (Bankr. S.D. Fla. 1982); *Home Life Ins. Co. v. Jones*, 20 Bankr. 988, 993 (Bankr. E.D. Pa. 1982); *Wickham v. United Am. Bank (In re Thompson)*, 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982).

The implications of *Durrett's* holding extend beyond § 548(a)(2). Section 544(b) of the Bankruptcy Code allows the trustee to avoid any transfer of an interest of the debtor in property that is voidable under applicable law by specified creditors. 11 U.S.C. § 544(b) (1982). If *Durrett's* holding is applied to § 544(b), the remedies available under state fraudulent conveyance statutes may be used to void non-collusive mortgage foreclosure sales. Because the trustee filing an action under § 544(b) is not limited by the one year provision in § 548(a)(2), *Durrett* would subject non-collusive mortgage foreclosure sales to attack for an indefinite time. *See Coppel & Kann, Defanging Durrett: The Established Law of "Transfer,"* 100 Banking L.J. 676, 681 n.14 (1983).

In the aftermath of the *Durrett* decision, courts have taken positions in conflict with the Fifth Circuit.<sup>12</sup> The Bankruptcy Court for the District of Alaska, for example, held that a foreclosure sale was not voidable because the transfer of the property at the foreclosure sale related back to the execution of the deed of trust, which occurred more than one year before the filing of the petition.<sup>13</sup> Alternatively, the Bankruptcy Appellate Panel for the Ninth Circuit has taken the position that the price received for property at a non-collusive and regularly conducted mortgage foreclosure sale should be presumed to be "reasonably equivalent value,"<sup>14</sup> effectively precluding avoidance

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12. Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the Durrett Problem*, 38 Bus. Law. 1605, 1607 (1983). Compare *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 204 (5th Cir. 1980) (mortgage foreclosure sales are among transfers voidable under § 67(d)) and *Home Life Ins. Co. v. Jones*, 20 Bankr. 988, 994 n.23 (Bankr. E.D. Pa. 1982) (§ 548(a)(2) is applicable to foreclosure sales) with *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983) (applying presumption that "reasonably equivalent value" is received at regularly conducted, non-collusive mortgage foreclosure sales and effectively removing such sales from consideration under § 548(a)(2)) and *Alsop v. Alaska*, 14 Bankr. 982, 986 (Bankr. D. Alaska 1981) (transfer of property effected at foreclosure sale related back to date of execution of deed of trust, rendering foreclosure sale non-voidable), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982).

13. *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982). In reaching its conclusion, the *Alsop* court noted that § 548(d)(1) of the Bankruptcy Code deems a transfer to occur when it is so far perfected that a bona fide purchaser could not have obtained an interest superior to that of the transferee. *Id.* Further, the court stated that under state law, the title of the purchaser at the foreclosure sale related back to the time of execution of the deed of trust. *Id.* Because no person purchasing in good faith from the debtor could have obtained title superior to that of the purchaser at the foreclosure sale after the execution of the deed of trust, the transfer was deemed to have occurred when the deed was executed. *Id.* The court conceded that the mortgage foreclosure sale might well constitute a transfer under the definition set forth in § 101(41) of the Bankruptcy Code. The court ruled, however, that for the purposes of § 548(a)(2) the transfer actually took place when the debtor executed the deed of trust, more than a year before he filed his petition. Thus, the foreclosure was not subject to avoidance under the fraudulent transfer provision of the Bankruptcy Code. *Id.*

The *Alsop* rationale was criticized in *Gillman v. Preston Family Inv. Co. (In re Richardson)*, 23 Bankr. 434 (Bankr. D. Utah 1982), which questioned the *Alsop* court's failure to consider the transfer of the debtor's equity in the property rather than the transfer of title. *Id.* at 445-46. Because the transfer of debtor's equity is the transfer the trustee seeks to avoid, and because this occurs only at the mortgage foreclosure sale, the *Richardson* court concluded that a mortgage foreclosure sale did constitute a transfer for the purposes of § 548(a)(2). *See id.* at 446.

14. *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983); *see Moore v. Gilmore*, No. C-83-232, slip op. at 4, 7 (E.D. Wash. July 6, 1983) (utilizing the *Madrid* presumption to uphold a sheriff's sale); *Rosner v. Worcester*, 28 Bankr. 910, 915 (Bankr. C.D. Cal. 1983) (adopting *Madrid* analysis and setting aside a foreclosure sale that was not regularly conducted).

of non-collusive mortgage foreclosure sales under section 548(a)(2).<sup>15</sup>

Part I of this Note identifies the types of transfers that should be subject to voidability under section 548(a)(2) through analysis of the common law of fraudulent conveyances and the incorporation of the common law into statutory law, concluding that the application of this section to void non-collusive mortgage foreclosure sales contravenes the intent of Congress. Part II interprets the "reasonably equivalent value" requirement of section 548(a)(2)(A) and argues that in the context of a non-collusive mortgage foreclosure sale, "reasonably equivalent value" should be interpreted as being the price received for the property sold at such a sale. Part III of this Note analyzes the policy considerations involved in the application of section 548(a)(2) to non-collusive foreclosure sales and concludes that detrimental economic effects as well as substantial interference with state foreclosure policies would result from such an application.

## I. MORTGAGE FORECLOSURE SALES AS TRANSFERS

### A. Textual Interpretation of "Transfer"

Section 548(a)(2) of the Bankruptcy Code allows a trustee in bankruptcy to avoid specified transfers of the debtor's interest in property.<sup>16</sup> Section 101(41) defines transfer as "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."<sup>17</sup>

The transfer of the debtor's property to the purchaser of his property at a non-collusive mortgage foreclosure sale arguably falls within the plain meaning<sup>18</sup> of section 101(41). For the purposes of section 548(a)(2), however, this literal interpretation should not prevail because it is inconsistent with the intent of Congress.<sup>19</sup>

### B. Intent of the Legislature

#### 1. The Statute of 13 Elizabeth and the Common Law

The legislative history of section 548(a)(2) is rooted in one of the earliest statutory attacks on fraudulent conveyances in the English

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15. *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983).

16. 11 U.S.C. § 548(a)(2) (1982).

17. *Id.* § 101(41) (1982).

18. The interpretation of a statute must begin with an examination of the plain meaning of its language. 2A C. Sands, *Sutherland's Statutes and Statutory Construction* § 46.01 (4th ed. 1973).

19. See *infra* notes 20-63 and accompanying text. One exception to the "plain meaning" rule is that the literal interpretation of the statute should not be followed when it is inconsistent with legislative intent. 2A C. Sands, *supra* note 18, § 46.07.

system of law—the Statute of 13 Elizabeth.<sup>20</sup> This statute, which was enacted in 1570, provided for the voiding of all conveyances by debtors which were intended to “delay, hinder or defraud creditors.”<sup>21</sup> In the United States, the Statute of 13 Elizabeth was “universally adopted” in common law as the basis of American jurisprudence on the subject.<sup>22</sup>

At common law, state courts typically set aside collusive and fraudulent sales held under a foreclosure of a mortgage or a deed of trust on real or personal property.<sup>23</sup> Those sales in which no fraud had been shown, however, were not voided by the vast majority of state courts.<sup>24</sup> Such sales were upheld even when less than market value had been received for the property.<sup>25</sup> Most courts, in fact, simply assumed that non-collusive mortgage foreclosure sales were not in the class of voidable fraudulent transfers.<sup>26</sup>

## 2. The Uniform Fraudulent Conveyances Act

In order to promote harmony in the law of fraudulent conveyances, the National Conference on Uniform State Laws and the American Bar Association approved the Uniform Fraudulent Conveyance Act (UFCA)<sup>27</sup> in 1918.<sup>28</sup> Although the UFCA adopted the concepts under-

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20. Statute of Fraudulent Conveyances, 1570, 13 Eliz., ch. 5., *quoted in* G. Glenn, *The Law of Fraudulent Conveyances* § 53, at 85 (1931); *see* H.R. Rep. No. 595, 95th Cong., 1st Sess. 375 (1977); 4 *Collier on Bankruptcy* ¶ 548.01, at 548-3 (L. King 15th ed. 1983).

21. Statute of Fraudulent Conveyances, 1570, 13 Eliz., ch. 5, *quoted in* G. Glenn, *supra* note 20, § 53, at 85.

22. 1 D. Moore, *supra* note 1, at 12; F. Wait, *supra* note 1, § 19, at 44.

23. *See* *Amici Curiae Brief*, *supra* note 7, at 16-19; 1 G. Glenn, *Fraudulent Conveyances and Preferences* § 214a, at 367 (rev. ed. 1940); A.B.A. Report, *supra* note 7, at 3; *see, e.g.*, *Isaacson v. Union Trust Co.*, 210 Cal. 473, 475-76, 292 P. 448, 449 (1930); *W.H. Collins Ice Cream Co. v. Talmage*, 210 Ill. App. 374, 375 (1918); *Joseph P. Manning Co. v. Shinopoulos*, 317 Mass. 97, 100, 56 N.E.2d 869, 871 (1944); *Citizens Bank v. Robinson*, 342 Mo. 697, 712, 117 S.W.2d 263, 271 (1937); *Fernhaber v. Stein*, 182 Wis. 61, 69-70, 195 N.W. 906, 909 (1923).

24. *Amici Curiae Brief*, *supra* note 7, at 16-18; *see, e.g.*, *Pierce v. Pierce*, 16 Cal. App. 375, 383, 117 P. 580, 583 (1911); *Citizens State Bank v. Haworth*, 208 Iowa 1100, 1105, 222 N.W. 428, 430 (1928); *Reeves v. Miller*, 121 Mich. 311, 312-13, 80 N.W. 19, 19 (1899); *Bourgeois v. Edwards*, 104 A. 447, 449 (N.J. Ch. 1918); *Magruder v. Clayton*, 29 S.C. 407, 413, 7 S.E. 844, 848 (1888); *Brown v. O'Meara*, 193 S.W.2d 715, 720 (Tex. Civ. App. 1946).

25. *Amici Curiae Brief*, *supra* note 7, at 17-18; *see, e.g.*, *Harris v. Wagshal*, 343 A.2d 283, 295 (D.C. 1975); *Lafin v. Central Publishing House*, 52 Ill. 432, 434 (1869); *Citizens State Bank v. Haworth*, 208 Iowa 1100, 1101-05, 222 N.W. 428, 429-30 (1928); *Reeves v. Miller*, 121 Mich. 311, 312, 80 N.W. 19, 19 (1899).

26. *See supra* note 24 and accompanying text.

27. *Unif. Fraudulent Conveyance Act*, 7A U.L.A. 161 (1978).

28. *Id.* Historical Note.

lying the Statute of 13 Elizabeth to a large extent,<sup>29</sup> there were changes in language.

Section 4 of the UFCA provided: "Every conveyance 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."<sup>30</sup> This language differed from the language in the Statute of 13 Elizabeth in that it removed the requirement of a showing of an actual intent by the debtor to defraud his creditors.<sup>31</sup> Thus, section 4 was potentially applicable to non-collusive mortgage foreclosure sales in which a low price was received for the property. The Commissioners' Prefatory Note to the UFCA (Note),<sup>32</sup> however, indicated that it was not the intention of the drafters to bring about such a radical change in the law.

In advancing the rationale behind the language in section 4, the Note acknowledged that many conveyances are made in which creditors are wronged, but in which there is no intent to defraud on the part of the debtor.<sup>33</sup> In such cases, many courts had presumed intent in order to do justice but, in doing so, had "pushed [the] presumption of fraud as a fact to an unwarranted extent."<sup>34</sup> To avoid the necessity of employing such a questionable rationale, the Note stated 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."<sup>35</sup>

Thus, the drafters indicated their intention to codify under section 4 of the UFCA only those common law cases in which presumptions of fraud were utilized to condemn certain conveyances. The vast majority of courts, however, did not condemn non-collusive foreclosure sales.<sup>36</sup> It is highly unlikely, therefore, that section 4 of the UFCA was intended to apply to non-collusive foreclosure sales.

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29. See *Hay v. Duskin*, 455 P.2d 281, 286 (Ariz. App. 1969) ("[T]he Uniform Fraudulent Conveyance Act . . . is declaratory of the common law and a restatement of the statute of 13 Elizabeth."); *Dorrington v. Jacobs*, 252 N.W. 307, 309 (Wis. 1934) ("The Uniform Fraudulent Conveyance Act . . . may be said to be a restatement of the Statute of 13 Elizabeth."); H.R. Rep. No. 1409, 75th Cong., 1st Sess. 32 (1937) ("[T]he Uniform Act is largely declaratory of the better decisions of American State courts construing the Statute of Elizabeth.").

30. Unif. Fraudulent Conveyance Act § 4, 7A U.L.A. 205 (1978).

31. See *supra* note 21 and accompanying text.

32. Unif. Fraudulent Conveyance Act, Commissioners' Prefatory Note, 7A U.L.A. 161.

33. *Id.* at 162.

34. *Id.*

35. *Id.*

36. See *supra* note 24 and accompanying text.

## 3. Section 67(d)(2) of the Chandler Act

In 1938, Congress passed the Chandler Act,<sup>37</sup> which made many substantive amendments to the Bankruptcy Act of 1898 (Bankruptcy Act).<sup>38</sup> Among these amendments was the addition of section 67(d)(2),<sup>39</sup> which incorporated a condensed version of section 4 of the UFCA.<sup>40</sup> Although section 4 of the UFCA as adopted in section 67(d)(2) remained substantially intact, one significant change was made by the drafters of the Chandler Act: The word "conveyance" was replaced with "transfer."<sup>41</sup> At first impression, the change in language of the UFCA found in section 67(d)(2) of the Chandler Act may evince an intent on the part of Congress to expand the application of this section to areas previously unaffected by section 4 of the UFCA because the definition of "transfer" in the Chandler Act includes involuntary dispositions of property.<sup>42</sup> Concededly, non-collusive mortgage foreclosure sales are included within this definition of "transfer."<sup>43</sup> Evidence indicating that Congress did not intend such sales to be voidable under section 67(d)(2), however, may be gleaned from committee reports and prints discussing this section.

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37. Chandler Act, ch. 575, 52 Stat. 840 (1938) (superseded by 11 U.S.C. §§ 101-151,326 (1982)).

38. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (superseded by 11 U.S.C. §§ 101-151,326 (1982)).

39. Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548 (1982)).

40. National Bankruptcy Conference, 74th Cong., 2d Sess., Analysis of H.R. 12889, at 214 n.3 (Comm. Print 1936) [hereinafter cited as Analysis of H.R. 12889].

41. Compare Unif. Fraudulent Conveyance Act § 4, 7A U.L.A. 205 (1978) with Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548 (1982)). Another change was made by the drafters of the Chandler Act. Under § 67(d)(2) of the Act, avoidance of the transfer required that a petition in bankruptcy be filed by the debtor within one year after the date of transfer. Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938). The UFCA, in contrast, which did not address itself specifically to bankruptcy situations, did not contain any time requirement. Unif. Fraudulent Conveyance Act § 4, 7A U.L.A. 205 (1978). An action to avoid a fraudulent conveyance under the UFCA, therefore, must be brought within the applicable state statute of limitations.

42. Chandler Act, ch. 575, § 1(30), 52 Stat. 840, 842 (1938) (superseded by 11 U.S.C. § 101(41) (1982)). "Transfer" is defined in § 1(30) of the Chandler Act as:

[T]he 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, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise.

*Id.*

43. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 204 (5th Cir. 1980); see Gillman v. Preston Family Inv. Co. (*In re Richardson*), 23 Bankr. 434, 448 (Bankr. D. Utah 1982); Alden, Gross & Borowitz, *supra* note 12, at 1608.



In its analysis of section 67(d)(2), for example, a House Committee Report indicated an intent to incorporate the UFCA into the Bankruptcy Act because the Committee approved of the common law that had been incorporated into the UFCA.<sup>44</sup> The Committee stated that the UFCA represented the reasoning of the better decisions of those American courts that had interpreted the Statute of 13 Elizabeth.<sup>45</sup> In addition, the notes of the drafters of section 67(d) indicate that the application of the section was designed to mimic to a large degree the application of section 4 of the UFCA.<sup>46</sup> Jacob I. Weinstein, one of the drafters of section 67, explained that the drafters had "condensed the provisions of the Uniform Fraudulent Conveyance Act, retaining its substance and, as far as possible, its language."<sup>47</sup>

Weinstein further explained that the change in language of the statute from "conveyance" to "transfer" was made "[i]n order to achieve uniformity [of] terminology" throughout the Bankruptcy Act.<sup>48</sup> The drafters, therefore, did not intend the change in language to be of substantive importance in incorporating the UFCA into the Chandler Act. Consequently, the use of the term "transfer" in section 67(d)(2) was not intended to bring under its purview any conveyances not condemned by the common law or the UFCA, such as non-collusive foreclosure sales.

There is, however, some evidence to the effect that the application of section 67(d) was not intended to duplicate entirely the previous application of the UFCA by state courts. The original draft of section 67(d) contained the following qualification: "The provisions of this subdivision shall be interpreted and construed so far as possible in uniformity with the law whenever the Uniform Fraudulent Conveyance Act is enacted."<sup>49</sup> This segment did not appear in the final

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44. See H.R. Rep. No. 1409, 75th Cong., 1st Sess. 32 (1937).

45. *Id.*; see Analysis of H.R. 12889, *supra* note 40, at 213 n.3 (quoting Prof. James Angell McLaughlin, a drafter of the UFCA).

46. Analysis of H.R. 12889, *supra* note 40, at 213-14 n.3.

47. *Id.* at 214 n.3.

48. *Id.* at 7 (Weinstein note); see H.R. Rep. No. 1409, 75th Cong., 1st Sess. 5 (1937). Because "transfer" was used in various sections of the Bankruptcy Act, it became necessary to expand the definition so that the term encompassed all its uses. Analysis of H.R. 12889, *supra* note 40, at 7 (Weinstein note); see H.R. Rep. No. 1409, 75th Cong., 1st Sess. 5 (1937). Thus, the use of the word "transfer," with its broadened definition, was intended to coordinate the language of the Bankruptcy Act and not to change the law of fraudulent conveyances. Cf. Coppel & Kann, *supra* note 11, at 696 & n.74. Coppel and Kann cite to the legislative history of the Chandler Act and view the drafters' stated purpose of coordinating language in the Bankruptcy Act as an indication that Congress did not intend to change the law of transfer. *Id.*

49. Analysis of H.R. 12889, *supra* note 40, at 217.

version of the bill<sup>50</sup> and, therefore, federal courts could interpret section 67(d) as they saw fit.<sup>51</sup> Nevertheless, because the drafters clearly indicated that the application of section 67(d) was intended to be guided by previous case law, it is not likely that the omission represented a move away from adherence to the underlying principles of the UFCA.

#### 4. Section 548 of the Bankruptcy Code

In 1978, the Bankruptcy Act was superseded by the Bankruptcy Code. Section 67(d)(2) of the Bankruptcy Act was replaced and simplified<sup>52</sup> by section 548(a)(2) of the Bankruptcy Code.<sup>53</sup> The Commission on the Bankruptcy Laws of the United States, created by Congress to recommend changes in the bankruptcy laws, explained in its report: "Section 67(d) is modeled upon the Uniform Fraudulent Conveyance Act. The Commission believes that it has worked satisfactorily and it does not recommend any substantial changes therein, except a simplification of its extremely complex language."<sup>54</sup> This statement indicates that no dramatic change in the law was envisioned.<sup>55</sup> Such an interpretation is strengthened by the absence of any legislative history directly supporting the application of section 548(a)(2) to new types of transfers such as non-collusive mortgage foreclosure sales.<sup>56</sup> In fact, the unprecedented application of section 548(a)(2) to void regularly conducted non-collusive mortgage foreclosure sales has recently inspired a legislative attempt to amend section 548 specifically to exclude such sales from the type of transfers that could be avoided.<sup>57</sup>

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50. See Chandler Act, ch. 575, § 67, 52 Stat. 840, 875 (1938) (superseded by 11 U.S.C. § 548 (1982)).

51. 4 Collier on Bankruptcy ¶ 67.29, at 481 (L. King & J. Moore 14th ed. 1978). Although federal courts could have interpreted § 67(d) independently, it was believed that the federal courts would find the case law under the UFCA persuasive and profit by the experience that had been gained from the operation of the Act. *Id.* at 481-82.

52. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. 20 (1973) [hereinafter cited as Commission Report].

53. 11 U.S.C. § 548(a)(2) (1982).

54. Commission Report, *supra* note 52, at 20. Congress adopted these recommendations of the Commission upon enacting the fraudulent transfer section of the Bankruptcy Code. See 11 U.S.C. § 548 (1982).

55. See Commission Report, *supra* note 52, at 20.

56. See H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977); S. Rep. No. 989, 95th Cong., 2d Sess. (1978); Commission Report, *supra* note 52.

57. Gold, *Proposed Amendment to Clarify Status of Property Bought in Foreclosure*, N.Y.L.J., Nov. 17, 1982, at 30, col. 4. Under this proposed amendment,

There was, however, an additional change in the language of the Bankruptcy Code that merits consideration: The definition of transfer was expanded in section 101(41).<sup>58</sup> The legislative history of that section evinces an intent to broaden the definition to include as many dispositions of property as possible.<sup>59</sup> An expansion of transfers voidable under section 548(a)(2) to include non-collusive mortgage foreclosure sales, however, would severely undermine the traditional application of section 67(d)(2).<sup>60</sup> Thus, it is unlikely that a radical change of this kind was intended.

The legislative history of section 548(a)(2) demonstrates that in enacting this section in 1978, Congress was approving the common law of fraudulent conveyances<sup>61</sup> just as Congress had done in 1938 in enacting section 67(d)(2) of the Chandler Act, and the National Conference of Commissioners on Uniform State Laws had done in approving the UFCA in 1918. At common law, non-collusive mortgage foreclosure sales were not usually voidable,<sup>62</sup> even when prices below market value were received for the property.<sup>63</sup> Consequently, such

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purchasers obtaining title to an interest of the debtor in property pursuant to a bona fide prepetition foreclosure sale would automatically take for reasonably equivalent value, and thus, that transfer would be protected from avoidance. *Id.* According to Robert M. Zinman, Chairman of the Subcommittee on Federal Bankruptcy Legislation of the American Council of Life Insurance, an organization that has supported legislation to abrogate the *Durrett* rule, after a controversial change in language was proposed by Senator Metzenbaum's staff, the anti-*Durrett* language was deleted from S.445, 98th Cong., 1st Sess. (1983) because there was insufficient time before it was to be submitted to the Senate Committee on the Judiciary to resolve the controversy. Douglas Comer, Chief Counsel to the Senate Judiciary Subcommittee on Courts, reported to Mr. Zinman that neither the Senate nor its Committee on the Judiciary considered the merits of the proposed anti-*Durrett* language. Telephone interview with Robert M. Zinman, Chairman of the Subcommittee on Federal Bankruptcy Legislation of the American Council of Life Insurance (Nov. 28, 1983).

58. Compare 11 U.S.C. § 101(41) (1982) with Chandler Act, ch. 575, § 1(30), 52 Stat. 840, 842 (1938).

59. H.R. Rep. No. 595, 95th Cong., 1st Sess. 314 (1977); see Alden, Gross & Borowitz, *supra* note 12, at 1608.

60. Prior to the decision in *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980), no court had applied constructive fraudulent transfer provisions to set aside a properly conducted non-collusive foreclosure sale. A.B.A. Report, *supra* note 7, at 3. Although § 67(d) was enacted in 1938, the A.B.A. Report found no case that had applied that section to set aside a properly conducted non-collusive foreclosure sale. *Id.* The dissent in *Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982), noted with interest that "*Durrett* [was] the first case treating this problem—after 90 years of bankruptcy law and mortgages of a time greater than the memory of man. It again establishes what an imaginative lawyer can do when he adds persuasion." *Id.* at 550 (Clark, J., dissenting).

61. See S. Rep. No. 989, 95th Cong., 2d. Sess. 89-90 (1978); See H.R. Rep. No. 595, 95th Cong., 1st Sess. 375 (1977).

62. See *supra* note 7 and accompanying text.

63. See *supra* note 8 and accompanying text.

transfers should not be subject to avoidance under section 548(a)(2) of the Bankruptcy Code. An analysis of the "reasonably equivalent value" requirement in section 548(a)(2)(A) further supports the conclusion that non-collusive mortgage foreclosure sales should not be voidable under section 548(a)(2).

## II. "REASONABLY EQUIVALENT VALUE" AT FORECLOSURE SALES

### A. Differing Positions on "Reasonably Equivalent Value"

In order to avoid a transfer, section 67(d)(2) of the Bankruptcy Act required a showing that the insolvent debtor had not received "fair consideration" in exchange for his property.<sup>64</sup> In 1978, section 67(d)(2) was superseded by section 548(a)(2) of the Bankruptcy Code,<sup>65</sup> with a concomitant change in language.<sup>66</sup> Under section 548(a)(2), avoidance is predicated upon the debtor not receiving "reasonably equivalent value" in exchange for the property.<sup>67</sup> Courts have differed in their application of these sections in the context of non-collusive mortgage foreclosure sales.<sup>68</sup>

In *Durrett v. Washington National Insurance Co.*,<sup>69</sup> the court determined that a mortgage foreclosure sale was a transfer under section 67(d)(2)<sup>70</sup> and held that the price paid for the debtor's property at the sale, approximately fifty-eight percent of the fair market value, did not constitute fair consideration.<sup>71</sup> The court based its decision on the fact that it was unable to locate a decision of any court that had approved the transfer of real property, subject to attack under section 67(d)(2), for which less than seventy percent of the market value had been received.<sup>72</sup> Consequently, the *Durrett* court voided the foreclosure sale as a fraudulent transfer.<sup>73</sup> Although *Durrett* did not establish a per se rule requiring seventy percent of fair market value to uphold a challenged foreclosure sale, several courts following *Durrett* have

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64. Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548(a)(2) (1982)).

65. 11 U.S.C. § 548(a)(2) (1982).

66. Compare Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938) with 11 U.S.C. § 548(a)(2) (1982).

67. 11 U.S.C. § 548(a)(2) (1982).

68. See *infra* notes 69-80 and accompanying text.

69. 621 F.2d 201 (5th Cir. 1980).

70. *Id.* at 204. The *Durrett* court based its determination upon the "comprehensive character" of the definition of transfer in § 1(30) of the Bankruptcy Act. *Id.* In reaching its conclusion, however, the court failed to consider the legislative history of § 67(d) indicating that Congress did not wish to render non-collusive foreclosure sales voidable. See *supra* notes 37-51 and accompanying text.

71. 621 F.2d at 203-04.

72. *Id.* at 203.

73. *Id.* at 204.

seized upon the seventy percent language to establish a quantitative figure for computing "reasonably equivalent value" under section 548(a)(2)(A).<sup>74</sup>

Recently, *Durrett* was rejected by the Bankruptcy Appellate Panel for the Ninth Circuit in *Lawyers Title Insurance Corp. v. Madrid*.<sup>75</sup> Confronted with a factual situation similar to *Durrett*,<sup>76</sup> the *Madrid* court reversed a lower court decision that held "reasonably equivalent value" had not been paid to the debtor at a non-collusive foreclosure sale because the seventy percent test was not met.<sup>77</sup> The appellate court in *Madrid* construed "reasonably equivalent value," as defined in section 548(a)(2)(A), "to mean the same as the consideration received at a non-collusive and regularly conducted foreclosure sale."<sup>78</sup> Thus, the transfer in question was not subject to avoidance.

In reaching its conclusion, the *Madrid* court indicated that *Durrett* had based its calculations on cases in which voluntary and private transfers had occurred.<sup>79</sup> The standard imposed by these cases, noted the court in *Madrid*, was not appropriate in the case of a regularly conducted foreclosure sale because such a sale is open to all bidders and creditors and, therefore, is "a safeguard against the evils of private transfers to relatives and favorites."<sup>80</sup>

The language of section 548(a)(2)(A) is not determinative of how the requirement of "reasonably equivalent value" is to be interpreted. It is necessary, therefore, to further analyze this requirement by exam-

74. See *Coleman v. Home Sav. Ass'n*, 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982); *Wickham v. United Am. Bank (In re Thompson)*, 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982); *Madrid v. Del Mar Commerce Co.*, 10 Bankr. 795, 800 (Bankr. D. Nev. 1981), *rev'd sub nom. Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983); *cf. Bakst v. Scarpa (In re Ocean Devs. of Am., Inc.)*, 22 Bankr. 834, 836 (Bankr. S.D. Fla. 1982) (voluntary conveyance of real property). Other cases have adopted *Durrett's* position that a non-collusive mortgage foreclosure sale is a transfer for the purposes of § 548(a)(2), but have not utilized the 70% rule, preferring to examine all the circumstances. *E.g.*, *Richard v. Tempest*, 26 Bankr. 560, 562 (Bankr. D.R.I. 1983); *Cooper v. Smith*, 24 Bankr. 19, 23 (Bankr. W.D.N.C. 1982); *Gillman v. Preston Family Inv. Co. (In re Richardson)*, 23 Bankr. 434, 448 (Bankr. D. Utah 1982); *Home Life Ins. Co. v. Jones*, 20 Bankr. 988, 994 n.23 (Bankr. E.D. Pa. 1982).

75. 21 Bankr. 424 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983).

76. *Madrid* involved a non-judicial foreclosure sale under a deed of trust in which the property at issue was sold for less than 30% of its fair market value. *Id.* at 425.

77. *Id.*, *rev'g Madrid v. Del Mar Commerce Co.*, 10 Bankr. 795, 800 (Bankr. D. Nev. 1981).

78. *Id.* at 427; see *Rosner v. Worcester*, 28 Bankr. 910, 914-15 (Bankr. C.D. Cal. 1983).

79. *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 426 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983).

80. *Id.* at 427.

ining the various definitions assigned to the term "value" in different sections of the Bankruptcy Code and other extrinsic evidence.

## B. Analysis of "Reasonably Equivalent Value"

### I. Value

Section 548(d)(2)(A) defines "value" for the purposes of section 548 as "property, or satisfaction or securing of a present or antecedent debt of the debtor."<sup>81</sup> Although this section lists the items that constitute "value," it fails to explain how "value" is to be calculated.<sup>82</sup> This omission is highly significant in light of the fact that special instructions for calculating "value" are set forth in other sections of the Bankruptcy Code.<sup>83</sup>

In section 522 of the Bankruptcy Code,<sup>84</sup> for example, which describes the property that can be exempted from the debtor's estate, "value" is defined as the "fair market value as of the date of the filing of the petition."<sup>85</sup> Under section 506 of the Bankruptcy Code,<sup>86</sup> which deals with the determination of secured status, "value" is "determined in light of the purpose of the valuation and of the proposed disposition or use of such property."<sup>87</sup>

Unlike other sections of the Bankruptcy Code which provide specific instructions for calculating "value," section 548 provides no such instructions. Therefore, defining "value" in section 548 as fair market value, and using an arbitrary figure of seventy percent of fair market value as constituting reasonable equivalence, as suggested in the *Durrett* decision, is inappropriate.<sup>88</sup> In the absence of specific instructions for calculating "reasonably equivalent value," the majority of courts

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81. 11 U.S.C. § 548(d)(2)(A) (1982).

82. The report of the Commission on the Bankruptcy Laws of the United States also fails to explain how "reasonably equivalent value" is to be calculated. See Commission Report, *supra* note 52, at 177. In analyzing the proposed replacement of § 67(d) of the Bankruptcy Act, the Commission's only reference to the value requirement was: "There is no need to define fair consideration since taken care of in the invalidating rules." [sic] *Id.* This comment appears to have been garbled in the printing of the report, see Gillman v. Preston Family Inv. Co. (*In re Richardson*), 23 Bankr. 434, 444 n.13 (Bankr. D. Utah 1982), and consequently there is no uniform definition of "reasonably equivalent value."

83. *E.g.*, 11 U.S.C. §§ 506, 522 (1982); see Brief for Appellee at 12, Madrid v. Lawyers Title Ins. Corp., *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983) [hereinafter cited as Appellee Brief].

84. 11 U.S.C. § 522 (1982).

85. *Id.* § 522(a)(2).

86. *Id.* § 506.

87. *Id.* § 506(a).

88. *Cooper v. Smith*, 24 Bankr. 19, 23 (Bankr. W.D.N.C. 1982); see *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 426 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983); *Richard v. Tempest*, 26 Bankr. 560,

has evaluated the value given in exchange for the debtor's property by investigating all the circumstances surrounding the transfer.<sup>89</sup> This approach is clearly less arbitrary than the seventy percent rule and allows for the consideration of special circumstances inherent in foreclosure sales<sup>90</sup> that would not be considered under a *Durrett* approach. In the context of a forced sale such as a mortgage foreclosure sale, the special circumstances must be taken into consideration.

The accepted legal definition of "fair market value" is "[t]he amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts."<sup>91</sup> In a mortgage foreclosure sale the debtor is not a willing seller.<sup>92</sup> Furthermore, several factors normally employed to arrive at fair market value,<sup>93</sup> such as reasonable time to find a purchaser, competition with other similar properties in the open market and the most profitable use of the property, are absent in the case of a mortgage foreclosure sale.<sup>94</sup> It is very likely, therefore, that a price below fair market value will be paid for property sold at such a sale.<sup>95</sup>

562 (Bankr. D.R.I. 1983); *Gillman v. Preston Family Inv. Co.* (*In re Richardson*), 23 Bankr. 434, 448 (Bankr. D. Utah 1982); *Home Life Ins. Co. v. Jones*, 20 Bankr. 988, 994 n.23 (Bankr. E.D. Pa. 1982).

89. 1 *Collier Bankruptcy Manual* ¶ 548.04, at 548-8 (L. King 3d ed. 1983); Cook, *Fraudulent Transfer Liability Under the Bankruptcy Code*, 17 Hous. L. Rev. 263, 277 (1980); Coppel & Kann, *supra* note 11, at 679 n.10; *see In re Southern Land Title Corp.*, 474 F.2d 1033, 1037 n.5 (5th Cir. 1973); *Darby v. Atkinson* (*In re Ferris*), 415 F. Supp. 33, 40 (W.D. Okla. 1976); *Murdock v. Plymouth Enters.* (*In re Curtina Int'l, Inc.*), 23 Bankr. 969, 974 (Bankr. S.D.N.Y. 1982); *Gillman v. Preston Family Inv. Co.* (*In re Richardson*), 23 Bankr. 434, 448 (Bankr. D. Utah 1982).

90. *See Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting) (foreclosure sales generally do not bring the best price), *cert. denied*, 454 U.S. 1164 (1982); *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981) (participation at foreclosure sales is minimal), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982); *see also Lifton, Real Estate in Trouble: Lender's Remedies Need an Overhaul*, 31 Bus. Law. 1927, 1937 (1976) (the mortgagee is the only bidder at 99% of public foreclosure sales).

91. *Black's Law Dictionary* 537 (5th ed. 1979); *see Almota Farmers Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 474 (1973); *State v. Cooper Alloy Corp.*, 136 N.J. Super. 560, 567, 347 A.2d 365, 368 (App. Div. 1975); H. Albritton, *A Critique of the Prevailing Definition of Market Value*, in *Controversies in Real Property Valuation: A Commentary* 7 (1982); J. Bonbright, *The Valuation of Property* 841 (1937).

92. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. Cal. L. Rev. 843, 870-71 (1980).

93. *Black's Law Dictionary* 537 (5th ed. 1979); *see Wickham v. United Am. Bank* (*In re Thompson*), 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982); *State v. Cooper Alloy Corp.*, 136 N.J. Super. 560, 567-68, 347 A.2d 365, 368 (App. Div. 1975); H. Albritton, *supra* note 91, at 8.

94. *See Lifton, supra* note 90, at 1936-37.

95. *Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982); Washburn, *supra* note 92,

Consistent with the notion that receipt of less than fair market value is common at regularly conducted mortgage foreclosure sales, state law recognizes that absent some element of fraud, unfairness or irregularity, the legitimacy of such sales should not be challenged simply because of inadequacy of price.<sup>96</sup> To ensure that the low price received at a foreclosure sale is not the result of a defect occurring in the sales process, state law generally provides procedural safeguards such as notice requirements<sup>97</sup> and public sales.<sup>98</sup> Because the receipt of value at a regularly conducted foreclosure sale is regulated by state law, and in addition, the probability of receiving fair market value at such sales is low, the actual price received best reflects these special circumstances.<sup>99</sup> Accordingly, the requirement in section 548(a)(2) that "reasonably equivalent value" be exchanged is best interpreted by holding that this requirement is presumptively met at a regularly conducted non-collusive mortgage foreclosure sale.

In addition, the state law position that the legitimacy of foreclosure sales should be upheld in the absence of irregularities comports with

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at 870-71; see *Gillman v. Preston Family Inv. Co. (In re Richardson)*, 23 Bankr. 434, 446 (Bankr. D. Utah 1982).

96. *E.g.*, *Madrid v. Lawyers Title Ins. Co.*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983); *Oller v. Sonoma County Land Title Co.*, 137 Cal. App. 2d 633, 635, 290 P.2d 880, 882 (1955); *Golden v. Tomiyasu*, 79 Nev. 503, 515-16, 387 P.2d 989, 995 (1963), *cert. denied*, 382 U.S. 844 (1965); see *G. Osborne, G. Nelson & D. Whitman, Real Estate Finance Law* § 7.21, at 479 (1979); *A.B.A. Report, supra* note 7, at 5.

97. *E.g.*, *Cal. Civ. Code* § 2924(b) (West Supp. 1983); *Colo. Rev. Stat.* § 38-37-113(2) to (3) (1982); *Idaho Code* § 45-1506 (1977); *Miss. Code Ann.* § 89-1-55 (1972); *Wash. Rev. Code* § 61.24-.040 (Supp. 1983); see *G. Osborne, G. Nelson & D. Whitman, supra* note 96, § 7.16, at 467 (judicial foreclosure); *id.* § 7.19, at 475 (power of sale foreclosure).

Judicial foreclosure is the "most pervasive method of foreclosure" in the United States. *Id.* § 7.11, at 447. Such foreclosure typically invokes, inter alia, a preliminary title search which is used to determine all parties in interest, service of process, hearings and notice of the foreclosure sale. *Id.* Certain defects in notice may subject the sale to being set aside. See *id.* § 7.16, at 468.

An alternate method of foreclosure is the power of sale foreclosure. Under this method the notice requirements vary, but they are usually less onerous than the requirements in judicial foreclosure. *Id.* § 7.19, at 475.

98. *E.g.*, *Cal. Civ. Proc. Code* § 726 (West Supp. 1983); *Ga. Code Ann.* § 44-14-187 (1982); *Minn. Stat. Ann.* § 581.03 (1945); see *G. Osborne, G. Nelson & D. Whitman, supra* note 96, § 7.16, at 466 (judicial foreclosure); *id.* § 7.19, at 475 (power of sale foreclosure).

99. See *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983). The American Bar Association has approved a resolution supporting legislation that would "amend the fraudulent conveyance provisions of state law and the federal Bankruptcy Code to make it clear that property purchased at a properly conducted non-collusive foreclosure sale is to be considered transferred for reasonably equivalent value." Summary of Action of the House of Delegates, *A.B.A. Ann. Meeting* 31 (Aug. 2-3, 1983).



the original common law of fraudulent conveyances, which did not condemn non-collusive mortgage foreclosure sales.<sup>100</sup> Because Congress endorsed this common law at the time of enactment of the fraudulent transfer sections of its bankruptcy legislation,<sup>101</sup> adopting the presumption that "reasonably equivalent value" is received at regularly conducted non-collusive mortgage foreclosure sales also gives effect to the intent of the legislature. This approach thus best interprets the requirement of "reasonably equivalent value" in the specific context of a regularly conducted non-collusive mortgage foreclosure sale and simultaneously removes such sales from the class of transfers voidable under section 548(a)(2), as Congress had intended. A complete analysis of this approach, however, necessitates consideration of good faith as a factor in determining "reasonably equivalent value" in mortgage foreclosure sales.

## 2. Good Faith as a Factor in Determining Reasonably Equivalent Value

Under section 67(d) of the Bankruptcy Act, "fair consideration" required a showing that the property was transferred in good faith and for fair equivalent value.<sup>102</sup> With little explanation,<sup>103</sup> the drafters of the Bankruptcy Code removed the good faith requirement and adopted the "reasonably equivalent value" standard.<sup>104</sup> The Commission on the Bankruptcy Laws of the United States (Commission), from whose draft this change was taken,<sup>105</sup> explained that this change was made because the term "fair consideration" had been "confusing as to its requirement of good faith."<sup>106</sup>

100. See *supra* notes 13, 15 and accompanying text.

101. See Commission Report, *supra* note 52, at 20; H.R. Rep. No. 1409, 75th Cong., 1st Sess. 32 (1937); Analysis of H.R. 12889, *supra* note 40, at 213 n.2; Amici Curiae Brief, *supra* note 7, at 20. See *supra* notes 20-63 and accompanying text.

102. Chandler Act, ch. 575, § 67(d)(1)(e)(1), 52 Stat. 840, 877 (1938) (superseded by 11 U.S.C. § 548 (a)(2)(A) (1982)).

103. See Commission Report, *supra* note 52, at 177 n.2; see also S. Rep. No. 989, 95th Cong., 2d Sess. 89-90 (1978) (no discussion of change in language); H.R. Rep. No. 595, 95th Cong., 1st Sess. 375 (1977) (same).

104. Compare Chandler Act, ch. 575, § 67(d)(1)(e), 52 Stat. 840, 877 (1938) with 11 U.S.C. § 548(a)(2)(A) (1982).

105. Compare Commission Report, *supra* note 52, at 175-76 with 11 U.S.C. § 548 (1982).

106. Commission Report, *supra* note 52, at 177 n.2. Commentators indicate that the confusion surrounding the good faith requirement originated in the historical lack of an adequate definition for the term. See Comment, *The New Bankruptcy Act: A Revision of Section 67d—The Death of a Dilemma*, 7 Hofstra L. Rev. 537, 541 (1979); see also 4 Collier on Bankruptcy, *supra* note 20, ¶ 548.07, at 548-61 ("The unpredictable circumstances in which the courts may find its presence or absence render any definition of 'good faith' inadequate.").

One court has seized upon this change in language as evidence that the position taken in *Madrid* is incorrect. In *Gillman v. Preston Family Investment Co. (In re Richardson)*,<sup>107</sup> the court determined that a non-collusive mortgage foreclosure sale was voidable under section 548(a)(2).<sup>108</sup> The *Richardson* court held that the *Madrid* approach, which employs a presumption that "reasonably equivalent value" has been exchanged in non-collusive foreclosure sales, necessarily reads good faith into section 548(a)(2)(A) and is therefore inconsistent with the deletion of the good faith requirement.<sup>109</sup> Accordingly, the court required an examination of all the circumstances involved in the transaction,<sup>110</sup> reserving the determination of the issue of reasonable equivalence for trial.<sup>111</sup> *Richardson's* reasoning is flawed, however, because the court refused to examine good faith as a *factor* in determining "reasonably equivalent value."

Courts generally determine "reasonably equivalent value" by examining all the circumstances surrounding the transfer.<sup>112</sup> Although section 548(a)(2)(A) no longer requires that a transfer that may be the subject of avoidance be effected in good faith, the use of good faith as a factor in determining whether "reasonably equivalent value" was exchanged has not been eliminated.<sup>113</sup> The utilization of good faith as a factor was recognized in *Cooper v. Smith*,<sup>114</sup> in which the court was asked to void a non-collusive foreclosure sale under section 548(a)(2).<sup>115</sup> The *Cooper* court analyzed value as the *Richardson* court had, by considering all factors presented.<sup>116</sup> *Cooper*, however, recognized that the good faith of the parties is one of the factors that should be considered<sup>117</sup> and did not allow the transfer to be voided.<sup>118</sup> Consequently, good faith has not been completely excised from the determination of "reasonably equivalent value," and therefore, the application of the *Madrid* presumption remains the best approach for determining the voidability of regularly conducted non-collusive mortgage foreclosure sales. Policy considerations further support the view that non-collusive mortgage foreclosure sales should not fall within the purview of section 548(a)(2).

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107. 23 Bankr. 434 (Bankr. D. Utah 1982).

108. *Id.* at 437.

109. *Id.* at 447.

110. *See id.* at 448.

111. *See id.* at 444.

112. *See supra* note 89 and accompanying text.

113. *See Cooper v. Smith*, 24 Bankr. 19, 23 (Bankr. W.D.N.C. 1982).

114. 24 Bankr. 19 (Bankr. W.D.N.C. 1982).

115. *Id.* at 23.

116. *Id.*

117. *Id.*

118. *Id.*

## III. POLICY CONSIDERATIONS

A. *Economic Effects*

Prior to the *Durrett* decision, the purchaser of property at a foreclosure sale bought it subject to the standard risks in that type of real estate transaction.<sup>119</sup> In the aftermath of *Durrett*, however, the purchase of such property for a price later determined by a court to be less than seventy percent of fair market value is subject to a new risk: The debtor whose property he had bought might file a petition under the Bankruptcy Code within one year after the sale, thereby permitting the trustee or debtor-in-possession to avoid the transaction.<sup>120</sup> A substantial number of title insurance companies will not insure against this risk,<sup>121</sup> and therefore, one consequence of *Durrett* is to affect adversely the marketability of property sold at foreclosure sales.<sup>122</sup>

The uncertainty of title caused by *Durrett* may inhibit competitive bidding at foreclosure sales,<sup>123</sup> and as a result, increase the likelihood of deficiency judgments against debtors.<sup>124</sup> In addition, debtors will be less likely to realize any of the equity in their property due to the decreased prices received at foreclosure sales.<sup>125</sup>

Another possible adverse effect of this uncertainty is to decrease the availability of credit. Because of the new risks involved in mortgage lending after *Durrett*, creditors will have to discount the value of collateral below the value it could be assumed to have had when

119. See Coppel & Kann, *supra* note 11, at 676. Before *Durrett* was decided, the purchaser at the foreclosure sale could expect to obtain clear and marketable title to the property "subject only to any statutory redemption right or senior encumbrance." *Id.*

120. See *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982); Pasion & Altizer, *Effect of Bankruptcy on Prepetition Nonjudicial Foreclosure Sales*, 17 Bev. Hills B.A.J. 11, 12 (1982). Although the trustee is given the right under *Durrett* to set aside certain foreclosure sales, the complaint to set aside the sale may be filed up to two years after the trustee is appointed. 11 U.S.C. § 546(a) (1982). The appointment of the trustee, furthermore, may take place at some indefinite time after the filing of the petition. *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982); see *Lovell v. Mixon*, No. 82-1844, slip op. at 9 (8th Cir. Oct. 31, 1983). Thus, the risk to the purchaser at the foreclosure sale can extend well beyond the one year period in § 548(a)(2).

121. Coppel & Kann, *supra* note 11, at 677 n.5; see Pasion & Altizer, *supra* note 120, at 12.

122. See Coppel & Kann, *supra* note 11, at 677; Gold, *supra* note 57, at 23, col. 1.

123. *Moore v. Gilmore*, No. C-83-232, slip op. at 6 (E.D. Wash. July 6, 1983); *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982); A.B.A. Report, *supra* note 7, at 4.

124. *Amici Curiae Brief*, *supra* note 7, at 29-30; A.B.A. Report, *supra* note 7, at 4; see *Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982).

125. See A.B.A. Report, *supra* note 7, at 4.

acquisition of marketable title at foreclosure sales was more certain.<sup>126</sup> Under section 548(c),<sup>127</sup> the secured creditor who acquires the debtor's property at a foreclosure sale may obtain a lien on the property for the value of his debt even after the foreclosure sale has been avoided.<sup>128</sup> This will be of little consolation to the creditor, however, in light of "the uncertainty of standards, the limitation of value, and the time delays imposed by that section,"<sup>129</sup> all of which will diminish the value of the security. Furthermore, section 548(c) does not award the secured creditor the costs of foreclosure or interest.<sup>130</sup> The detrimental ramifications of the *Durrett* approach to section 548(a)(2) were recently highlighted in a report by the Section on Real Property, Probate and Trust Law of the American Bar Association, which concluded that "[t]he entire result [of *Durrett*] will have a severe adverse effect on the economy and stifle mortgage and other secured investments at a time when they should be encouraged."<sup>131</sup> Thus, the ulti-

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126. Amici Curiae Brief, *supra* note 7, at 32.

127. 11 U.S.C. § 548(c) (1982).

128. *Id.* The secured creditor will be able to retain such a lien, if he "takes for value and in good faith." *Id.*

129. *Alsop v. Alaska*, 14 Bankr. 982, 987 n.7 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982).

130. 11 U.S.C. § 548(c) (1982).

131. A.B.A. Report, *supra* note 7, at 5. The implications of applying § 548(a)(2) to non-collusive mortgage foreclosure sales extend to personal property sales. Under § 9-504(3) of the Uniform Commercial Code, collateral may be sold "by public or private proceedings" but every aspect of the sale must be "commercially reasonable." U.C.C. § 9-504(3) (1978). The receipt of a low price at such a sale when a better price could have been obtained by other means does not alone establish, under the U.C.C., that the sale was not commercially reasonable. See U.C.C. § 9-507(2) (1978). Commentators have argued that the *Durrett* approach is equally applicable to the sale of personal property collateral under § 9-504 of the U.C.C. See Alden, Gross & Borowitz, *supra* note 12, at 1623; Coppel & Kann, *supra* note 11, at 681. Such an application might well result in lenders becoming reluctant to grant loans on security they may now be unable to foreclose upon. See A.B.A. Report, *supra* note 7, at 5.

The *Durrett* rule may have yet another detrimental economic effect: applying § 548(a)(2) to void non-collusive mortgage foreclosure sales may cause lenders to halt, or at least reduce, nonrecourse financing. Under § 704(d) of the Internal Revenue Code, "[a] partner's distributive share of partnership loss[es] shall be allowed only to the extent of the adjusted basis of [his] interest in the partnership at the end of the partnership year in which such loss occurred." I.R.C. § 704(d) (1984). Nonrecourse liabilities of a limited partnership may be added to the bases of limited partners, giving them bases for their partnership in excess of their actual capital contribution. As a result, a limited partner participating in a typical real estate development partnership "may be able to deduct a share of partnership losses in excess of his capital contribution, reduced by prior distributions to him." 2 A. Willis, *Partnership Taxation* § 56.02, at 137 (2d ed. 1976). The opportunity to take such deductions has made real estate tax shelter syndications very attractive to limited partners. *Id.*

Because neither the partners nor the partnership assume personal liability on a mortgage acquired through nonrecourse financing, the lender of such financing can

mate consequences of *Durrett* will be an increase in the cost of credit and a negative impact upon the marketability of property sold at foreclosure sales.

### B. Effect On State Foreclosure Policies

In approximately one-half of the states, the debtor whose property has been sold in a foreclosure sale has a statutory right to redeem the property for a certain period of time.<sup>132</sup> This right of redemption has been criticized for inhibiting participation at foreclosure sales,<sup>133</sup> thereby lowering the prices received at such sales and increasing deficiency judgements.<sup>134</sup> The adverse effects of statutory redemption periods have discouraged their use in many states.<sup>135</sup>

The policy of encouraging stability of title in those states rejecting statutory rights of redemption would, to a large degree, be defeated by the holding in *Durrett*. Under *Durrett*, if a bankruptcy petition is filed within one year of the date of the foreclosure sale, the sale may be subject to avoidance.<sup>136</sup> The actual attempt by a trustee to void the sale, however, may occur at some indefinite time in the future.<sup>137</sup>

obtain repayment after the borrowers have defaulted only by foreclosing upon the mortgaged property. The *Durrett* rule, however, jeopardizes the lender's ability to obtain repayment by selling the foreclosed property because the foreclosure sale may be subject to avoidance. Thus, the lender is now potentially unable to obtain his repayment from any source. Faced with this uncertainty, it is likely that lenders will reevaluate their nonrecourse financing policies, which in turn will adversely affect real estate tax shelter syndications. Telephone interview with Robert M. Zinman, Chairman of the Subcommittee on Federal Bankruptcy Legislation of the American Council of Life Insurance (Nov. 28, 1983).

132. G. Osborne, G. Nelson & D. Whitman, *supra* note 96, § 8.4, at 537; e.g., Ariz. Rev. Stat. Ann. § 12-1282 (1982); Ky. Rev. Stat. § 426.220 (1972); Mich. Comp. Laws Ann. § 600.3140 (West Supp. 1983); N.D. Cent. Code § 32-19-18 (1976); S.D. Codified Laws Ann. §§ 21-52-1 to -32 (1979 & Supp. 1983); Wyo. Stat. § 1-18-103 (1977 & Supp. 1983).

133. See *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982); G. Osborne, G. Nelson & D. Whitman, *supra* note 96, § 8.4, at 538; Comment, *Statutory Redemption: The Enemy of Home Financing*, 28 Wash. L. Rev. 39, 40 (1953) [hereinafter cited as *Statutory Redemption*].

134. *Statutory Redemption*, *supra* note 133, at 40; see A.B.A. Report, *supra* note 7, at 4.

135. *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982). One state, California, has recently abolished its statutory redemption period. Compare Cal. Civ. Proc. Code § 725a (West 1980) with Cal. Civ. Proc. Code § 725a (West Supp. 1983).

136. See *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 204 (5th Cir. 1980); Alden, Gross & Borowitz, *supra* note 12, at 1606-07; Pasion & Altizer, *supra* note 120, at 12; A.B.A. Report, *supra* note 7, at 1.

137. The complaint to set aside the sale may be filed up to two years after the trustee is appointed. 11 U.S.C. § 546(a) (1982). The appointment of the trustee, however, may take place at some indefinite time in the future. *Alsop v. Alaska*, 14

Thus, the *Durrett* rule creates “a *de facto* redemption right in bankruptcy situations”<sup>138</sup> that results in a destabilizing effect upon the title of property purchased at foreclosure sales.<sup>139</sup> This effect is precisely what many states hoped to avoid by refusing to enact a statutory redemption period.

Moreover, the rule in *Durrett* conflicts with unanimously followed state policy. It is widely recognized that foreclosure sales often bring low prices,<sup>140</sup> and state courts in all jurisdictions refuse to invalidate mortgage foreclosure sales based upon mere inadequacy of price.<sup>141</sup> Consequently, the application of section 548(a)(2) to void any foreclosure sale in which less than seventy percent of fair market value is received interferes substantially with each state’s interest in ensuring stability of title.<sup>142</sup> By holding that section 548(a)(2) is not applicable to regularly conducted, non-collusive mortgage foreclosure sales, or alternatively, that the price received at such foreclosure sales is presumed to be “reasonably equivalent value,” courts can eliminate the *Durrett* right of redemption and prevent chaos in state foreclosure policies and the national credit market.

#### CONCLUSION

Congress’ use of broad language in delineating the transfers subject to avoidance under section 548(a)(2) of the Bankruptcy Code has led courts to apply this section to void regularly conducted non-collusive mortgage foreclosure sales. The legislative history of section 548(a)(2), however, indicates that this section was not intended to change the historic non-voidability of non-collusive mortgage foreclosure sales under fraudulent conveyance law. Moreover, the detrimental effects upon credit markets and state foreclosure policies that result from

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Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff’d*, 22 Bankr. 1017 (D. Alaska 1982); see *Lovell v. Mixon*, No. 82-1844, slip op. at 9 (8th Cir. Oct. 31, 1983).

138. *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff’d*, 22 Bankr. 1017 (D. Alaska 1982); see *Moore v. Gilmore*, No. C-83-232, slip op. at 5, (E.D. Wash. July 6, 1983); *Pasion & Altizer*, *supra* note 120, at 12.

139. See *Moore v. Gilmore*, No. C-83-232, slip op. at 6 (E.D. Wash. July 6, 1983); *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff’d*, 22 Bankr. 1017 (D. Alaska 1982); *Pasion & Altizer*, *supra* note 120, at 12.

140. *Abramson v. Lakewood Bank & Trust Co.*, 647 F.2d 547, 550 (5th Cir. 1980) (Clark, J., dissenting) (“[i]t is generally known that such sales do not bring the best price”), *cert. denied*, 454 U.S. 1164 (1982); *Washburn*, *supra* note 92, at 871 (“[d]istress sales often produce very low prices”); see *Gillman v. Preston Family Inv. Co.* (*In re Richardson*), 23 Bankr. 434, 446 (Bankr. D. Utah 1982) (“the price obtained at foreclosure sales is weak evidence of value”).

141. See *supra* note 96 and accompanying text.

142. See *Lawyers Title Ins. Corp. v. Madrid*, 21 Bankr. 424, 427 (Bankr. 9th Cir. 1982), *appeal argued*, No. 82-4433 (9th Cir. Feb. 18, 1983); *Alsop v. Alaska*, 14 Bankr. 982, 987 (Bankr. D. Alaska 1981), *aff’d*, 22 Bankr. 1017 (D. Alaska 1982).

permitting such avoidances under the Bankruptcy Code further demonstrate that an extension of the application of section 548(a)(2) to non-collusive foreclosure sales is not warranted. The implications of subjecting such foreclosure sales to avoidance under the fraudulent transfer section of the Bankruptcy Code have already inspired legislative attempts to correct this problem.<sup>143</sup> Until an amendment to the Bankruptcy Code specifically narrowing the scope of section 548(a)(2) is passed, however, courts should adopt a presumption that “reasonably equivalent value” is the value received at regularly conducted non-collusive mortgage foreclosure sales, thus removing such sales from avoidance under section 548(a)(2).

*Edward Goodman*

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143. See *supra* note 57 and accompanying text.