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The Texas Nonjudicial Foreclosure Process - A Proposal to Reconcile the Procedures Mandated by State Law with the Fraudulent Conveyance Principles of the Bankruptcy Code

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THE TEXAS NONJUDICIAL FORECLOSURE PROCESS—A PROPOSAL TO RECONCILE THE PROCEDURES MANDATED BY STATE LAW WITH THE FRAUDULENT CONVEYANCE PRINCIPLES OF THE BANKRUPTCY CODE

by

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THE nonjudicial foreclosure process in Texas has, for over a century, permitted lenders considerable ease in recovering mortgaged real estate and fixing deficiency liabilities of borrowers. The statutorily mandated procedures[1] are both simple and efficient, and no one-action or anti-deficiency[2] statutes limit the range of remedies available to a lender or dictate the price that a lender must bid at a nonjudicial sale. So relatively unfettered is the Texas nonjudicial foreclosure process that the only practical defense for the defaulting borrower has often been the filing of a petition for relief in the bankruptcy courts.

Federal bankruptcy law has always been a theoretical haven for the debtor aggrieved by an economically unfair foreclosure sale.[3] In 1980, however, a

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1. TEX. PROP. CODE ANN. § 52.001 (Vernon 1984).

2. A "one-action" statute is any of a variety of statutes requiring that there be only one action to recover a debt and enforce the security for that debt. *E.g.*, CAL. CIV. PROC. CODE § 726(a) (West Supp. 1987). An "anti-deficiency" statute is any of a variety of statutes that prohibit or limit the rights of a creditor to recover a deficiency judgment against a debtor following the foreclosure of real property security. *E.g.*, CAL. CIV. PROC. CODE § 580(b) (West Supp. 1987). For an excellent discussion of the variety of different one-action and anti-deficiency statutes in the various states, see Fitch v. Buffalo Fed. Sav. & Loan Ass'n, 751 P.2d 1309 (Wyo. 1988).

3. Bankruptcy Code § 548, 11 U.S.C. § 548 (1988) establishes independent federal grounds for avoidance of fraudulent transfers as defined by that section. In addition, Bankruptcy Code § 544(b), 11 U.S.C. § 544(b) (1988) incorporates by reference all non-bankruptcy avoidance law for use by a trustee or debtor in bankruptcy court, including the applicable state fraudulent transfer law. Bankruptcy Code § 550(a), 11 U.S.C. § 550(a) (1988) provides, in substance, that the debtor or trustee may then recover such avoided transfer, or, upon court order, the value thereof, from an immediate or subsequent transferee or any entity for whose

federal court decision aimed the bankruptcy apparatus specifically at this problem. In that year, in *Durrett v. Washington National Insurance Co.*,[4] the Fifth Circuit for the first time[5] applied bankruptcy's fraudulent conveyance principles to a nonjudicial foreclosure sale and held that such a sale constituted a transfer within the meaning of section 67(d) of the Bankruptcy Act.[6] Having established the statutory link, the Fifth Circuit determined that the transfer effected by a foreclosure sale for only 57.7% of the admitted fair market value of the property was not made for fair consideration within the meaning of that statute and, therefore, was subject to avoidance as a fraudulent conveyance. In so holding, the court also mused about standards of fair market value, observing that no prior case soley involving section 67(d) of the Bankruptcy Act had approved a real estate transfer under section 67(d) "for less than 70 percent of the market value of the property."[7]

Although the reference to 70% has been frequently interpreted as a benchmark for judging the sufficiency of the sales price obtained at a nonjudicial foreclosure sale,[8] *Durrett* did not hold that a sale for 70% of fair market value would always constitute fair consideration (or now reasonably equivalent value under section 548(a) of the Bankruptcy Code), nor that a sale at less than 70% of fair market value would always constitute less than fair consideration (or a reasonably equivalent value). Nevertheless, confusion over a "*Durrett* 70% rule" has lasted almost ten years.[9]

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benefit such transfer was made. For a more detailed discussion of the operation of the Bankruptcy Code provisions for avoidance of fraudulent transfers, see Haskel & Lynn, *Preference and Fraudulent Conveyance Litigation*, in SMU SCHOOL OF LAW THIRD ANNUAL INSTITUTE ON ADVANCED BANKRUPTCY LAW, LITIGATING IN THE BANKRUPTCY COURT: PRACTICE STRATEGIES AND CURRENT DEVELOPMENTS 1989 11-1 (M. Rochelle ed. 1989); Tatelbaum & Wannamaker, *Recovering Fraudulently Conveyed Assets*, in BANKRUPTCY PRACTICE AND STRATEGY 8.01-8.10 (A. Resnick ed. 1987).

4. 621 F.2d 201 (5th Cir. 1980).

5. *See* Coppell & Kahn, *Defanging* Durrett: *The Established Law of Transfer*, 100 BANKING L.J. 676, 676-77 (1983).

6. Section 67(d) of the Bankruptcy Act, 11 U.S.C. § 107(d) (1898) (repealed 1978), the predecessor of § 548(a) of the Bankruptcy Code, 11 U.S.C. § 548(a) (1988), declared fraudulent any "transfer" made within one year of the filing of a bankruptcy proceeding if the transfer was made "without fair consideration" (or under § 548(a) of the Bankruptcy Code, at "less than a reasonably equivalent value") by a debtor who was then insolvent or who was thereby rendered insolvent. *Durrett*, 621 F.2d at 202.

7. 621 F.2d at 203.

8. *See, e.g.*, Richard v. Tempest (*In re* Richard), 26 Bankr. 560, 562 (Bankr. D.R.I. 1983); 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. (*In re* Perdido Bay Country Club Estates, Inc.), 23 Bankr. 36, 39 (Bankr. S.D. Fla. 1982); Coleman v. Home Sav. Ass'n (*In re* Coleman), 21 Bankr. 832, 834 (Bankr. S.D. Texas 1982); Home Life Ins. Co. v. Jones (*In re* 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); Marshall v. Spindle Sav. & Loan Ass'n (*In re* Marshall), 15 Bankr. 738, 744 (Bankr. W.D.N.C. 1981); *see also* Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the* Durrett *Problem*, 38 BUS. LAW 1605, 1613 n.22 (1983) (although *Durrett* cited for 70% rule, case held that only 57.7% of fair market value does not constitute reasonably equivalent value).

9. The following constitute a sample of the numerous articles that have been written on the *Durrett* controversy. Alden, Gross & Borowitz, *supra* note 8, at 1605; Berman & Fierberg, Durrett: *The Problem and Suggestions for its Solution*, 90 COM. L.J. 162 (1985); Castanares, *Foreclosures in Bankruptcy: Are They Fraudulent Conveyances?*, 21 IDAHO L. REV. 517

As economic conditions in Texas deteriorated during the past decade, and foreclosures and bankruptcies proliferated, concern over the implications of *Durrett* has caused an almost de facto minimum bid practice to develop among lenders bidding at Texas nonjudicial foreclosure sales.[10] Moreover, recent Texas cases have begun to question the consistent line of Texas authority establishing both the rule that inadequacy of price alone is not sufficient to set aside a foreclosure sale and the rule that the amount the borrower is entitled to have credited against the secured debt, for the purposes of a deficiency action following a nonjudicial foreclosure sale, is determined solely by reference to the amount actually paid to or credited by the lender at such sale.[11] Similarly, in mid-1989 the Texas Legislature almost enacted new legislation to provide debtors a means of causing the lender, following a nonjudicial foreclosure sale, to credit against the secured debt the fair market value of the property sold at such sale.[12]

While many bankruptcy courts in the Fifth Circuit apply some variation

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(1985); Cohn, *Foreclosures as Fraudulent Transfers: Solving the* Durrett *Problem*, 103 BANKING L.J. 259 (1986); Davis & Standiford, *Foreclosure Sale as Fraudulent Transfer Under the Bankruptcy Code: A Reasonable Approach to Reasonably Equivalent Value*, 13 REAL EST. L.J. 203 (1985); Fierberg, Durrett *After the 1984 Amendments to the Bankruptcy Code*, 59 FLA. B.J. July-Aug. 1985, at 41; Grossman, *Pre-Bankruptcy Forfeiture of Installment Land Contracts for the Sale of Farmland*, 8 J. AGRIC. TAX & L. 357 (1987); Henning, *An Analysis of* Durrett *and its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications*, 63 N.C.L. REV. 257 (1985); Nelson, *The Impact of Mortgagor Bankruptcy On the Real Estate Mortgagee: Current Problems and Some Suggested Solutions*, 50 MO. L. REV. 217 (1985); Reamer, *Upsetting the Law of Transfer: Mortgage Foreclosures as Fraudulent Conveyances Under the Bankruptcy Code*, 63 AM. BANKR. L.J. 321 (1989); Roberts & Moriarty, *Mortgage Foreclosure Sales as Fraudulent Conveyances: The* Durrett *Issue*, 10 OKLA. CITY U.L. REV. 579-602 (1985); Schuchman, *Data on the* Durrett *Controversy*, 9 CARDOZO L. REV. 605 (1987); Shupack, *Confusion in Policy and Language in the Uniform Fraudulent Transfer Act*, 9 CARDOZO L. REV. 811 (1987); Simpson, *Real Property Foreclosures: The Fallacy of* Durrett, 19 REAL PROP. PROB. & TR. J. 73 (1984); Weintraub & Resnick, *From the Bankruptcy Courts—Mortgage Foreclosure Sales as Fraudulent Conveyances-Does the 1984 Act Make a Difference?*, 17 U.C.C. L.J. 376 (1985); Zinman, Durrett *Data: Shucking the Husks from the Grain*, 9 CARDOZO L. REV. 1013 (1988); Zinman, *Nonconclusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 CARDOZO L. REV. 581 (1987); Zinman, Durrett: *Yin and Yang*, 13 PROB. & PROP. 49 (1985); Zinman, Houle & Weiss, *Fraudulent Transfers According to Alden, Gross & Borowitz: A Tale of Two Circuits*, 39 BUS. LAW. 977 (1984); Comment, *Mortgage Foreclosure Sales as Fraudulent Conveyances: Living Under* Durrett, 13 OHIO N.U.L. REV. 631 (1986); Comment, *Mortgage Foreclosure as Fraudulent Conveyance: Is Judicial Foreclosure an Answer to the* Durrett *Problem?*, 1984 WIS. L. REV. 195; Note, *Nonjudicial Foreclosure Under Deed of Trust may be a Fraudulent Transfer of Bankrupt's Property*, 47 MO. L. REV. 345 (1982); Counsel's Corner, Durrett - *Chink in the Armor?*, 103 BANKING L.J. 79 (1986).

10. *See In re* Raylin Dev. Co. (No. 88-1221), 3 Tex. Bankr. Ct. Rptr. 490, 494 n.10 (Bankr. W.D. Tex. June 30, 1989) (order on motion for valuation of assets).

11. *See* Olney Sav. & Loan Ass'n v. Farmers Market of Odessa Inc., 764 S.W.2d 869, 871 (Tex. App.—El Paso 1989, writ pending); Halter v. Allied Merchants Bank, 751 S.W.2d 286, 288 (Tex. App.—Beaumont 1988, writ denied); *see also* Lee v. Sabine Bank, 708 S.W.2d 582, 584 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.) (lender with secured collateral has duty to make honest effort to reduce debt by getting fair price at foreclosure). *But see* Savers Fed. Sav. & Loan Ass'n v. Reetz, 888 F.2d 1497, 1503-06 (5th Cir. 1989) (applying Texas law); Greater Southwest Office Park, Ltd. v. Texas Commerce Bank N.A., No. 01-89-00314-CV, slip op. at 6-7 (Tex. App.—Houston [1st Dist.] Jan. 18, 1990, n.w.h.) (inadequacy of price alone insufficient to set aside trustee's sale).

12. *See infra* text accompanying note 70.

of the *Durrett* 70% rule as a basis for post-bankruptcy avoidance of state foreclosures, certain commentators[13] and a recent decision from the Seventh Circuit[14] have suggested that the determination of reasonably equivalent value under section 548(a) of the Bankruptcy Code should not be based upon a simple comparison of the price obtained with an appraiser's opinion of fair market value. Rather, one should examine the procedures used in conducting the foreclosure "sale to determine whether commercially reasonable steps were taken to achieve the best price at the foreclosure."[15] According to this view, if the lender has taken commercially reasonable steps in the sale, the price obtained at such a sale is a better indicator of reasonably equivalent value for the purposes of section 548(a) of the Bankruptcy Code than an appraiser's opinion of the price that would have been obtained at a theoretical sale.

Given the turbulence in bankruptcy court decisions in this area and the apparent willingness of the Texas Legislature, as well as some Texas courts, to consider changing the rules governing the long-standing and highly abbreviated procedures for nonjudicial foreclosures, the time may be ripe for an overhaul of the Texas nonjudicial foreclosure process. Unlike the Texas Legislature's efforts in 1989 to limit deficiency judgments by an artificial determination of the fair market value of foreclosed real estate, the authors believe that the much more fundamental need under Texas foreclosure law is to establish procedures calculated to yield the fairest possible price under the circumstances, while recognizing the limitations inherent in a forced sale, and eschew the probably futile attempt to suggest any specific formula that would yield a presumptively standard, fair, or reasonable price.[16]

The authors believe that the Texas legislature should focus its efforts on changing the procedures used in conducting a nonjudicial foreclosure sale rather than simply addressing the inadequacy of the price obtained under existing procedures.[17] Likewise, the authors believe that the pertinent inquiry in the bankruptcy courts for reasonable equivalence in the context of a foreclosure sale is whether the procedures employed were designed to achieve the highest price possible, not whether the price obtained constituted a specified percentage or approximation of fair market value.[18]

In order to explore these themes, section I of this Article traces the history

13. Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933, 960-61 (1985); Comment, *Avoidance of Foreclosure Sales as Fraudulent Transfers Under Section 548(a) of the Bankruptcy Code: An Impetus to Changing State Foreclosure Procedures*, 66 NEB. L. REV. 383, 409 (1987) (hereinafter Comment, *Avoidance of Foreclosure Sales*). These articles helped focus the authors' suggested revisions to the Texas foreclosure laws on the procedures used rather than on the price obtained.

14. Bundles v. Baker (*In re* Bundles), 865 F.2d 815, 820 (7th Cir. 1988).

15. Lindsay v. Beneficial Reinsurance Co.(*In re* Lindsay), 98 Bankr. 983, 991 (Bankr. S.D. Cal. 1989).

16. "I must admit that I possess no instinct by which to know the 'reasonable' from the 'unreasonable' in prices and must seek some conscious design for decision." Federal Power Comm'n. v. Hope, 320 U.S. 591, 645 (1944) (Jackson, J., dissenting).

17. *See* Ehrlich, *supra* note 13, at 965.

18. *Id.*

of the power of sale in Texas, including the various legislative attempts to regulate its use. Section II examines the concept of reasonably equivalent value under the Bankruptcy Code, tracing the development of fraudulent conveyance law as applied to foreclosure sales. Finally, section III suggests certain amendments to the Texas nonjudicial foreclosure process that would be designed to achieve the highest price possible without unnecessarily requiring the lender to credit against the secured debt a minimum bid price that is based solely upon an appraiser's opinion of fair market value. The suggested amendments are designed as much as possible so that state foreclosure law can be reconciled with the fraudulent conveyance principles of the Bankruptcy Code.

I. THE DEED OF TRUST AND THE POWER OF SALE IN TEXAS

A. Current Practice

On the first Tuesday of every month one can witness the legal ritual known as the nonjudicial foreclosure sale at county courthouses throughout Texas. Pursuant to previously published notices mandated by Texas law,[19] a trustee (usually an attorney for or an officer of the lender) announces to those present, if any, his or her intent to sell, at public auction, certain real estate securing a debt now in default. After completing the formalities of describing the land and the debt, the trustee asks the assembled mass of interested onlookers or no one at all: "Are there any bids?" For a brief moment the trustee obligingly waits for a bid from a third party bidder, who is almost never there. Some third party occasionally does speak up in response to the trustee's question, but not often. In the absence of third party bidders the trustee or an officer or agent of the lender will bid a stated amount as a credit against the secured debt. The sale is then concluded and the land is conveyed to the lender.[20]

Although simple and efficient, the exercise of a secured lender's power of sale under a deed of trust in the manner previously described has been labelled by at least one Texas court as a "harsh remedy."[21] Contrary to popular opinion, a lender is not required to bid any specified amount at a nonjudicial foreclosure sale in Texas. If the lender observes all of the formalities, a nonjudicial foreclosure sale will not be invalidated merely because the price obtained is below the fair market value of the land.[22] Moreover, the price bid at a nonjudicial foreclosure sale is ordinarily conclusive evi-

19. TEX. PROP. CODE ANN. § 52.001 (Vernon 1984).

20. For another description of a generic nonjudicial foreclosure sale, see Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 384-85, which the authors located after they penned the above description.

21. *See* Purnell v. Follett, 555 S.W.2d 761, 763 (Tex. Civ. App.—Houston [14th Dist.] 1977, no writ).

22. American Sav. & Loan Ass'n v. Musick, 531 S.W.2d 581, 587 (Tex. 1975); Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d 473, 475 (Tex. 1965); Crow v. Davis, 435 S.W.2d 176, 178 (Tex. Civ. App.—Waco 1968, writ ref'd n.r.e.); Richardson v. Kent, 47 S.W.2d 420, 425 (Tex. Civ. App.—Dallas 1932, no writ); *see also* W. BAGGETT, TEXAS FORECLOSURE: LAW & PRACTICE § 2.61, § 2.61 n.167 (1984) (discussing rule that inadequacy of consideration not sufficient to set aside foreclosure sale).

dence of the credit to which the debtor was entitled as a result of the sale of the land securing a debt.[23] The deficiency remaining after the nonjudicial sale is subject to collection by the lender regardless of the actual value of the land acquired or whether the lender realizes a profit upon its resale.[24]

In the most recent regular session of the Texas Legislature, a bill was enacted that would have permitted a debtor to require the lender, in an action to collect a deficiency following a nonjudicial foreclosure sale, to credit against the secured debt the lesser of the outstanding balance of the secured debt or the fair market value of the land sold.[25] Although vetoed by the Governor, the bill focused renewed attention on the inequities that can arise under current Texas law from the lender's exercise of its power of sale, particularly in view of the devastating decline of Texas real estate values in recent years. In order to examine the propriety of this legislative effort, it is necessary first to understand the historical underpinnings of the nonjudicial foreclosure process in Texas.

B. Historical Development of Nonjudicial Foreclosure in Texas

1. General Background

A deed of trust as used in Texas purports to be a conveyance of the land covered thereby to a trustee as security for a debt, subject to a condition of defeasance or redemption upon the repayment of such debt.[26] It has long been held in Texas, however, that no title passes as a result of the execution of a deed of trust.[27] Rather, the legal effect of a deed of trust is to create a lien on the land covered thereby in favor of the creditor, as security for the debt, and to authorize the trustee to sell the land upon default in the payment of the debt "without necessity of resort to litigation."[28] In other words, a deed of trust is merely a mortgage creating a lien in favor of the mortgagee and containing a power of sale in favor of a third party trustee.[29]

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23. Maupin v. Chaney, 163 S.W.2d 380, 382 (Tex. 1942); Martin v. Uvalde Sav. & Loan Ass'n, 773 S.W.2d 808, 814 (Tex. App.—San Antonio 1989, n.w.h); Whalen v. State Farm Auto Ins. Co., 428 S.W.2d 824, 830 (Tex. Civ. App.—San Antonio 1968, writ ref'd n.r.e.).

24. W. BAGGETT, *supra* note 22, §§ 2.62, 2.71.

25. Tex. S.B. 452, 71st Leg. (1989) (vetoed).

26. Lucky Homes, Inc. v. Tarrant Sav. Ass'n, 379 S.W.2d 386, 388 (Tex. Civ. App.—Fort Worth 1964), *rev'd on other grounds*, 390 S.W.2d 473 (Tex. 1965); *see also* 30 TEX. JUR. 3D, *Deeds of Trust and Mortgages* § 2 (1983) (in Texas, trust deed is legal equivalent of mortgage with power of sale).

27. *See* McLane v. Pascal, 47 Tex. 365, 369 (1877).

28. *Lucky Homes Inc.*, 379 S.W.2d at 388.

29. Johnson v. Snell, 504 S.W.2d 397, 399 (Tex. 1973); Southern Trust & Mortgage Co. v. Daniel, 43 Tex. 32, 184 S.W.2d 465, 467 (1944); Alliance Milling Co. v. Eaton, 86 Tex. 401, 25 S.W. 614, 615 (1894); Aggs v. Shackelford County, 85 Tex. 145, 19 S.W. 1085, 1086 (1892); Jackson v. Harby, 65 Tex. 710, 714-15 (1886); Thornton v. Goodman, 216 S.W. 147, 148 (Tex. Comm'n App. 1919, opinion adopted); Cortez v. Brownsville Nat'l Bank, 664 S.W.2d 805, 809-10 (Tex. App.—Corpus Christi 1984, no writ); Phillips v. Campbell, 480 S.W.2d 250, 253 (Tex. Civ. App.—Houston [14th Dist.] 1972, writ ref'd n.r.e.); Graham & Locke Invs., Inc. v. Madison, 295 S.W.2d 234, 242 (Tex. Civ. App.—Dallas 1956, writ ref'd n.r.e.); Dall v. Lindsey, 237 S.W.2d 1006, 1008 (Tex. Civ. App.—Amarillo 1951, writ ref'd n.r.e.); Cunningham v. Paschall, 135 S.W.2d 293, 296 (Tex. Civ. App.—Ft. Worth 1939, writ dism'd).

A power of sale in mortgages, although permitted under Roman law,[30] was not used extensively in England prior to the nineteenth century.[31] In the United States the power of sale was apparently in use somewhat earlier than in England, as a statute relating to its use was enacted in New York in 1774.[32] Although several early English cases expressed some doubt as to the validity of a power of sale in a mortgage,[33] the power of sale has been generally recognized in this country, except where it was expressly prohibited by statute.[34] Because a power of sale is a right created by contract and not a creation of the common law or statutory enactment,[35] it has been upheld largely on the basis of ordinary principles of freedom of contract.[36]

2. *Early Statutory Regulation of the Manner of Conducting Nonjudicial Foreclosure Sales in Texas*

The deed of trust gained early acceptance in Texas.[37] The familiar scene at the courthouse steps on the first Tuesday of the month, however, was not a necessary part of the early use of the power of sale in Texas. Indeed, prior to the passage of the first Texas statute regulating the use of powers of sale, the only required notices and procedures governing the sale of the land by the trustee were those agreed to in the deed of trust between the mortgagor and the mortgagee.[38] No law required uniformity of time, manner, or place in conducting a nonjudicial foreclosure sale in Texas.[39] Although the courts required strict compliance with the specific provisions of the deed of trust, the procedures were so loose that one court remarked that many deeds of trust had simply become "absolute conveyances" to the mortgagee.[40]

The first Texas legislation regulating the use of powers of sale was enacted on March 21, 1889.[41] The purpose of this legislation was to prescribe the place and time for sales conducted pursuant to powers conferred by deeds of

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30. L. JONES, TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY 437 (7th ed. 1915).

31. Turner, *The English Mortgage of Land as Security*, 20 VA. L. REV. 729, 732 (1934).

32. L. JONES, *supra* note 30, at 440-41.

33. G. GLENN, MORTGAGES, DEEDS OF TRUST AND OTHER SECURITY DEVICES AS TO LAND 612 (1943); L. JONES, *supra* note 30, at 437.

34. G. GLENN, *supra* note 33, at 613; L. JONES, *supra* note 30, at 441.

35. International Bldg. & Loan Ass'n v. Hardy, 86 Tex. 610, 26 S.W. 497, 500 (1894).

36. L. JONES, *supra* note 30, at 442. As stated in an early decision by the New Hamphire Supreme Court:

> [W]e are unable to see upon what ground, in the absence of legislative prohibition, the court can put a restriction upon the freedom of the citizen to contract for the sale of his land upon terms and in a mode stipulated in a mortgage, any more than upon his liberty to contract for its sale in any other way, or by stipulations contained in any other instrument.

Very v. Russell, 65 N.H. 464, 23 A. 522, 522 (1874).

37. *See, e.g.*, Hess v. Dean, 66 Tex. 663, 664, 2 S.W. 727, 728 (1886).

38. West & McDonald, *Deed of Trust Foreclosures—Selected Issues*, Advanced Creditors Rights Course (State Bar of Texas) at F-1 (1988).

39. *Id.*

40. *Id.* (citing Wylie v. Hays, 114 Tex. 46, 49, 263 S.W. 563, 566 (Tex. Comm'n App. 1924, opinion adopted)).

41. *Id.* at F-2.

trust.[42] The 1889 Act required all sales to be made at a public auction to be held between the hours of 10 o'clock a.m. and 4 o'clock p.m. on the first Tuesday of any month, in the county where the land covered by the deed of trust was located, after notice of such sale had been posted at least twenty days prior to the sale in three public places, including the courthouse door.[43] With a few modifications and amendments, the basic requirements set forth in the 1889 Act remain those currently in force under section 52.001 of the Texas Property Code.

In light of the broad range of procedures available to lenders prior to the enactment of the 1889 Act, it is not surprising that the 1889 Act met with considerable resistance in the courts. Indeed, in *International Building & Loan Association v. Hardy*[44] the Texas Supreme Court declared the 1889 Act unconstitutional to the extent it applied to sales conducted pursuant to deeds of trust entered into prior to the effective date of the Act. The court based its holding on the fact that the right of the trustee to sell the land covered by a deed of trust was one created solely by the contract of the parties. While the legislature was free to modify remedies created by statute or common law, the court held that a remedy arising solely from contract could not be retroactively altered.[45]

The preference of the Texas courts for the sanctity of private contract over legislative fiat did not hold when the 1889 Act was later challenged in its prospective, rather than retroactive, application. In *Wylie v. Hays*[46] the Texas Commission of Appeals held that a trustee's sale conducted in compliance with the 1889 Act, but in contravention of the terms of the deed of trust, was valid.[47] Although the deed of trust had been entered into subsequent to the passage of the 1889 Act, it nevertheless required the trustee to sell the land in the county where the mortgagor and mortgagee were both residents, rather than in the county where the land was located as required by the Act.[48] The trustee had conducted the sale in conformance to the Act by holding the sale in the county where the land was located. Because the deed of trust required the sale to be held elsewhere, however, the mortgagor argued that the sale was void and that the Act was unconstitutional to the extent it purported to deprive the parties of the freedom to contract for the sale of the land in a county other than where the land was located. The court, while acknowledging that a power of sale is a "valuable contractual right, the full and free exercise of which is [constitutionally guaranteed],"[49] also noted that this contractual right may nevertheless be "regulated, or in

42. *Id.*

43. *Id.* (citing International Bldg. & Loan Ass'n v. Hardy, 86 Tex. 610, 26 S.W. 497 (1894)).

44. 86 Tex. 610, 613, 26 S.W. 497, 500 (1894).

45. *Id.* In *Hardy*, the only material difference between the requirements of the deed of trust and those specified by the 1889 Act was that the 1889 Act required twenty days notice and the deed of trust required only ten. *Id.*

46. 114 Tex. 46, 263 S.W. 563 (Tex. Comm'n App. 1924, opinion adopted).

47. *Id.* at 61, 263 S.W. at 569-70.

48. *Id.* at 53, 263 S.W. at 565-66.

49. *Id.* at 51, 263 S.W. at 565.

certain instances denied by the Legislature in a proper use of the police power."[50]

In determining whether the 1889 Act was a "valid exercise of that power" and therefore "superior to the liberty of contract," the court was obligated to determine whether the Act "has as its object that which may be clearly and reasonably considered by the Legislature to be the public welfare, prescribes means reasonably calculated and necessary to aid in accomplishing that object, and operates in a reasonable and not an arbitrary, capricious, or oppressive manner."[51] Noting the abuses to which debtors had been subjected through the use of unregulated powers of sale, which were "so worded as practically to prevent a mortgagor from saving his equity in the land,"[52] the court held that the 1889 Act was a valid exercise of the police power[53] and therefore constitutional as applied to deeds of trust entered into after the date of the Act.[54]

Since the adoption of the 1889 Act the legislature has made few improvements in the nonjudicial foreclosure process in Texas. Sales are still required to be held on the first Tuesday of the month, although the required notice has been increased to twenty-one days.[55] On the other hand, the requirement that the notice be posted in three public places has been eliminated. Under current law the notice is required to be given by certified mail to all persons obligated on the debt and to be filed with the county clerk and posted at the courthouse of the county where the sale will be held.[56] Although sales can still only be held between the hours of 10 o'clock a.m. and 4 o'clock p.m., the required notice must state the earliest time at which the sale will commence, and the sale must be actually held within three hours after the stated time.[57] Likewise, although the county where some

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50. *Id.*
51. *Id.*
52. *Id.* at 58, 263 S.W. at 56.
53. *Id.* In so holding, the court noted:

> In the light of what has been observed, it is thought that the provision of the Texas statute, which makes it necessary for the sale in this state to take place in the county where the land lies, being the one in question in this case, is calculated to be a wise regulation and one that is for the public welfare. The size and extent of the state of Texas furnish so wide a range as to place of sale that, if the matter be left without regulation, provisions can be readily made in any mortgage or deed of trust that will render the presentation of the mortgagor's rights at a sale extremely inconvenient, if not impossible, and that, because of the remoteness and inaccessibility of the land and of the records of title to the property, are calculated to destroy bidding, in that strangers to the land and its possession and title will not ordinarily be willing to purchase. . . . These provisions [of the Act] reasonably tend to assist in guaranteeing that mortgages and deed of trust shall not have the effect of absolute conveyances, but shall have that of security only.

Id. at 56, 263 S.W. at 567.

54. *Id.* at 58, 263 S.W. at 568. The court also ruled that the Act could be constitutionally applied to deeds of trust entered into before the date of the Act if the deed of trust in creating the power of sale made reference to compliance with the law, which would have contemplated the law as amended from time to time. *Id.* at 57, 263 S.W. at 567.
55. TEX. PROP. CODE ANN. § 51.002(a) (Vernon Supp. 1990).
56. *Id.* § 51.002(b)(1)-(3).
57. *Id.* § 51.002(a).

part of the land covered by the deed of trust is located remains the required place to hold the sale, sales are now required to be held in a more clearly defined area within the county courthouse, either as designated by the County Commissioners Court or, in the absence of such designation, as specified in the required notice.[58]

While the 1889 Act and the various amendments may have allowed a debtor to be more assured of his right to participate in the sale, neither the 1889 Act nor any of these amendments appear to have fostered competitive bidding. As previously indicated, a third party bidder is a rare sight at a nonjudicial foreclosure sale in Texas. Consequently, notwithstanding the 1889 Act and the various amendments thereafter enacted prescribing the procedures for nonjudicial foreclosure sales in Texas, the price realized at such a sale rarely approximates the market value of the land.[59]

3. *Texas Legislative Efforts to Limit Deficiencies Resulting from Nonjudicial Foreclosure Sales*

In the 1930s the Texas Legislature again recognized the harshness of the nonjudicial foreclosure process. The focus of the legislature in the 1930s, however, was not upon the procedures used but upon the price obtained. In 1933 the legislature enacted a law that permitted a debtor, through judicial proceedings, to offset against a deficiency resulting from either a judicial or nonjudicial foreclosure sale the amount by which the actual value of the land sold exceeded the foreclosure sales price.[60]

Like the 1889 Act, the 1933 Act was challenged as an impairment of the obligation of contracts as it was applied to deeds of trust and mortgages entered into prior to the date of the Act.[61] In *Langever v. Miller*[62] the Texas Supreme Court sustained the challenge and declared that the 1933 Act was an unconstitutional impairment of the obligation of contracts.[63] The 1933

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58. *Id.*

59. *See, e.g.*, Price v. Gulf Atl. Life Ins. Co., 621 S.W.2d 185, 187 (Tex. Civ. App.—Texarkana 1981, writ ref'd n.r.e.).

60. Act of 1933, ch. 92, 1933 Tex. Gen. Laws 198, *repealed by* Rules of Civil Procedure Acts 1939, ch. 25, 1939 Tex. Gen. Laws 201, § 1. Section 5 of the 1933 Act is instructive as to the perceived evils that the Act was designed to eliminate:

> Sec. 5. The fact that many honest, hard working and worthy city home owners and farm owners are being foreclosed in these hard, stringent and depressed times when their real estate is being bought in [sic] at foreclosure sales, in many instances, at unconscionably low prices by mortgage holders and lien holders who are securing deficiency judgments for the unpaid balance of the mortgage or lien held against these property holders, thereby, harassing and embarrassing honest, worthy people by hanging unwarranted judgments over their heads and further depressing their spirits when calamity overtook them through no fault of their own, creates an emergency and an imperative public necessity . . . .

Id. § 5.

61. TEX. CONST. art. I, § 16; U.S. CONST. art. I, § 10, cl. 1.

62. 124 Tex. 80, 76 S.W.2d 1025 (1934).

63. *Id.* at 85-86, 76 S.W.2d at 1028. In so holding the court observed:

> It is obvious that the legal effect of this act is to cancel all deficiency judgments to the extent of the difference between the actual value of the property sold under foreclosure and the amount which it may have brought at such sale, provided, of course, an action is brought by the judgment debtor for such purpose,

Act was then repealed by the Texas Legislature three years later.

The 1933 Act was virtually identical to the legislation recently enacted by the Texas Legislature in May, 1989, but vetoed by the Governor. The 1989 legislation began with Senate bill 1394, introduced by Senator Parker. Senate bill 1394 would have limited a deficiency judgment following a foreclosure sale to the difference between the unpaid balance of the secured debt and 70% of the fair market value of the land at the time the loan was made.[64] The stated purpose of Senate bill 1394 was to bring Texas in line with other states that have anti-deficiency statutes, particularly in view of the current downturn in the Texas real estate market.[65] Senate bill 1394 never emerged from committee. When Senate bill 452, a bill of technical amendments to the Property Code, passed the Senate and was being considered by the House, however, an amendment to that bill was added which required a lender to exhaust its remedies against the collateral for a loan prior to bringing suit against any debtor of the secured loan.[66] The House amendment to Senate bill 452 also prohibited a lender from seeking a deficiency judgment against the debtor following a nonjudicial foreclosure sale.[67] The House passed Senate bill 452, as amended, on May 16, 1989. When Senate bill 452, together with the House amendment, was returned to the Senate, a Joint Conference Committee was created.[68] The Conference Committee compromise, which was enacted by both houses, permitted a debtor, in an action by the lender to recover a deficiency judgment, to prove that the fair market value of the land sold exceeded the sales price obtained at a nonjudicial foreclosure sale.[69] To the extent the debtor was able to establish that the fair market value of the land exceeded the sales price obtained, the debtor would then have been entitled to offset the deficiency "by

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> and the necessary proof of value made. In the case of sales under deeds of trust without judicial foreclosure, the effect is the same, since the purpose of the law is to deny recovery of a deficiency judgment for any amount of the debt in satisfaction of which the sale under the deed of trust or mortgage may have taken place.

Id. The position of the Texas Supreme Court in *Langever* was somewhat more strict than that of other states' courts in ruling on the constitutionality of similar depression era legislation limiting deficiency judgments. *See, e.g.*, Kresos v. White, 47 Ariz. 175, 54 P.2d 800 (1936); Atlantic Loan Co. v. Peterson, 181 Ga. 266, 182 S.E. 15 (1935); Klinke v. Samuels, 269 N.Y. 144, 190 N.E. 324 (1934); Beaver County Bldg. & Loan Ass'n v. Winowich, 363 Pa. 483, 187 A. 481 (1936); Federal Land Bank of Columbia v. Garrison, 185 S.C. 255, 193 S.E. 308 (1937); Citizens Mut. Bldg. Ass'n, Inc. v. Edwards, 67 Va. 399, 189 S.E. 453 (1937); *see also* Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937) (North Carolina statute limiting deficiency judgments is not contrary to United States constitutional protection against statutory impairment of contract obligation).

64. Tex. S.B. 1394, 71st Leg. (1989). The *Durrett* 70% rule appears to have influenced the formulation of this legislation. Even at its most extreme, however, the *Durrett* 70% rule never suggested that the appropriate time for judging value was the time the deed of trust was executed rather than the time the foreclosure occurred.

65. *Id.*, Legislative Initiative (Bill Summary).

66. Kilday, *Texas House Approves Foreclosure Law Change*, Dallas Morning News, May 17, 1989, at 1A, col. 1.

67. Tex. S.B. 452, 71st Leg. (1989) (House Amendment No. 2).

68. Stutz, *Senate Rejects Foreclosure Changes*, Dallas Morning News, May 20, 1989, at 43A, col. 1.

69. *See* Tex. S.B. 452, 71st Leg. (1989) (as enacted; later vetoed).

the amount by which the fair market value exceed[ed] such sales price."[70] Although it was widely thought that the Conference Committee compromise had the support of both consumer and lender groups,[71] the Governor vetoed the bill on the day before the bill would have otherwise become law without his signature.[72]

While some legislators are apparently trying to revive this bill, the authors believe that a more comprehensive approach is required to lessen the perceived inequities of nonjudicial foreclosure procedures in Texas. That approach will be discussed in detail in section III of this Article. Because bankruptcy laws also have a significant influence on nonjudicial foreclosure sales, section II of this Article examines the impact on a foreclosure sale of the fraudulent conveyance provisions of the Bankruptcy Code.

II. THE NONJUDICIAL FORECLOSURE SALE AS A FRAUDULENT CONVEYANCE

A. Early Development of Fraudulent Conveyance Laws

Like the laws governing powers of sale, laws regarding fraudulent conveyances apparently existed under Roman law.[73] Slow acceptance of the power of sale in the English courts, however, does not parallel the early acceptance of fraudulent conveyance principles in England.[74] The Statute of Elizabeth, enacted in the English Parliament in 1570, is frequently referred to as the basis for the fraudulent conveyance laws adopted in this country.[75]

In their earliest form, fraudulent conveyance laws were designed to protect creditors from a debtor's intentional action in placing his property beyond a creditor's reach.[76] Although actual intent to defraud may have been the original test for determining whether a conveyance was fraudulent, the courts soon recognized certain fact patterns as "presumptively indicative of fraudulent intent."[77] These fact patterns, or badges of fraud, included the existence of pending suits, the transfer of all property subject to execution, and any transfers to relatives, especially when any of these transfers were made without fair consideration.[78]

In response to the increasing use of presumptive intent based on certain badges of fraud, the original version of the Uniform Fraudulent Conveyance Act, as approved by the National Conference of Commissioners on Uniform

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70. *Id.*

71. Slater, *Foreclosure Law Accord Reached*, Dallas Morning News, May 26, 1989, at 1A, col. 1.

72. Slater, *Clements Vetoes Bill on Foreclosure*, Dallas Morning News, June 19, 1989, at 1A, col. 1.

73. Comment, *Avoidance of Foreclosure Sales*, *supra* note 13, at 389.

74. *See id.* at 390.

75. *See, e.g., id.* at 389; Alden, Gross & Borowitz, *supra* note 8, at 1605; Castanares, *supra* note 9, at 518.

76. *See* Alden, Gross & Borowitz, *supra* note 8, at 1605.

77. Comment, *Avoidance of Foreclosure Sales*, *supra* note 13, at 391.

78. *See, e.g.*, Texas Sand Co. v. Shield, 381 S.W.2d 48, 52-53 (Tex. 1964); Shearon v. Henderson, 38 Tex. 245, 246 (1873); Adams v. Wilhite, 636 S.W.2d 851, 856 (Tex. App.—Tyler), *rev'd on other grounds*, 640 S.W.2d 875 (Tex. 1982).

State Laws in 1918, required that the intent to hinder, delay, or defraud a creditor as the result of a transfer of a debtor's property must be "actual intent, as distinguished from intent presumed in law."[79] Nevertheless, certain transactions that had been branded by the courts as evidencing presumptive intent to defraud remained fraudulent conveyances even without the requisite actual intent.[80] Section 4 of the original version of the Uniform Fraudulent Conveyance Act provided that "[e]very 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."[81] This approach was adopted in section 67(d) of the Bankruptcy Act in 1938.[82] Thereafter, in 1978, section 548(a) of the Bankruptcy Code superseded section 67(d) of the Bankruptcy Act.[83]

B. Foreclosure Sales as Fraudulent Conveyances

Despite the continuous existence of some form of fraudulent conveyance provisions in the bankruptcy laws of this country since the early 1800s,[84] those provisions do not appear to have been applied to set aside a foreclosure sale prior to the Fifth Circuit's holding in *Durrett*.[85] Indeed, *Durrett* has been widely criticized both for its holding that a foreclosure sale constituted a transfer subject to review as a fraudulent conveyance and its presumed holding that a sales price of less than 70% of the fair market value of the property was not fair consideration.[86]

The concept that a nonjudicial foreclosure sale is a transfer subject to review under section 548(a) of the Bankruptcy Code was first challenged in *Alsop v. Alaska (In re Alsop)*,[87] a decision by a bankruptcy court in the District of Alaska. While acknowledging that a nonjudicial foreclosure sale may constitute a transfer pursuant to the definition of transfer set forth in section 101(40) (now section 101(50)) of the Bankruptcy Code, the court noted that the time when a transfer is deemed to have occurred for the purposes of section 548 is determined by reference to the special definitional provisions set forth in section 548(d)(1).[88] Section 548(d)(1) of the Bankruptcy Code states that a transfer is deemed to have occurred when it "is so perfected [in the transferee] 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

79. UNIFORM FRAUDULENT CONVEYANCE ACT § 7, 7A U.L.A. 509 (1918); Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 392.
80. *See* Castanares, *supra* note 9, at 522; Roberts & Mariarty, *supra* note 9, at 583.
81. UNIFORM FRAUDULENT CONVEYANCE ACT § 4; 7A U.L.A. 474 (1918).
82. Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 392.
83. *Id.*
84. *See id.* at 390.
85. *See* Davis & Standiford, *supra* note 9, at 204; Simpson, *supra* note 9, at 75.
86. *See, e.g.*, Coppell & Kahn, *supra* note 5; Simpson, *supra* note 9; Zinman, Houle & Weiss, *supra* note 9.
87. 14 Bankr. 982 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982).
88. 14 Bankr. at 986.

[of the transferee]."[89] According to the court in *Alsop*, federal law determines whether a transfer occurred, but "[s]tate law determines the time and method of perfection."[90] Because Alaska law provided that the title of a purchaser at a foreclosure sale "relates back to the time of the execution of the deed of trust,"[91] the court held that the transfer resulting from a foreclosure sale was perfected and therefore deemed to have occurred as of the time the original deed of trust was recorded.[92] In other words, because, under state law, no one acquiring an interest in the property from the debtor after the recording of the deed of trust could have acquired an interest superior to a purchaser at a foreclosure sale conducted pursuant to that deed of trust, the transfer accomplished through a foreclosure sale was deemed to have occurred, for the purposes of section 548, as of the date of the recording of that deed of trust.

While the basic rationale of *Alsop* was followed by the Ninth Circuit in *Madrid v. Lawyers Title Insurance Corp. (In re Madrid)*[93] and supported by the Sixth Circuit in *In re Winshal Settlor's Trust*,[94] that rationale is flawed.[95] The purpose of section 548(d)(1) was "to prevent a secret 'transfer' by postponing the commencement of the fraudulent conveyance period until the transferee [took] the necessary steps under state law to perfect (by recording, possession, or otherwise) its interest against a subsequent bona fide purchaser dealing with the debtor."[96] Section 548(d)(1) does not limit the number of transfers of an interest of the debtor in the land that may be possible in a mortgage transaction.[97] In Texas, as in most states,[98] no transfer of title to land occurs upon the execution of a deed of trust; rather, the interest of the debtor transferred pursuant to the deed of trust is simply a lien that is subject to foreclosure upon the default of the debtor.[99] Actual title to the land is only transferred at the time of the foreclosure, when the trustee executes and delivers a deed to the purchaser on behalf of the debtor.[100] Although a foreclosure sale may extinguish all encumbrances junior to the lien of the deed of trust, so that the purchaser's title to the land is said to relate back to the recording of the deed of trust, that fact cannot support the conclusion that a mortgage foreclosure transaction constitutes

89. 11 U.S.C. § 548(d)(1) (1988).

90. 14 Bankr. at 986.

91. *Id.* (quoting Alaska Laborers Training Fund v. P&R Enter., 583 P.2d 825, 826-27 (Alaska 1978)).

92. *Id.*

93. 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984); *see also* Calairo v. Pittsburgh Nat'l Bank (*In re* Ewing), 36 Bankr. 476 (Bankr. W.D. Pa.), *aff'd*, 746 F.2d 1465 (3d Cir. 1984), *cert. denied*, 469 U.S. 1214 (1985) ("transfer" of pledged securities occurred when creditor perfected security interest under state law by taking possession, not when securities were later foreclosed).

94. 758 F.2d 1136 (6th Cir. 1985).

95. *See Madrid*, 725 F.2d at 1204 (concurring opinion).

96. Ehrlich, *supra* note 13, at 939 n.17.

97. *Id.* at 940.

98. *Id.* at 940 n.20.

99. *See supra* notes 24-27 and accompanying text.

100. *Id.*

only a single transfer.[101]

In 1984, the Bankruptcy Code was amended to include within the definition of transfer the foreclosure of the debtor's equity of redemption.[102] The Bankruptcy Code was also amended to add the word "involuntarily" to the types of transfers by the debtor that may be avoided under section 548(a).[103] While some courts and commentators have interpreted these amendments as a rejection of the *Alsop* and *Madrid* rationale,[104] it is not certain that these amendments accomplished that result.[105] Indeed, neither *Alsop* nor *Madrid* challenged the concept that a transfer occurred as a result of a foreclosure sale; rather, both *Madrid* and *Alsop* questioned the effective date of such transfer pursuant to section 548(d)(1). The language of section 548(d)(1) has not been amended so as to resolve the timing issue raised by *Madrid* and *Alsop*. The vast majority of the courts considering the transfer issue, however, have rejected the rationale of *Madrid* and *Alsop* in favor of *Durrett*.[106] For the Texas practitioner, moreover, the transfer issue is, in fact, not an issue at all, because *Durrett* has been consistently followed in the bankruptcy courts in Texas.[107]

C. *Determining Reasonably Equivalent Value in a Nonjudicial Foreclosure Sale*

Clearly the most controversial holding in *Durrett* did not relate to the transfer issue, but to the fair consideration, or now, under the Bankruptcy Code, reasonably equivalent value, issue. Section 67(d)(1)(e) of the Bankruptcy Act did not define consideration but did set forth the conditions making consideration fair.[108] Section 548 of the Bankruptcy Code, on the other

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101. *See* Ehrlich, *supra* note 13, at 940; *see also* First Sav. & Loan Ass'n of Bismark Inc. v. Hulm (*In re* Hulm), 738 F.2d 323, 327 (8th Cir.), *cert. denied*, 469 U.S. 990 (1984) (distinctly separate transfers of interest in real property may occur at different times). As stated by the bankruptcy court in Pruitt v. Gramaton Investors Corp. (*In re* Pruitt), 72 Bankr. 436, 443-44 (Bankr. E.D.N.Y. 1987):

> At the time of the creation of a mortgage, certain of the debtor's rights are transferred to the mortgagee, while others are retained. The transferred rights are security interests which generally do not ripen into possessory interests until a default occurs. Retained rights generally include the rights of enjoyment and the right to redeem the property from the lien of the security transaction upon payment of the obligation secured thereby . . . . A foreclosure terminates the mortgagor's rights and transfers to the purchaser all of the property rights in the premises.

Id. (citations omitted).

102. 11 U.S.C. § 101(50) (1988) (formerly 11 U.S.C. § 101(48) (1984)).

103. 11 U.S.C. § 548 (1988).

104. *See* Pruitt v. Gramaton Inv. Corp. (*In re* Pruitt), 72 Bankr. 436, 442 (Bankr. E.D.N.Y. 1987); Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 401.

105. *See* Weintraub & Resnick, *supra* note 9.

106. Ehrlich, *supra* note 13, at 940 n.21 (cases therein cited represent majority position).

107. *See, e.g.*, Jackson v. Security Fed. Sav. & Loan Ass'n (*In re* Jackson), 76 Bankr. 597 (Bankr. N.D. Tex. 1987); Willis v. Borg-Warner Acceptance Corp. (*In re* Willis), 48 Bankr. 295 (Bankr. S.D. Tex. 1985); Coleman v. Home Sav. Ass'n (*In re* Coleman), 21 Bankr. 832 (Bankr. S.D. Tex. 1982); *see also* Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547, 549 (5th Cir. 1981) (broad statutory definition of transfer includes nonjudicial foreclosure sale), *cert. denied*, 454 U.S. 1164 (1982).

108. Section 67(d)(1)(e) stated:

hand, defines value,[109] but does not define reasonably equivalent. In any event, the change in language from section 67(d) of the Bankruptcy Act to section 548(a) of the Bankruptcy Code does not appear to have had any appreciable impact on the approach of the courts in determining whether the price obtained at a foreclosure sale was sufficient when such a sale otherwise met the test of a fraudulent conveyance by occurring within one year prior to the bankruptcy filing and at a time when the debtor was insolvent.[110] In that regard, commentators have identified three differing approaches by the courts in determining whether a reasonably equivalent value was obtained at a foreclosure sale.[111]

The first approach is the so-called 70% rule, derived from the statement in *Durrett* that the court had been unable to locate any case upholding a sale of real property for less than 70% of its fair market value.[112] Despite the fact that the holding of *Durrett* was founded on the court's conclusion, based upon all of the evidence, that "the price which [the purchaser] paid for the property at the trustee's sale was not a 'fair equivalent' for the property,"[113] many courts have nevertheless viewed *Durrett* as having created a general rule[114] or presumption[115] that a sale for less than 70% of fair market value is not a reasonably equivalent value.[116] In other words, according to this approach, federal law has superimposed a minimum bid or upset price on state foreclosure law, whereby any purchase of property through a foreclosure sale for less than 70% of its appraised value is voidable in bankruptcy if the other elements of fraudulent transfer are present.[117]

Regardless of the fact that *Durrett* did not create a 70% rule, valid arguments favor its application to the question of reasonably equivalent value in the context of a foreclosure sale. Assuming a lender could rely upon an appraisal conducted prior to the foreclosure sale, application of a mathemat-

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> consideration given for the property or obligation of a debtor is "fair" (1) when, in *good faith*, in exchange and as a fair equivalent therefor, property is transferred or an antecedent debt is satisfied, or (2) when such property or obligation is received in *good faith* to secure a present advance or antecedent debt in an amount not disproportionately small as compared with the value of the property or obligation obtained.

11 U.S.C. § 107(d)(1)(e) (1978) (repealed 1979) (emphasis supplied).

109. Section 548(d)(2)(A) states: " '[V]alue' means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C.A. § 548(d)(2)(A) (1988).

110. *See* Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 405.

111. *See, e.g., id.*; Alden, Gross & Borowitz, *supra* note 8; Cohn, *supra* note 9.

112. Cohn, *supra* note 9, at 273; Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 405.

113. 621 F.2d at 204.

114. Wickham v. United Am. Bank (*In re* Thompson), 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982).

115. Berge v. Sweet (*In re* Berge), 33 Bankr. 642, 649-50 (Bankr. W.D. Wis. 1983).

116. Cohn, *supra* note 9, at 273. *See* Jackson v. Security Fed. Sav. & Loan Ass'n (*In re* Jackson), 76 Bankr. 587, 599 (Bankr. N.D. Tex. 1987); Pelican Homestead v. Wooten (*In re* Gabel), 61 Bankr. 661, 667-68 (Bankr. W.D. La. 1985); Willis v. Borg-Warner Acceptance Corp. (*In re* Willis), 48 Bankr. 295, 300-01 (Bankr. S.D. Tex. 1985).

117. *See* Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 Bankr. 818, 821 (Bankr. N.D. Ala. 1983).

ical 70% formula would promote certainty.[118] Moreover, as observed by the court in *Jackson v. Security Federal Savings & Loan Association (In re Jackson)*,[119] even if appraisals differ, the 70% rule provides a 30% cushion that "give[s] the purchaser at foreclosure some discount for the risks of making a purchase at such a sale in addition to eliminating minor differences of opinion as to fair market value."[120] As some commentators have observed, however, if the determination of reasonably equivalent value was intended by Congress to be based solely upon the application of a mathematical formula, "Congress would hardly have asked courts to determine whether the consideration was 'fair,' as it did in the Bankruptcy Act, or 'reasonably equivalent,' as it does in the Bankruptcy Code. The terms 'fair' and 'reasonable' mean that the trial judge or jury is to evaluate the case in light of all material facts and circumstances."[121]

The decision by the Bankruptcy Appellate Panel of the Ninth Circuit in *Lawyers Title Insurance Corp. v. Madrid (In re Madrid)*,[122] represents the second and much more certain approach to the issue of reasonable equivalence in the context of foreclosure sales. That approach, simply, is to recognize that the price obtained "at a non-collusive and regularly conducted foreclosure sale should be conclusively presumed to be a reasonably equivalent value for the property sold."[123] The court justified this approach by pointing out that it caused state foreclosure law, under which the mere inadequacy of price would not invalidate a sale, to "be harmonized with" the fraudulent conveyance provisions of the Bankruptcy Code.[124] While this approach is consistent with the revised Uniform Fraudulent Conveyance Act,[125] it effectively allows state foreclosure law to override the requirements of section 548(a) of the Bankruptcy Code.[126] Regardless of state law policies

118. *See* Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 406.

119. 76 Bankr. 597 (Bankr. N.D. Tex. 1987).

120. *Id.* at 599.

121. Davis & Standiford, *supra* note 9, at 225-26.

122. 21 Bankr. 424 (Bankr. 9th Cir.), *aff'd*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984).

123. Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 397.

124. 21 Bankr. at 427.

125. Pursuant to the Texas Uniform Fraudulent Transfer Act, adopted in Texas in 1987, a regularly conducted, non-collusive foreclosure sale cannot be challenged based upon the price obtained. TEX. BUS. & COM. CODE ANN. § 24.004 (Vernon 1987). A person acquiring land at such a sale is deemed to have given "a reasonably equivalent value," regardless of the actual sales price. *Id.* § 24.004(b).

126. The dissenting judge in the Bankruptcy Panel's decision in Lawyers Title Insurance Corp. v. Madrid (*In re* Madrid) noted:

> The Bankruptcy Code is a federal statute. Section 548 states a standard with respect to reviewing consideration in the event of a transfer of the debtor's property. Section 548 transcends the dispute between this debtor and the secured creditor. It brings into focus the claims of the debtor's other creditors that they have been deprived of recourse to an asset by an improvident sale. The majority would hold that despite widespread differences in law and practices relating to foreclosure, no bankruptcy court may entertain the factual issue of whether, under § 548, the consideration paid was the reasonably equivalent value. By concluding that a regularly conducted sale in the absence of collusion satisfies the "reasonably equivalent value" test, the majority has excised vital language from § 548 in order to create an exception to the statute where a forced sale of

for upholding foreclosure sales despite an inadequacy of price, the Bankruptcy Code has its own distinct policies respecting the preservation of the debtor's estate for unsecured creditors, which policy may require the setting aside of a particular foreclosure sale despite compliance with state law procedures.[127]

The third approach to the issue of reasonably equivalent value is the case-by-case analysis that is suggested by the language of section 548(a) of the Bankruptcy Code, which approach requires a review of the facts and circumstances of each foreclosure sale in determining whether reasonable equivalence has been obtained.[128] Courts that have endorsed the case-by-case approach have generally recognized that a forced sale inevitably results in a price that is less than fair market value.[129] After all, fair market value is "the amount of money that a person desiring to sell, but not bound to do so, could, within a reasonable time, procure for such property from a person who desires and is able to buy, but is not bound to purchase the property."[130] Because a foreclosing lender is compelled to sell, that fact changes the basic assumptions underlying the ordinary determination of fair market value. Consequently, the fact of a forced sale should be taken into account in defining reasonable equivalence. Indeed, "[a] price that might be unreasonably low in the context of an arm's-length sale might be reasonable in the context of a forced sale."[131]

Taking into account the fact of a forced sale, however, does not necessarily mean that a particular court must accept the state's foreclosure procedures in determining reasonable equivalence. To do so would be to adopt the conclusive presumption approach offered by the Bankruptcy Panel's decision in *Madrid* or a rebuttable presumption test that compared a particular foreclosure sale with the results achieved at the average foreclosure sale con-

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> the debtor's property is involved. There is nothing in the Code nor its legislative history to suggest that such an exception was intended.

21 Bankr. at 428 (Volinn, J., dissenting).

127. *See* Davis & Standiford, *supra* note 9, at 228.

128. For example, the court in Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 Bankr. 434 (Bankr. D. Utah 1982) noted:

> Although *Durrett* has been so interpreted, *Durrett* does not hold that reasonably equivalent value must be 70 percent or more of fair market value. *Durrett* held that on the facts of the case, 57.7 percent of fair market value was not a fair equivalent. Naturally, reasonable equivalence will depend on the facts of each case.

Id. at 448.

129. Alden, Gross & Borowitz, *supra* note 8, at 1613; Davis & Standiford, *supra* note 9, at 230.

130. West Tex. Hotel Co. v. City of El Paso, 83 S.W.2d 772, 775 (Tex. Civ. App.—El Paso 1935, writ dism'd); *accord* State v. Carpenter, 126 Tex. 604, 89 S.W.2d 979, 980 (Tex. Comm'n App. 1936, opinion adopted). *See generally* Comment, *Fair Market Value: A Primer for Texas Legal Practice*, 15 TEX. TECH L. REV. 637 (1984) [hereinafter Comment, *Fair Market Value*] (providing basic understanding of definition of and approaches to valuation). For a thoughtful discussion of the difficulties posed under alternative methods of real property valuation that are available in bankruptcy court in a case where foreclosure had not occurred, see *In re* Raylin Dev. Co. (No. 88-1221), 3 Tex. Bankr. Ct. Rptr. 490 (Bankr. W.D. Tex. June 30, 1989) (order on motion for valuation of assets).

131. Davis & Standiford, *supra* note 9, at 230.

ducted pursuant to state law.[132] As previously observed, however, it is accepted by virtually everyone that even a properly conducted nonjudicial foreclosure sale in Texas simply does not promote competitive bidding or otherwise result in the maximization of price, even giving due regard to the circumstances of a forced sale. As one commentator has observed, *Durrett*'s attack on "the adequacy of prices received under current methods of foreclosure . . . [simply reinforces our own] basic instincts as to the overall shortcomings of current foreclosure practices."[133] Accordingly, the proper application of the case-by-case approach must focus not upon the price obtained in the factual context of foreclosure but upon the adequacy of state foreclosure procedures.[134]

In *Bundles v. Baker (In re Bundles)*,[135] for example, the Seventh Circuit focused its review of a state foreclosure sale on the procedures employed rather than simply upon the price obtained. While the Seventh Circuit did not clearly articulate the standard for reviewing procedures to determine reasonable equivalence, the court did direct bankruptcy courts within its jurisdiction to consider each foreclosure sale to determine "whether the procedures employed were calculated not only to secure for the mortgagee the value of its interest but also to return to the debtor-mortgagor his equity in the property."[136] This examination was to include consideration of such factors as whether there was a fair appraisal of the property, whether the property sale was widely advertised, and whether competitive bidding had been encouraged.[137]

A recent bankruptcy court opinion from California illustrates the methodology embodied in the procedural approach suggested by *Bundles*. In *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*[138] the court reviewed a Texas foreclosure sale to determine whether reasonable equivalence had been obtained under section 548 of the Bankruptcy Code.[139] Acknowledging the essential correctness of the Seventh Circuit's *Bundles* approach, the

132. *Id.*

133. Comment, *Avoidance of Foreclosure Sales, supra* note 13, at 412.

134. *See* Ehrlich, *supra* note 13, at 936. As stated by this commentator:

> If a foreclosure sale conducted under state mandated conditions really did effectuate a competitive bidding market for the property, the price bid at the sale would be an excellent and realistic indication of reasonably equivalent value under the circumstances. The policies embodied in Section 548(a)(2) permit an interpretation that reasonable equivalence in the context of a forced sale will frequently be less than what might be received at a private sale with optimal time to market the property and negotiate a higher price. The state interest in assuring mortgagees an expeditious and final opportunity to resort to the mortgaged property justifies some unavoidable reduction in value at the forced foreclosure sale. The bankruptcy trustee, however, should be allowed to show that even a noncollusive foreclosure sale has failed to bring a reasonably equivalent price, even under the circumstances of a forced sale, because the state-mandated procedure is intrinsically defective and has caused imperfect market results.

Id. at 960-61.

135. 856 F.2d 815 (7th Cir. 1988).

136. *Id.*

137. *Id.*

138. 98 Bankr. 983 (Bankr. S.D. Cal. 1989).

139. Although the court was sitting in the Ninth Circuit and was therefore bound to follow

court adopted a three-part test for determining reasonable equivalence in the foreclosure context. The first step was to determine whether the procedures used in conducting the foreclosure sale complied with applicable state law. If the procedures used were in compliance with state law, then the second step was to determine whether those procedures provided minimum standards of commercial reasonableness so as to assure a bid-in price that was a fair equivalent of the value of collateral in the context of a forced sale. If the court concluded that the procedures followed were commercially reasonable in the context of a forced sale, then the inquiry ended, and no basis for avoiding the sale arose. On the other hand, to the extent it is determined that the procedures were not commercially reasonable, the court must consider the third part of the test—whether the price obtained was less than could have been obtained if commercially reasonable procedures were followed. Not surprisingly, although current Texas procedures had been followed by the lender in *Lindsay*, the court concluded that those procedures failed the second part of the court's three-part test—technical compliance with Texas law did not result in a commercially reasonable sale.[140]

While the courts applying this approach do not appear to have clearly articulated the standards to be employed in reviewing foreclosure sale procedures to determine reasonable equivalence, and while the bankruptcy courts in the Fifth Circuit appear to continue to vacillate between a case-by-case analysis and a strict application of the 70% rule,[141] the authors believe that the foregoing procedural analysis, which echoes that of other commentators,[142] is sound. If the procedures employed in a foreclosure sale permit the sale to be conducted in a manner that allows market forces to work to the maximum extent possible, the price realized at such a sale is clearly the best indicator of the value of the land in the context of a forced sale.[143] Substituting an appraiser's opinion as to reasonably equivalent value merely results in the court looking to find what an imaginary buyer will pay an imaginary seller under unreal conditions, rather than finding what a real buyer and seller do in real circumstances.[144] While being as "well informed as possible," an appraiser's opinion of value is, after all, merely a guess.[145] Accordingly, to the extent state foreclosure procedures could be improved so as actually to promote competitive bidding, the sales price obtained at a sale conducted pursuant to these procedures would indeed be the best evidence of reasonably equivalent value in the context of a foreclosure sale.[146]

Madrid, the court concluded, incorrectly in the authors' view, that the enactment of the bankruptcy amendments in 1984 overruled *Madrid*.

140. 98 Bankr. at 987.

141. *Compare* Coleman v. Home Sav. Ass'n (*In re* Coleman), 21 Bankr. 832 (Bankr. S.D. Tex. 1982) (following case-by-case approach) *with In re* Marble, 40 Bankr. 751 (Bankr. W.D. Tex. 1984) (adhering to strict application of *Durrett*).

142. *See* Ehrlich, *supra* note 13; Comment, *Avoidance of Foreclosure Sales, supra* note 13.

143. Ehrlich, *supra* note 13, at 966.

144. Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 Bankr. 434, 443 n.12 (Bankr. D. Utah 1982).

145. Kimball Laundry Co. v. United States, 338 U.S. 1, 6 (1949); *see also* Comment, *Fair Market Value, supra* note 130 (discussing three basic methods of valuation).

146. Ehrlich, *supra* note 13, at 980. The authors acknowledge that where there is no mar-

The Fifth Circuit, although continuing to adhere to *Durrett*,[147] discourages bankruptcy filings that are made solely to avoid the perceived inequities of state foreclosure law.[148] The adoption by the Fifth Circuit of the approach taken by the courts in *Bundles* and *Lindsay*, coupled with the enactment of Texas legislation establishing a foreclosure mechanism that would better assure fair foreclosure sales, however, might relieve the federal judiciary from the necessity of frequently reviewing foreclosure sale prices in bankruptcy. If the foreclosure procedures actually used in conducting a sale are found to have been designed to achieve the highest price possible in the context of a forced sale, reasonable equivalence, in the authors' view, should be conclusively presumed to have been achieved in connection with a foreclosure sale conducted pursuant to those procedures, regardless of the actual price obtained or its relationship to fair market value. Moreover, emphasizing the procedures used over the price obtained can be reconciled to *Durrett*'s actual rather than its presumed holding (the so called 70% rule) and with the policies underlying section 548 of the Bankruptcy Code.[149] Thus, to improve the fundamental fairness of Texas nonjudicial foreclosure procedures and to anticipate or encourage the Fifth Circuit's adoption of the *Bundles* and *Lindsay* approach to the determination of reasonable equivalence in the review of foreclosure sales under section 548 of the Bankruptcy Code, the authors recommend several changes in Texas law.

III. PROPOSED MODIFICATIONS TO TEXAS NONJUDICIAL FORECLOSURE PROCEDURES

The following discussion proposes some modifications to the Texas nonjudicial foreclosure procedures designed to allow ordinary market forces to work to the largest extent possible in the context of a forced sale. Although the authors would encourage the bankruptcy courts to endorse these procedures, the authors believe that these procedures will be beneficial to debtors and creditors regardless of whether the bankruptcy courts recognize the use of these procedures as necessarily achieving reasonable equivalence under section 548 of the Bankruptcy Code.

A. Defining the Problem

Although it is common to think of the trustee under a deed of trust as acting solely as the lender's agent in conducting a nonjudicial foreclosure

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ket, as has been the case recently in Texas, this statement would be viewed as patently untrue by the borrower who is convinced that given enough time and proper marketing of his property, the borrower will not only be able to repay the lender, but will also recover his equity. Unfortunately, as indicated in Section III, real estate values fluctuate and must be determined by exposure to the market (or lack thereof) as it exists at that time.

147. Wheless Drilling v. Bennett (*In re* Emerald Oil Co.), 807 F.2d 1234, 1238 n.6 (5th Cir. 1987).

148. *See* Sandy Ridge Dev. Corp. v. Louisiana Nat'l Bank (*In re* Sandy Ridge Dev. Corp.), 881 F.2d 1346, 1350 (5th Cir. 1989); Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1074 (5th Cir. 1986).

149. Ehrlich, *supra* note 13, at 966.

sale, a fairly well defined body of law in Texas obligates the trustee to act in the best interests of both the mortgagor and the mortgagee in obtaining the highest price possible for the property.[150] Unfortunately, the existing procedures mandated by section 52.001 of the Texas Property Code provide inadequate tools for the trustee to carry out his duty to the debtor and secured creditor.

A public auction after only twenty-one days prior notice is not the customary manner for marketing real estate. Real estate transactions, particularly those involving commercial land, are normally the subject of intensely negotiated contracts providing for title review, physical inspection, and warranties. Even if third party bidders appear at a public sale, the trustee at a nonjudicial foreclosure sale conducted pursuant to current law has no ability to condition a sale upon the purchaser's satisfactory review of the title to and physical condition of the property, nor does the trustee have the right to negotiate a customary contract of sale with the potential purchaser. Indeed, under current Texas law:

> One who bids upon property at a foreclosure sale does so at his peril. If the trustee conducting the sale has no power or authority to offer the property for sale, or if there is other defect or irregularity which would render the foreclosure sale void, then the purchaser cannot acquire title to the property.[151]

This is so because neither the trustee nor the mortgagee warrant either their authority to sell the property under the deed of trust or the title to the property conveyed.[152] The only warranty derived by a purchaser at a foreclosure sale is one from the debtor on behalf of whom the trustee is conveying the property, assuming, of course, that the trustee has followed the correct procedures so as to have the requisite authority to do so.

The extent to which this rule of *caveat emptor* can be carried is illustrated by *Truman v. Continental Savings Association (In re Niland)*,[153] a Fifth Circuit opinion applying Texas law. In *Niland* a purchaser acquired a house by being the highest bidder at a nonjudicial foreclosure sale conducted in compliance with state law and under the terms of a deed of trust executed by the debtor. Nevertheless, the debtor was able successfully to set aside the sale at a later date, because the property covered by the deed of trust was the debtor's homestead and the debt secured by the deed of trust had not been incurred for the constitutionally prescribed purposes. Moreover, although the purchaser had paid cash to the trustee at the sale, which had been applied by the trustee to the payment of the debt, the court held that the purchaser had no right to recover his purchase price from the creditor. Rather, under established Texas law, the only remedy of a purchaser at a void fore-

150. *See* Hammonds v. Holmes, 559 S.W.2d 345, 347 (Tex. 1977); First Fed. Sav. & Loan Ass'n v. Sharp, 359 S.W.2d 902, 904 (Tex. 1962); *see also* W. BAGGETT, *supra* note 22, § 2.64.

151. Henke v. First S. Properties, Inc., 586 S.W.2d 617, 620 (Tex. Civ. App.—Waco 1979, writ ref'd n.r.e.).

152. Diversified, Inc. v. Walker, 702 S.W.2d 717, 723 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

153. 825 F.2d 801 (5th Cir. 1987).

closure sale is to be equitably subrogated to the debt and lien of the creditor.[154] Because the lien was invalid as a result of the homestead designation of the property, the purchaser was effectively subrogated to an unsecured note enforceable against a debtor then in bankruptcy.[155]

In addition, the purchaser could not sue the lender because, as previously noted, the only warranty given by a trustee at a foreclosure sale is one given on behalf of the debtor.[156] As a result, the creditor received the benefit of the purchaser's cash payment, the debtor had his exempt homestead returned to him, and the purchaser was left with a claim against a debtor in a no asset case. Recognizing the somewhat inequitable result, the court nevertheless noted that the purchaser took a risk that inheres in all nonjudicial foreclosure sales in Texas.[157]

Existing statutory procedures are therefore not designed either to attract interested buyers or to allow truly interested buyers to conduct basic due diligence in connection with the purchase. Moreover, those purchasers who are attracted to current foreclosure sales must essentially part with cash without any assurance that the trustee has the authority to sell, that is, that a default has occurred and that the statutory requirements have been observed. Is it any wonder that there is rarely any competitive bidding at foreclosure sales in Texas? Rather than penalize the lender for the inadequacies of existing foreclosure procedures by adopting anti-deficiency or one-action statutes, however, the authors believe that a few minor additions to the existing state procedures could substantially increase the attractiveness of a foreclosure sale to potential purchasers.

B. Proposing the Solution—Suggested Changes to the Existing Nonjudicial Foreclosure Process in Texas

The Uniform Land Transaction Act (ULTA),[158] adopted by the National

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154. *Id.* at 813.

155. *Id.* at 814.

156. According to the court:

> In conformity with the lien theory, a foreclosure sale transfers legal title from the owner of the mortgaged property to the purchaser at the foreclosure sale. The title never vests in the creditor, and the foreclosure deed is not a conveyance from the trustee or the creditor to the purchaser. In executing the foreclosure deed, the trustee does no more than effect the transfer of title from the debtor to the foreclosure purchaser. It follows that the warranty contained in the trustee's deed in this case does not bind the [trustee or the lender] but binds only the [debtor].

Id. (citing Sandel v. Burney, 714 S.W.2d 40, 41 (Tex. App.—San Antonio 1986, no writ)).

157. Had [the purchaser] purchased the property from [the debtor], he would have obtained a warranty deed and no homestead issue would have arisen. Instead, thinking that he could obtain the property for less than it was worth, [the purchaser] purchased at the foreclosure sale. He was able to obtain the property at a good price, but, under Texas law, he risked the possibility that there would be a failure of title, as in fact there was. We do not think that a Texas court would protect [the purchaser] in this situation, and we decline to do so.

Id. at 813.

158. 13 U.L.A. 476 (1986). The authors are aware that article 3 of the ULTA has been revised and adopted as the Uniform Land Security Interest Act. Because the authors are not

Conference of Commissioners on Uniform State Laws in 1975, provides a ready reference for improvements to the Texas nonjudicial foreclosure process. The authors' observations at a few foreclosure sales, as well as the work of other commentators,[159] provide an additional reference. Accordingly, the authors suggest the following statutory alterations to existing Texas foreclosure procedures.

1. Apply The Good Faith Purchaser for Value Concept to Nonjudicial Foreclosure Sales

The good faith purchaser for value doctrine is inapplicable to a "void" foreclosure sale.[160] In other words, even a purchaser who pays valuable consideration in good faith and without notice of any defects in the foreclosure process or any lack of authority of the trustee to act is subject to having the apparent title he acquires at the foreclosure sale set aside by subsequent actions.[161] The authors believe that, in balancing the equities, a third party purchaser who acquires title from a trustee duly appointed by a recorded instrument executed by the secured creditor in accordance with the terms of the deed of trust, and who is without notice of any defect in the deed of trust, should be entitled to acquire title to the property free of subsequent claims of the mortgagor questioning the authority of the trustee to sell the property. To that end, the authors propose that the Texas Legislature adopt a provision similar to § 3-511 of the ULTA. Section 3-511 of the ULTA provides, in pertinent part:

> (a) If real estate is sold by a creditor under a power of sale . . . a good faith purchaser for value acquires the debtor's and creditor's rights in the real estate, free of the security interest under which the sale occurred and any subordinate interest, even though the creditor or person conducting the sale fails to comply with the requirements of this Part on default . . . .[162]

To the extent that the foreclosure was improper, the aggrieved mortgagor

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urging adoption of either act in Texas, we trust that the readers will indulge our reference to the older act.

159. *See* Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843 (1980).

160. Henke v. First S. Properties, Inc., 586 S.W.2d 617 (Tex. Civ. App.—Waco 1972, writ ref'd n.r.e.).

161. *See* Slaughter v. Qualls, 162 S.W.2d 671 (Tex. 1942). If, however, the trustee has authority but fails to observe the prescribed procedures, chills the bid, or otherwise acts in a manner that gives rise to an equitable right in the debtor to set aside the sale, that equitable right can be avoided by a good faith purchaser for value. *See* Dillard v. Broyles, 633 S.W.2d 636, 644 (Tex. App.—Corpus Christi 1982, writ ref'd n.r.e.).

162. UNIFORM LAND TRANSACTIONS ACT § 3-511(a), 13 U.L.A. 476, 619 (1975) [hereinafter ULTA]. The official comments to § 3-511 of the ULTA explain that the section:

> is intended to eliminate the necessity of a rigorous examination to determine whether the foreclosure transaction complies with the statutory requirements in meticulous detail. The purpose of freeing the purchaser from the risk of the faulty foreclosure is to further assure that the sales price at the foreclosure sale will be more closely related to the real market value of the property thus liquidating the debt for the best interest of the lender and borrower.

Id. comment 1.

should be content with his action against the secured creditor for damages arising from the wrongful foreclosure,[163] unless he can show that the purchaser failed to meet the test of a good faith purchaser for value.[164] Although the technical requirements of the good faith purchaser for value doctrine do not apply when legal title never passed because the trustee's deed was void, application of the doctrine to trustee's sales is justified when one balances the equities of the innocent purchaser against the mortgagor who executed the deed of trust and thus "made it possible for the trustee to create the appearance of good title" in the purchaser.[165]

2. *Increase the Notice Period*

While the twenty-one day period currently provided under Texas law is clearly insufficient to adequately market real property, the authors recognize that in some situations there is no time that would be long enough to adequately market a given parcel of real estate. To increase the likelihood of a foreclosure proceeding actually exposing a property to the market, however, the authors propose that the notice period for a nonjudicial sale be increased to sixty days. In that connection, the authors do not believe that the current requirement that all sales occur on the first Tuesday of each month or at the courthouse steps of the county in which the property is located need be continued. Notices that clearly specify a date and place and otherwise comply with the remaining procedures proposed herein should be sufficient. Moreover, by dispensing with the requirement that a sale only occur on the first Tuesday of a month, the lengthening of the period is probably not that significant to lenders. Under current practices, it can take almost sixty days to foreclose after the occurrence of a default, simply because the default may occur at a time when it is too late to give the required twenty-one days notice for a sale on the first Tuesday of the next month.

3. *Require Notice to Junior Lienholders and Owners of Record*

Texas law generally does not require that a notice of sale be given to any junior lienholder.[166] Moreover, there is technically no requirement that notice be given to the owner of the land unless he is personally obligated on the debt.[167] The authors believe that notifying junior lienholders and owners of

163. *See* Charter Nat'l Bank-Houston v. Stevens, No. A14-88-00421-CV (Tex. App.—Houston [14th Dist.], Oct. 26, 1989, n.w.h.) (not yet reported) (Westlaw, TX-CS, DATABASE NO. 126319); Diversified, Inc. v. Gibraltar Sav. Ass'n, 762 S.W.2d 620 (Tex. App.—Houston [14th Dist.] 1988, writ denied).

164. *See* Williams v. Jennings, 755 S.W.2d 874, 882 (Tex. App.—Houston [14th Dist.] 1988, no writ).

165. Slaughter v. Qualls, 139 Tex. 340, 346, 162 S.W.2d 671, 675 (1942); *see also* Phillips v. Latham, 523 S.W.2d 19, 24 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.); Thurmond v. International Harvester Co., 166 S.W.2d 742, 744 (Tex. Civ. App.—Amarillo 1942, no writ).

166. Chandler v. Orgain, 302 S.W.2d 953, 956 (Tex. Civ. App.— Fort Worth 1957, no writ); W. BAGGETT, *supra* note 22, § 2.45.

167. American Sav. & Loan Ass'n v. Musick, 531 S.W.2d 581, 588 (Tex. 1975); Lawson v. Gibbs, 591 S.W.2d 292, 295 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.); W. BAGGETT, *supra* note 22, § 2.39.

any interests in the land subject to the debt would not impose an undue burden on secured lenders and may result in an increased participation at foreclosure sales. Clearly the more persons aware of the sale and actively soliciting potential buyers the better. As in the requirements of section 3-505(g) of ULTA, the authors believe that the requirement for notice to junior lienholders and other persons owning an interest in the land should be limited to the debtor, mortgagor (if different from the debtor), and those who recorded their liens or interests after the date of the recording of the deed of trust and no less than a specified period prior to the date of the foreclosure sale. Section 3-505(g) provides that the documents creating the lien or interest must be recorded at least seven weeks before the sale. The authors believe that thirty days is a sufficient period in light of the fact that under existing practice a foreclosing lender must obtain a lien search thirty days prior to the sale in order to give the proper notices to the Internal Revenue Service to the extent the land has been encumbered by a federal tax lien.[168]

The trustee's obligation to give notices to junior lienholders and other interest owners should be limited, however, to mailing notice to the addresses specified in the documents filed of record to create such liens and interest. This avoids the lender's concern that it may unintentionally be aware (through other officers of the lender) of another address for a particular party. In the event of a change of address, junior lienholders and other owners of interest in the property can protect themselves by recording supplement documents changing their addresses for notice.

4. Encourage the Use of Market Advertising

The concept that notice of a foreclosure is sufficient by mailing a copy to the debtor, posting a copy at the courthouse door and filing a copy with the county clerk is highly improbable. While the ULTA proposes a concept of commercial reasonableness respecting notice and advertising similar to that imposed by the Uniform Commercial Code and suggested by *Bundles* and *Lindsay*, the authors suggest that certain minimum standards for required advertising be clearly defined by the Texas Legislature after consulting with the real estate industry. In prescribing minimum standards, however, the legislature should not limit the ability of a trustee to conduct additional marketing activities. Indeed, in order to meet the second part of the three-part test for reasonable equivalence, as adopted by *Lindsay* and endorsed by the authors, the marketing efforts of the trustee must demonstrate an actual effort to obtain the highest price possible under the circumstances.[169] Existing Texas law also appears to impose a similar duty on trustees.[170] Unlike ex-

168. 26 U.S.C. § 7425 (1982).

169. *See supra* note 135 and accompanying text.

170. *See supra* note 150. Existing statutory procedures restrict that duty to strict compliance with the statute and the terms of the deed of trust. Only where the trustee is excercising discretion does a higher obligation arise.

isting procedures, however, it is intended that the new procedures give the trustee the flexibility actually to fulfill that duty.

In most cases, of course, the trustee should list the property with a licensed real estate broker on or before the posting date. It can be expected that competent real estate brokers would know how best to advertise a property for sale.[171] Moreover, because a real estate agent will only be paid if the property sells, the real estate agent has an incentive for marketing the property to the best advantage of both the lender and the debtor.

5. *Bifurcate the Public Sale*

Clearly the most significant deterrent to participants at a nonjudicial foreclosure sale is the requirement to bid on property and consummate the transaction on the courthouse steps without the benefits of even the most basic due diligence. Borrowing conceptually again from the ULTA, the authors propose that the successful bidder at a public sale, other than the secured creditor, be required to deposit with the trustee (or with a designated representative of the trustee) at least 10% percent of the bid price in cash or bank obligation and enter into a contract to purchase the land.[172] The contract, like a trustee's deed, would be executed by the trustee on behalf of the mortgagor. The contract could contain all such customary terms and conditions relating to inspections and reports as may be negotiated by the buyer and the trustee.

If the marketing effort has been successful, the trustee, in theory will have pre-negotiated a contract form as a result of contacts from a number of interested buyers who will finalize their offers at the public sale. As this system has time to work, however, it is anticipated that deeds of trust may be drafted specifying certain warranties that the trustee may give on behalf of the mortgagor in a contract executed in connection with such a public sale. If the contract is not closed, the trustee may enforce the remedies therein provided against the highest bidder, if any, or resell the property by readvertising for another public sale in the manner previously described.[173] To the extent that the trustee becomes entitled to the deposit, it should be applied against the debt in the same manner as the proceeds of a completed sale.[174]

6. *Terminate the Equity of Redemption at Public Sale*

Although the trustee would not deed the property to the successful bidder at the public sale under the revised procedures advocated by the authors, the execution of the contract of sale could effectively burden or "clog" the debtor's equity of redemption to the extent the contract thereafter closed.[175]

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171. *See* ULTA § 3-508 comment 1, 13 U.L.A. 476, 613, (1975).

172. *Id.* § 3-508(b), 13 U.L.A. at 614. If the secured creditor is the successful bidder at the public sale, the secured creditor may dispense with the bifurcated approach and proceed directly to closing.

173. *Id.*

174. *Id.*

175. *See* Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.).

In other words, once a contract was executed, the debtor could no longer pay off the debt and receive his land back because the contract would be binding upon the debtor. The authors believe this is a necessary and unavoidable result of the bifurcated approach. Accordingly, it would probably be appropriate for any new legislation to recognize this clogging as permissible.

7. Facilitate Secured Creditor's Right to Possession

Because the time between notice and ultimate consummation of the sale is somewhat longer under the procedures recommended by the authors, and because potential purchasers will demand access to the property to perform due diligence, a summary judicial proceeding to give possession of or access to the property is desirable in the event the debtor is uncooperative. As provided in ULTA section 3-508, special protections for residential property occupied by a debtor may be required. Likewise, as provided in ULTA section 3-504, certain protections may need to be provided to the creditor arising from its possession of the property prior to foreclosure.[176]

8. Recognition of Inherent Inequities

The authors recognize that most borrowers will complain that the foregoing proposals do nothing to eliminate the inherent inequity of any foreclosure that occurs during a significant downturn in the market, or when no market exists. Despite compliance with all of the foregoing recommendations, the secured creditor may still be the only bidder at the sale. In balancing the interests of borrowers and lenders, however, the authors cannot perceive of any ready solution to this inherent problem in the enforcement of liens on real estate. A property's value from time to time necessarily fluctuates. While it may be true that if a lender is patient and waits long enough a particular property will increase in value, a borrower who has agreed to pay a debt at a specific time and who has pledged property as security for that debt must accept the risk that the pledged property may not produce a price at foreclosure sufficient to discharge the debt at the time the debt becomes due. Moreover, regardless of the property's fair market value as determined by an appraiser, the debtor must also assume the risk that despite all realistic and reasonable efforts to market the property in the context of a foreclosure sale, buyers willing to pay that appraised value may not exist. Accordingly, the authors believe that neither fairness nor the concept of reasonable equivalence under the Bankruptcy Code requires that a nonjudicial foreclosure process provide a solution to the soft or no-market problem.

9. Constitutional Issues

It is beyond the scope of this Article to discuss in detail the constitutional

176. The legislature should also protect creditors and trustees for liability associated with the disclosure of information regarding the property to the extent such disclosure is made in connection with a sale.

issues presented by the foregoing proposals, but it is relevant to point out that many, if not most, deeds of trust currently in use state that the foreclosure procedures are to be in compliance with section 52.001 of the Texas Property Code "as it may be amended from time to time." Accordingly, to the extent these proposals are challenged solely on the basis of the impairment of the obligation of pre-existing deeds of trust, it may be that the parties have already contracted for a change in law.[177] That issue, however, can be left for another article if the foregoing proposals, or some variation thereof, are ever adopted.

IV. CONCLUSION

The statutory procedures mandated by current Texas law are inadequate either to provide the debtor with a reasonable expectation or to provide the creditor with a means of assuring that the maximum price is obtained for the sale of land through a nonjudicial foreclosure. While the early efforts of the Texas Legislature to curb the abuses of the unregulated use of powers of sale may have helped to assure that a debtor could attend the sale and attempt to protect his equity in the land by either repaying the secured debt or bidding at the sale, the procedures, adopted in 1889 and, with a few modifications, still in use today, have done little to increase participation at such sales by interested buyers.

The recent efforts by the Texas Legislature to change existing foreclosure law by limiting a lender's rights to a deficiency judgment following a foreclosure sale based upon the introduction of evidence regarding fair market value, moreover, would unfairly penalize the secured lender holding a lien on real estate. While it is common for debtors to speak in terms of giving the property back to the lender, in most cases the lender never had the property to begin with, nor was it ever the lender's intent or desire to be forced to have the loan it made to a debtor repaid by the land rather than cash. After all, "[t]he purpose of a mortgage is not to enable the mortgagee to acquire the mortgaged property but to secure him in the payment of his debt."[178] Anti-deficiency statutes, one-action rules, and redemption periods,[179] as adopted in the various states, may protect the debtor from the effects of a foreclosure procedure that inevitably produces an inadequate price, but they penalize the lender who is given no alternative but to follow archaic procedures that simply do not permit the property to be marketed so as to produce the highest price possible in the context of a forced sale. Furthermore, in light of bankruptcy's fraudulent conveyance principles, a foreclosure sale can be set aside, notwithstanding anti-deficiency statutes, one-action rules, or redemption periods.[180]

177. Wylie v. Hays, 114 Tex. 46, 263 S.W. 563 (Tex. Comm'n App. 1924, opinion adopted).

178. Pearce v. Stokes, 155 Tex. 564, 291 S.W.2d 309, 312 (1956).

179. A "redemption period" is any of a variety of post foreclosure time periods granted by statutes in many states during which a borrower can redeem foreclosed property by paying the unpaid balance of the secured debt. BLACK'S LAW DICTIONARY 1149 (5th ed. 1979).

180. For an excellent discussion of the failure of anti-deficiency statutes, one-action rules,

Since the Texas Legislature is almost certain to reconsider legislation affecting Texas foreclosure law in its next session, the authors hope that the more comprehensive approach briefly outlined in section III of this Article will stimulate discussion of these proposals so that some similar, but refined, proposals could be considered by the Texas Legislature. Such an approach would benefit both lenders and debtors, and, it is hoped, serve to reconcile state foreclosure procedures to the fraudulent conveyance provisions of the Bankruptcy Code.[181]

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and redemption periods to resolve the inherent unfairness of current foreclosure practices, see Washburn, *supra* note 159.

181. The authors acknowledge that any reconsideration of nonjudicial foreclosure laws should also encompass judicial foreclosure laws. Because judicial foreclosure is so rarely used in Texas, however, a discussion of judicial foreclosure remains for a future article.