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Security Devices

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I. MORTGAGES—REVOCATORY ACTIONS

The 1984 revisions to the Civil Code amended, among many items, those articles dealing with the revocatory and oblique actions.[1] Recently, two cases have arisen interpreting the scope of the revocatory action. In both, creditors were trying to annul transfers into trusts and the issue was the peremptive period applicable to revocatory actions.

Louisiana Civil Code article 2041 provides:

> The action of the obligee must be brought within one year from the time he learned or should have learned of the act, or the result of the failure to act, of the obligor that the obligee seeks to annul, but never after three years from the date of that act or result.[2]

The question raised by the language of Article 2041 is what constitutes knowledge of the obligee. Can an obligee be subject to a claim that he "should have learned of the act" merely because it was recorded in the public records, or is actual knowledge sufficient? Is the test merely knowledge of the transfer or rather knowledge of the harm caused by the transfer? The two appellate cases hold, under Article 2041 (which covers both liquidated and unliquidated claims), that the peremptive period begins to run from the date of the harm, not the date

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1. La. Civ. Code arts. 2036-2044.

2. The Louisiana revocatory action was in existence many years before the common-law Uniform Fraudulent Conveyance Act, 7A U.L.A. 427 (1918).

of the transfer. The cases note a distinction between the transfer itself and the harm caused by the transfer.

First Federal Savings & Loan Ass'n v. Jones[3] was an action by a creditor holding a mortgage who sought to annul a transfer of movable and immovable assets into a trust that was created *after* execution of the mortgage. In 1986, the mortgage was put in place; in 1989 the trust was formed and assets were transferred into the trust. Seven months later, also in 1989, the lender filed suit on the promissory note and mortgage and obtained a judgment. Two years later, in 1991, the lender filed this revocatory action to set aside the transfer into the trust.[4]

The following stipulation was entered into:

> [The lender] had actual knowledge of the Trust and its recordation . . . more than one year prior to the date on which [the lender] filed this [revocatory action] lawsuit . . . but [the lender] did not discover the harm created by the transfer and recordation until . . . less than one year prior to the date [of the filing of the revocatory action] lawsuit. . . .[5]

The trial judge sustained the debtors' exception of prescription, but the appellate court reversed and remanded, finding the fact that the public records reflected the transfer into the trust was not the sole determinative issue. The appellate court emphasized it was not the recordation itself that could put lenders on notice of the harm the revocatory action is designed to prevent—the court reasoned the harm is insolvency and the inability of the creditor to collect the judgment.[6] The court noted that merely because someone may have transferred property did not demonstrate that the creditor necessarily was harmed at the time of the transfer.

> The trial judge's reliance on the recordation date of the trust instrument in the public records as the date prescription began to run was clearly misplaced. While recordation of the trust instrument clearly put future lenders on notice as to which assets of Horace Lynn Jones, if any, were available to secure his personal indebtedness, the recordation did no more than put First Federal on notice of the possibility that it had been damaged.[7]

Because the lender did not know of the damage—that is, the inability to collect the judgment and the increase in the debtor's insolvency—the plaintiff's inscription of the trust did not start the peremptive clock running.

3. 620 So. 2d 408 (La. App. 3d Cir.), *writ denied*, 629 So. 2d 347 (1993).
4. *Id.* at 409-10.
5. *Id.* at 410.
6. *Id.* at 411.
7. *Id.*

If prescription does not begin merely upon the date of the transfer but upon the date of knowledge of the harm, when is a creditor engaged in a foreclosure process knowledgeable of the harm caused by a prior transfer? Several dates might be looked at: the date of transfer, the date suit is filed, the date judgment is obtained, the date of the appraisal, or the date of the sheriff's sale. *Premier Bank, N.A. v. Stout*[8] found the appropriate date to look at was the date of the sheriff's sale *if* a deficiency judgment was being sought.

The facts of the *Premier Bank* case are that, in 1988, the Stouts established the Stout Family Trust; the trust instrument gave the grantors the right to transfer and the trustees the right to receive other property into the trust. In 1989, First Federal, another creditor of the Stouts, filed suit on promissory notes and later filed a deficiency judgment action. In 1990, Premier Bank filed suit on the promissory notes it held. Premier Bank claimed it first learned of the trust's existence during the judgment debtor examination in April, 1991. First Federal claimed it first learned of the trust during its review of the transcript of Premier Bank's judgment debtor examination. The suit to revoke the transfer into trust was filed within one year of the judgment debtor examination and within three years of the date of the trust's existence. The trial judge sustained an exception of prescription.[9]

The appellate court's ruling had several levels of analysis. First, the exception of peremption (termed here an exception of "prescription") seeking to unwind the original $1500 donation to the trust was sustained. Second, the case was remanded to determine if there were subsequent transfers into the trust. Third, the exception of "prescription" was overruled on the subsequent transfers pending further court hearings.[10] Relying both upon *Jones* and on an extensive review of Planiol's discussion of the Paulian action, the *Stout* appellate court held damage did not occur to a secured creditor until the conclusion of the foreclosure sale, "because this is the earliest date a creditor should know of the damage sustained by it as a result of the wrongful transfer into the debtor's assets."[11]

While the original transfer into the trust was felt by the court to be outside of the peremptive period, the court reasoned subsequent transfers might not be, because the harm could not be known to the creditor until the time of the foreclosure sale. If the foreclosure sale brought sufficient funds to pay off the creditor, then the creditor, reasoned the court, could not be harmed at all by the transfer because the proceeds of the foreclosure sale would have extinguished the plaintiff-creditor's debt. On the other hand, if the foreclosure sale did not bring sufficient funds to pay the foreclosing creditor in full, then it is only at this point, when the bid price is determined, that the creditor can realize there is a harm.

8. 627 So. 2d 188 (La. App. 3d Cir. 1993).

9. *Id.* at 188-89.

10. *Id.* at 191.

11. *Id.* at 190. Planiol's discussion of the Paulian action is located at 2 Marcel Planiol & George Ripert, Treatise on the Civil Law §§ 296-336, at 178-96 (Louisiana State Law Institute trans., West 1959) (1939).

Judge Domengeaux expressly pointed out that a creditor who seeks a revocatory action following a foreclosure sale must be seeking a deficiency judgment; if there is no deficiency judgment, there is no cause of action to revoke the transfer because there is no damage.[12]

II. THE PUBLIC RECORDS AND THE NAME OF THE MORTGAGOR

Since the mortgage records are indexed only by the parties' names and not by property descriptions, the method by which the index is maintained plays an important role in helping third parties determine what mortgages may affect them.[13] There are actually four distinct steps in placing a mortgage on the public records. The first step is called filing, and it is the process by which the document is presented to the Recorder of Mortgages.[14] Filing is accomplished by providing the document to the clerk at the usual and customary place in the clerk's office where such filings occur.[15] The second step is the assembly of everything that is filed into a chronologically bound volume. In every parish except Orleans, the clerk of court is both the recorder of mortgages and the recorder of conveyances. Therefore, in every parish except Orleans, the originals consist of all documents filed with the clerk, whether they are ultimately destined for recordation in the conveyance records or the mortgage records.[16] The third step is the process of creating the index for the mortgage and conveyance records. This is the process by which employees of the clerk's office read through the document and extract the names of the mortgagor, mortgagee, vendor, and vendee. These indices are what one searches when looking for documents in the public records. The fourth and final step is the process of "recordation," which is the method by which a copy of the original document is transferred into a special conveyance book or mortgage book.

In the 1800s, the distinction between filing and recordation was very clear. The original document was filed; a clerk's employee would then copy the entire document, in longhand, onto large sheets of paper bound in a special book. There was a single book for mortgages and a single book for conveyances. Therefore, the process of rewriting and copying the document into the mortgage or conveyance book was the process of recordation. Later, typewriters were used, and in the twentieth century, photocopies, microfiche, and microfilm have been used to create the conveyance and mortgage books. It can be anticipated that, in the not-too-

12. *Premier Bank, N.A.*, 627 So. 2d at 192 (Domengeaux, J., concurring).

13. La. R.S. 9:2721 (1991 & Supp. 1994) contains the basic rules for the Louisiana Public Records Doctrine. *See also* McDuffey v. Walker, 125 La. 152, 51 So. 100 (1910).

14. The rules regulating recorders of mortgages and their duties are contained in La. R.S. 9:5141-:5216 (1991 & Supp. 1994).

15. *See, e.g.*, Godchaux Sugars, Inc. v. Leon Boudreaux & Bros., 153 La. 685, 96 So. 532 (1923).

16. The special rules regulating Orleans Parish are contained in La. R.S. 9:5207-:5209, :5215 (Supp. 1994).

distant future, electronic means of creating the conveyance and mortgage books will be used. In each instance, however, the mortgage and conveyance books are distinct from the originals themselves. The originals are filed, but the mortgage and conveyance books are separate and distinct compilations of the materials which consist, in one form or another, of copies of the originals.

Louisiana law historically has always distinguished between filing and recordation. Conveyances were always deemed effective upon filing, even if not recorded, while mortgages were effective only upon recordation.[17] In an effort to make the effective date of mortgages the date of filing, the predecessor to Louisiana Revised Statutes 9:5141 was enacted.[18] The function of the statute was to try to make the date of filing the date of the effectiveness of mortgages. The statute, however, has been interpreted to mean filing is the effective date only if recordation later occurs in a timely fashion.[19]

When the Civil Code provisions on mortgages were revised in the 1990s, an attempt was made to transform the language of "recordation" to "filing." Other provisions of the Civil Code, however, have remained unchanged, such as those articles dealing with privileges, which refer sometimes to "filing," sometimes to "inscription," and sometimes to "recordation."[20]

In light of the inability of third parties to locate documents unless they are indexed, the indices become all important. Nonetheless, Louisiana courts uniformly hold filing (and, if necessary, recordation) alone is sufficient to affect third persons. A document which is not indexed nonetheless affects third parties.[21]

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17. For an example of the rule concerning conveyances, see Schneidau v. New Orleans Land Co., 132 La. 264, 61 So. 225 (1913) (on rehearing). The rule concerning mortgages was part of the Louisiana Constitution of 1921, and was carried forward as an unnumbered statute. *See* La. Const. art. XIV, § 16 (1974).

18. La. R.S. 9:5141 (1991 & Supp. 1994) provides:

> A. All acts or instruments of writing which import mortgage or privilege, when filed for record with the recorder of mortgages, shall be immediately indorsed by him with the date, hour, and minute of filing which indorsement shall be recorded with the registry of the instrument.
>
> B. All such instruments shall be effective against all persons from the time of their filing.
>
> C. All such instruments filed after December 31, 1991, shall include the Social Security number or the taxpayer identification number of the mortgagor, whichever is applicable. Failure to include such numbers shall not affect the validity of the instruments.
>
> D. No clerk of court or recorder of mortgages shall refuse to accept for recordation any instrument which does not contain the social security number or taxpayer identification number as prescribed in this Section.

19. *Compare* Kennibrew v. Tri-Con Prod. Corp., 244 La. 879, 154 So. 2d 433 (1963) (holding recordation within three days is sufficient) *with* Opelousas Fin. Co. v. Reddell, 9 La. App. 720, 119 So. 770 (1st Cir. 1929) (holding recordation after eighteen months is insufficient).

20. *Compare* La. Civ. Code art. 3320 ("A mortgage . . . is given the effect of recordation when it is filed . . . .") *with* La. Civ. Code art. 3328 (entitled "Duration of inscription; general rule") *and* La. Civ. Code art. 3330 ("The effect of recordation of a . . . judicial mortgage ceases ten years after the date of the judgment.").

21. *See, e.g.*, Agurs v. Belcher & Creswell, 111 La. 378, 35 So. 607 (1903).

A creditor who files a mortgage is concerned not only about putting third parties on notice of this encumbrance, but also about finding the existence of prior encumbrances. This requires a search of the indices; and, since the name of the mortgagor is the way the indices are kept, an index search requires looking for specific names. Most cautious attorneys look for variations of the name, knowing the name is only the first step in the process; it is only by review of the actual document that one can determine whether the specific property is encumbered (in a conventional mortgage) or whether the person named in the index is a mortgagor under a legal or judicial mortgage.

It is in this context that Louisiana Revised Statutes 9:2728 was enacted concerning conventional mortgages:

> A conventional or collateral mortgage shall not be deemed inferior and subordinate to another security device solely by reason of:
> (1) its inclusion of or failure to contain the middle name or initial of the mortgagor; or
> (2) the use of any reasonable variation of the mortgagor's name, including but not limited to initials or abbreviations for the mortgagors' given names.

The purpose of the statute was to legislatively overrule *First Financial Bank, FSB v. Johnson*,[22] a case which held a mortgage in the name of "James Johnson" did not affect property purchased in the name of "James J. Johnson," so as to outrank later creditors who used this name for the mortgagor, although the purchaser and mortgagor were one in the same. Confusing the concept of a conveyance certificate with a title search,[23] the court held the mortgageholder "had the duty of properly styling the name of its mortgagee in the act of mortgage."[24] *First Financial Bank, FSB* stands in stark isolation; the same appellate court later restricted the case's ruling to prospective effect only.[25] Furthermore, given both that it was overruled legislatively in 1987 by Louisiana Revised Statutes 9:2728, and that no other court has cited it with approval, *First Financial Bank, FSB* is destined to be relegated to an historical footnote.

There is a tension, however, that *First Financial Bank, FSB* brings to the fore and that merits discussion. When no property description is required to create the mortgage, as is the case with a legal or judicial mortgage,[26] the

22. 477 So. 2d 1267 (La. App. 4th Cir. 1985).

23. A conveyance certificate is merely a request to the clerk of court to check for a specific name in the conveyance records; a mortgage certificate is the same request to be run in the mortgage indices. This is distinguished from a title search or a title examination, which is a search of *all* pertinent records, not just of a specific name and a specific format.

24. *First Fin. Bank, FSB*, 477 So. 2d at 1270.

25. Voelkel v. Harrison, 572 So. 2d 724 (La. App. 4th Cir. 1990), *writ denied*, 575 So. 2d 391 (1991).

26. A judicial mortgage is created simply by filing a money judgment with the recorder of mortgages. La. Civ. Code arts. 3299-3300. A legal mortgage is created in accordance with

mortgagor's name takes on more importance than in a conventional mortgage, where a property description not only is required but becomes the controlling issue.[27] Names that are not even close to the actual name of the owner may be ineffective to create a legal or judicial mortgage or a privilege on property. Therefore, recordation of a lien against "Greener & Sumner, Architects" was insufficient to create a materialman's lien against the owner of a property known as Corporate Towers, Ltd., although the name "Greener & Sumner Architects" was a "d/b/a." This was the holding of *Cardinal Federal Savings Bank v. Corporate Towers Partners, Ltd.*[28] Likewise, in *Ducote v. United States*,[29] a tax lien was avoided because it was recorded in the name of "Hugh es J. de la Vero ne II" rather than in the name of "Hugu es J. de la Verg ne II." On the other hand, in *Succession of Montgomery*,[30] recording a judgment against "Sterling N. Harris" resulted in a judicial mortgage against property owned by Mr. Harris, whether purchased in the name of "Sterling N. Harris" or merely "Sterling Harris."

Obviously, when the mortgagor's name is the sole method of determining what property may be affected by the mortgage, lien, or privilege, the name is more important than when it is merely a method to get into the public records to find a property description. Although there is no express authority for this point, the following proposed principles are supportable by the jurisprudence and represent a reasonable policy under the Louisiana Public Records Doctrine:

> (1) In a conventional mortgage, the name of the mortgagor on the document may be the mortgagor's actual name or any reasonable variation of the name.[31]
>
> (2) The name in a document that creates a judicial or legal mortgage or creates a lien or privilege without a property description is effective as to third parties if the legal name of the mortgagor or any reasonable variation is contained in the document; however, courts are entitled to review such names with stricter scrutiny than if a conventional mortgage were involved.

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particularized laws. La. Civ. Code art. 3301. *See, e.g.*, La. Civ. Code art. 322 (creating a legal mortgage in favor of a minor subject to a natural tutorship). Both judicial and legal mortgages are general in nature and need not contain descriptions of specific properties burdened by the mortgage. La. Civ. Code art. 3303.

27. See the discussion of La. Civ. Code art. 2440, *infra* text accompanying notes 33-41.

28. 629 So. 2d 462 (La. App. 3d Cir. 1993). This opinion is merely one part of a lengthy litigation process. For an earlier decision, see Cardinal Fed. Sav. Bank v. Corporate Towers Partners, Ltd., 564 So. 2d 1282 (La. App. 3d Cir. 1990).

29. (*In re* de la Vergne), 156 B.R. 773 (Bankr. E.D. La. 1993).

30. 46 So. 2d 677 (La. App. Orl. 1950). *See also* Metairie Bank & Trust Co. v. Wendryhoski, 338 So. 2d 978 (La. App. 4th Cir. 1976), *writ dismissed*, 345 So. 2d 498 (1977).

31. Under this rule, any of the following may be appropriate for a mortgage against "James Patrick Johnson": "James P. Johnson," "James Johnson," "Jim Johnson," "J. Johnson," "J.P. Johnson," "Jimmy Johnson," or "Jamie Johnson." More difficult questions would arise if the name in the document was listed as "James Jahnson," or "Patrick Johnson."

III. PROPERTY DESCRIPTION IN A MORTGAGE

All conventional mortgages must contain a property description; a conventional mortgage must "state precisely the nature and situation of each of the immovables or other property over which it is granted."[32]

Official Revision comment (b) to Article 2440 states in pertinent part:

> (b) Under this Article, a description of immovable property in an act of sale is sufficient if it enables a person to locate and identify the property.

Hargrove v. Hodge,[33] cited in the comment, states:

> The description in a deed must be such that the property intended to be conveyed can be located and identified, and the general rule is that the description must fully appear within the four corners of the instrument itself, or that the deed should refer to some map, plat or deed as a part of the description, so that the same may be clear.
>
> The purpose of registry is that third persons may have notice of the transfer, and, if the description in the deed is so vague, indefinite and uncertain that the property cannot be located and identified, the sale is void as to third persons who deal upon the faith of the public records. The deed, under which defendant claims, is too vague and indefinite—it really describes nothing.[34]

It is interesting to note the requirements of Article 2440 are for the effectiveness of a mortgage even as between the parties. Whether parol evidence can be used to correct a totally invalid property description is an open question. A recent case that did not question the effectiveness of a property description was *Belle Pass Terminal, Inc. v. Jolin, Inc.*,[35] in which an act of sale and a mortgage included, apparently, the sole property description as:

> Any and all assets and improvements located on properties owned, leased, or rented by Jolin, Inc., Fourchon Docks, Inc. and Joe Blanchard in Fourchon, Louisiana.[36]

If third parties were involved, it is questionable whether this description, standing alone, would be sufficient to affect them.

While most cautious attorneys today use metes and bounds descriptions for rural property, including reference to acquisition transactions, and neighboring

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32. La. Civ. Code art. 3288.
33. 9 La. App. 434, 121 So. 224 (2d Cir. 1928), *writ refused*, No. 3281 (Jan. 28, 1929).
34. *Id.* at 436, 121 So. at 225.
35. 634 So. 2d 466 (La. App. 1st Cir.), *writ denied*, 638 So. 2d 1094 (1994).
36. *Id.* at 472.

properties, and while most cautious attorneys in urban areas refer to subdivisions, maps, and plats in developed areas, there are older cases where the descriptions are, to be generous, cryptic. For example, sufficient descriptions were found to exist for the following:

> [Mortgagor's] entire landed interest in the . . . parish of West Feliciana, situated on and adjacent to the Mississippi river [sic], and composed of thirty-eight hundred acres of land more or less, as per acts of sale to be found at [the recorder's] office in the town of St. Francisville, parish aforesaid.[37]

and

> A certain cotton plantation upon which . . . John Tullis resides.[38]

The former description, concerning West Feliciana Parish, arguably is close to the line, since the name of the vendor is given and therefore reference and review of that earlier act is appropriate. The latter description, however, is such that it is difficult to believe any court today would sustain it. Indeed, in a number of older cases equally cryptic descriptions were held invalid. For example, the following descriptions were all held invalid: (1) "[A]ll the property owned by us in the Parish of Orleans";[39] (2) All property appertaining to the succession of Joseph Schalatre;[40] and (3) "All the property herein described consisting of one house and lot, with other improvements thereon; also the half interest in the store building adjoining, with all right and title and interest of the [mortgagor]."[41]

IV. AN UPDATE ON DUE PROCESS

Because Louisiana is not a "self-help" state and does not have a "deed of trust" theory by which a creditor obtains title to property as security for a debt,[42] a creditor who wishes to seize and sell immovable property must do so through the court system. This involves either a lawsuit by ordinary process or by executory process, both of which require seizure by the sheriff. Therefore, state action is involved and the requirements of due process under the Fifth Amendment of the United States Constitution must be considered.

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37. City Nat'l Bank v. Barrow, 21 La. Ann. 396, 396 (1869).

38. Miller v. Utley-Holloway Sawmill Co., 168 La. 934, 938, 123 So. 625, 626 (1929).

39. State *ex rel.* Brisbois v. Recorder of Mortgages, 13 Orl. App. 229 (La. App. 1915), *writ denied*, No. 6559 (Feb. 23, 1916). This description was held invalid even as between the parties to the mortgage.

40. Edwards v. Caulk, 5 La. Ann. 123 (1850).

41. Keiffer Bros. v. Starn, 27 La. Ann. 282 (1875).

42. *See, e.g.*, Miller v. Shotwell, 38 La. Ann. 890 (1886).

There are a number of key cases involving procedural due process issues that have an impact on Louisiana foreclosures.[43] The current rule in Louisiana is that because of due process requirements, owners, mortgageholders, and other possessors of real rights must be given constitutionally required notices prior to being deprived of property rights.[44] The essential requirement under *Mennonite*[45] is that the holder of a protected property interest must be given notice of the sale.[46] In an attempt to preserve the sanctity of titles of property, and to preserve the due process rights of those who do not receive the necessary notice, the legislature adopted Louisiana Revised Statutes 13:3886.1 in 1991,[47] which

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43. The key procedural due process cases are: Wyatt v. Cole, 112 S. Ct. 1827 (1992); Connecticut v. Doehr, 500 U.S. 1, 111 S. Ct. 2105 (1991); Tulsa Professional Collection Servs., Inc. v. Pope, 485 U.S. 478, 108 S. Ct. 1340 (1988); Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 103 S. Ct. 2706 (1983); Lugar v. Edmondston Oil Co., 457 U.S. 922, 102 S. Ct. 2744 (1982); Flagg Bros. v. Brooks, 436 U.S. 149, 98 S. Ct. 1729 (1978); Mitchell v. W.T. Grant Co., 416 U.S. 600, 94 S. Ct. 1895 (1974); Fuentes v. Shevin, 407 U.S. 67, 92 S. Ct. 1983 (1972); Sniadach v. Family Fin. Corp., 395 U.S. 337, 89 S. Ct. 1820 (1969); Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 70 S. Ct. 652 (1950); Davis Oil Co. v. Mills, 873 F.2d 774 (5th Cir.), *cert. denied*, 493 U.S. 937, 110 S. Ct. 331 (1989); Small Engine Shop, Inc. v. Cascio, 878 F.2d 883 (5th Cir. 1989); Sterling v. Block, No. CA-89-4682, 1992 WL 365114 (E.D. La. Nov. 25, 1992); Bonner v. B-W Util., Inc., 452 F. Supp. 1295 (W.D. La. 1978); Magee v. Amiss, 502 So. 2d 568 (La. 1987); Buckner v. Carmack, 272 So. 2d 326 (La. 1972), *appeal dismissed*, 417 U.S. 901, 94 S. Ct. 2594 (1974).

44. *See, e.g.*, Magee v. Amiss, 502 So. 2d 568 (La. 1987). *See also* Michael H. Rubin, *Security Devices, Developments in the Law, 1987-1988*, 49 La. L. Rev. 495 (1988); Michael H. Rubin & E. Keith Carter, *Notice of Seizure in Mortgage Foreclosures and Tax Sale Proceedings: The Ramifications of* Mennonite, 48 La. L. Rev. 535 (1988); Michael H. Rubin & R. Marshall Grodner, *Security Devices, Developments in the Law, 1991-1992*, 53 La. L. Rev. 969 (1993).

45. Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 103 S. Ct. 2706 (1983).

46. *See* Rubin & Carter, *supra* note 44; Rubin & Grodner, *supra* note 44.

47. La. R.S. 13:3886.1 (Supp. 1994) provides:

A. The failure to notify any lienholder or other interested person having an interest in the property shall not affect the rights of the seizing creditor nor invalidate the sheriff's sale; nor shall any lien, privilege, or other encumbrance that is inferior to the rank of the lien of the seizing creditor affect the property after the sheriff's adjudication. The exclusive remedy for any person affected by the provisions of this Subsection shall be to institute a claim by summary pleadings, within one year from the date of the sheriff's adjudication, proving that he has been damaged by the failure to notify him. In connection with any such claim, the court shall consider and the person claiming damages shall have the burden of proving all of the following:

(1) That his name and address were reasonably ascertainable through the exercise of reasonable diligence.

(2) That he lacked actual knowledge of the seizure.

(3) The respective ranking and amounts of all liens, privileges, and other encumbrances affecting the property as of the date of the sheriff's adjudication.

(4) The value of such respective rights.

(5) The value of the property as of the date of the sheriff's adjudication.

(6) The respective positions the parties would have occupied had the required notice been given.

(7) His ability and capacity to have obtained funds to purchase the property at the foreclosure sale had the required notice been given.

grants a claim for damages to the holder of the property right who was not notified if the complaining party can prove that there was equity in the property and that, had notice been given, equity could have been preserved.

Although no Louisiana court has yet definitively interpreted this provision, several courts have indicated a willingness to allow creditors who fail to give notice to use procedures similar to those of the statute or to conduct a new sale. For example, in *USX Corp. v. Champlin*,[48] a second mortgageholder was not given notice of a foreclosure sale. The court determined that although the first mortgageholder had purchased the property at the foreclosure sale, it would not elevate the second mortgageholder to a first lien position. The court ordered the property to be resold at a private auction and found this to be an "appropriately tailored remedy."[49] The court further stated, "it does not completely restore the parties to the status quo, but it does restore the opportunity to bid the property and purchase at the foreclosure sale while avoiding the wastefulness of a second foreclosure proceeding."[50]

It should be noted, however, when the person to whom notice is not given is the federal government, a different result may apply because the federal government, particularly the Internal Revenue Service, has a "federally prescribed remedy"[51] that may not be available to private-party litigants.[52]

The scope of procedural due process continues to receive scrutiny from the highest levels. The United States Supreme Court recently had an opportunity to review the issue in both *United States v. Carlton*[53] and *United States v. James Daniel Good Real Property*.[54] While *Carlton* involved retroactive legislation and *Good* involved seizure of property under a drug forfeiture statute, the language of the cases may well turn out to be as important as that of *Mennonite*, which involved a tax sale but which was later held to apply to private foreclosure actions.

In *Carlton*, the Supreme Court held a retroactive change in the tax code did not violate the due process rights of taxpayers although it was clear the party

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(8) That in such circumstances he would have bid on the property in such an amount as to have prevented him from suffering the alleged damages, either by such bid being successful or by such bid leading to a higher bid by another party.

B. In no event shall the claim of any such person exceed the value of the interest he possessed on the date of the sheriff's adjudication.

C. The provisions of this Section shall be applied both retrospectively and prospectively; however, any action for which the time period for bringing such action would otherwise be shortened by the provisions hereof shall be instituted within one year from July 17, 1991, and any suit not instituted within that time and any claims relating thereto shall be forever barred.

48. 992 F.2d 1380 (5th Cir. 1993).
49. *Id.* at 1386.
50. *Id.*
51. *Id.* (discussing Myers v. United States, 647 F.2d 591 (5th Cir. 1981)).
52. *See, e.g.*, Myers v. United States, 647 F.2d 591 (5th Cir. 1981).
53. 114 S. Ct. 2018 (1994).
54. 114 S. Ct. 492 (1993).

litigant had relied upon the statute prior to its retroactive amendment.[55] In a separate concurring opinion, Justice Scalia, joined by Justice Thomas, made the following comment about due process:

> [T]he Due Process Clause guarantees no substantive rights, but only (as it says) process.[56]

In *James Daniel Good Real Property*, the federal civil forfeiture laws[57] were at issue. Although the case involved neither a private foreclosure action nor any mortgages, the language of the case may ultimately prove as broad as that of *Mennonite*. The importance of *Mennonite* is that notice and an opportunity to be heard is what is crucial prior to a deprivation of rights. This rule was expanded and clarified in *James Daniel Good Real Property*.

The underlying facts are that Hawaii police officers executing a search warrant in 1985 found 89 pounds of marijuana and other drugs. Four and a half years later, the United States filed an action seeking to forfeit Good's house and the four acre parcel on which it was located. In an ex parte proceeding the warrant of arrest in rem was issued. Using the in rem proceeding and the magistrate's order, the government seized the property without prior notice to Good or an adversary proceeding.[58] "At the time of the seizure, Good was renting his home to tenants for $900 per month. The Government permitted the

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55. "Although Carlton's reliance is uncontested—and the reading of the original statute on which he relied appears to have been correct—his reliance alone is insufficient to establish a constitutional violation." *Carlton*, 114 S. Ct. at 2023.

56. *Id.* at 2027 (Scalia, J., concurring).

57. The federal civil forfeiture laws are contained in 21 U.S.C. § 881 (1988 & Supp. V 1993). This statute provides in pertinent part:

> (a) The following shall be subject to forfeiture to the United States and no property right shall exist in them:
>
> . . . .
>
> (7) All real property, including any right, title, and interest (including any leasehold interest) in the whole of any lot or tract of land and any appurtenances or improvements, which is used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, a violation of this subchapter punishable by more than one year's imprisonment, except that no property shall be forfeited under this paragraph, to the extent of an interest of an owner, by reason of any act or omission established by that owner to have been committed or omitted without the knowledge or consent of that owner.

Although the Justice Department has used the 1984 forfeiture laws extensively and, some allege, aggressively, the Court has put some limitations on this approach. The Court, for example, has used the Eighth Amendment to add a "proportionality" test to civil forfeiture actions. Austin v. United States, 113 S. Ct. 2801 (1993). The Court has ruled that appeal bonds may not be necessary to challenge forfeitures under wrongful circumstances. Republic Nat'l Bank v. United States, 113 S. Ct. 554 (1992). The Court also has upheld an "innocent owner" defense to civil forfeiture for those who did not know their property was used in drug transactions. United States v. A Parcel of Land, Bldgs., Appurtenances & Improvements, Known as 92 Buena Vista Ave., Rumson, N.J., 113 S. Ct. 1126 (1993). For comments on these opinions, see Richard C. Reuben, *Putting Brakes on Forfeiture*, A.B.A. J., Feb. 1994, at 14.

58. *James Daniel Good Real Property*, 114 S. Ct. at 497-98.

tenants to remain on the premises subject to an occupancy agreement, but directed the payment of future rents to the United States Marshal."[59]

Good challenged the seizure and the Court found it to be unlawful. The Court stated the underlying question and its holding succinctly:

> The principal question presented is whether, in the absence of exigent circumstances, the Due Process Clause of the Fifth Amendment prohibits the Government in a civil forfeiture case from seizing real property without first affording the owner notice and an opportunity to be heard. We hold that it does.[60]

Justice Kennedy, writing for the majority, underlined the importance of both prior notice and a hearing, employing forceful language and relying upon a prior case involving private-party litigants. The following quotation from the opinion may be held to apply to private-party foreclosures:

> The right to prior notice and a hearing is central to the Constitution's command of due process. "The purpose of this requirement is not only to ensure abstract fair play to the individual. Its purpose, more particularly, is to protect his use and possession of property from arbitrary encroachment—to minimize substantively unfair or mistaken deprivations of property. . . ."[61]

The Court noted the importance of notice of a hearing is unrelated to actual interference with an owner's possession or use:

> And in *Connecticut v. Doehr*, we held that a state statute authorizing prejudgment attachment of real estate without prior notice or hearing was unconstitutional, in the absence of extraordinary circumstances, even though the attachment did not interfere with the owner's use or possession and did not affect, as a general matter, rentals from existing leaseholds.[62]

Ex parte and prejudgment seizures create an "unacceptable risk of error" according to the Court.[63] Although the language the Court used involves government seizures only, its implications are broad:

> The *ex parte* preseizure proceeding affords little or no protection to the innocent owner. In issuing a warrant of seizure, the magistrate judge need determine only that there is probable cause to believe that the real

59. *Id.* at 498.
60. *Id.* at 497.
61. *Id.* at 500-01 (quoting Fuentes v. Shevin, 407 U.S. 67, 80-81, 92 S. Ct. 1983, 1994-95 (1972)).
62. *Id.* at 501 (citation omitted).
63. *Id.*

> property was "used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of" a felony narcotics offense. The Government is not required to offer any evidence on the question of innocent ownership or other potential defenses a claimant might have. . . . "[F]airness can rarely be obtained by secret, one-sided determination of facts decisive of rights. . . . No better instrument has been devised for arriving at truth than to give a person in jeopardy of serious loss notice of the case against him and opportunity to meet it."
>
> The purpose of an adversary hearing is to ensure the requisite neutrality that must inform all governmental decisionmaking. That protection is of particular importance here, where the Government has a direct pecuniary interest in the outcome of the proceeding.[64]

Consider how, with just a few minor changes, this argument might be adapted to certain types of seizures involving private parties. In ex parte pre-seizure proceedings involving private parties, the foreclosing creditor is not, using language from the case, "required to offer any evidence on . . . potential defenses"[65] the owner or mortgagor might have.

The Court went on to note it is not merely the lack of notice that is crucial; physical seizure itself is inherently suspect absent procedural protections for the possessor of the property interest.

> Nor is the *ex parte* seizure of real property necessary to accomplish the statutory purpose of § 881(a)(7). The Government's legitimate interests at the inception of forfeiture proceedings are to ensure that the property not be sold, destroyed, or used for further illegal activity prior to the forfeiture judgment. These legitimate interests can be secured without seizing the subject property.
>
> Sale of the property can be prevented by filing a notice of *lis pendens* as authorized by state law when the forfeiture proceedings commence. . . . The Government's policy of leaving occupants in possession of real property under an occupancy agreement pending the final forfeiture ruling demonstrates that there is no serious concern about destruction in the ordinary case.[66]

Not all pre-judgment seizures are suspect. The Court specifically noted procedural protections can apply. Indeed, Chief Justice Rehnquist's partial concurrence[67] (in which Justices Scalia and O'Connor joined) specifically relied

64. *Id.* at 502 (quoting 21 U.S.C. § 881(a)(7) (1988 & Supp. V 1993), and Joint Anti-Facist Refugee Comm. v. McGrath, 341 U.S. 123, 170-72, 71 S. Ct. 624, 647-49 (1951) (Frankfurter, J., concurring)) (citations omitted).

65. *Id.*

66. *Id.* at 503.

67. *Id.* at 507-11 (Rehnquist, C.J., concurring in part).

upon *Mitchell v. W.T. Grant Co.*,[68] a case sustaining the validity of Louisiana's sequestration provisions.

The importance of *James Daniel Good Real Property* cannot be understated. If "the right to prior notice and a hearing is central to the Constitution's command of due process," then what is crucial is the notice of the action that will deprive the owner of property. Likewise, if physical seizure is suspect, and if a notice of lis pendens may be sufficient, as *James Daniel Good Real Property* indicated, then this leaves one to question whether Louisiana's procedures involving erasure of lis pendens notices may cause concern for seizing creditors, particularly remembering that private-party defendants who invoke state statutes later found to be unconstitutional can be sued for liability under 42 U.S.C. § 1983.[69] Under the rationale of *James Daniel Good Real Property*, the proper method for a creditor who is concerned about the prejudgment seizure is to first file a notice of lis pendens. On the other hand, under Louisiana law, when a trial court orders removal of a lis pendens notice, this order is deemed an interlocutory order, not an appealable order. A creditor who wishes to protect its rights may thus have limited opportunity to do so if another creditor is moving forward with a foreclosure sale.

For example, assume Creditor A is proceeding forward with a foreclosure sale. Creditor B then files a suit for recognition of its mortgage and files a notice of lis pendens. Creditor C files a writ of sequestration and Creditor D files writs of attachment. Creditors B, C, and D all file notices of lis pendens and the trial court orders these deleted from the public records. What are the creditors to do? Some guidance is given in *Dawsey v. Gruber*.[70] The opinion, in its entirety, reads:

> [Writ] granted. Although cancellation of a notice of lis pendens is an interlocutory judgment, relator has made a sufficient showing under the facts of this case that the sale of the immovable property would cause her irreparable harm. Accordingly, the judgment of the court of appeal dismissing relator's appeal is vacated and set aside. Relator's suspensive appeal is reinstated. Case remanded to the court of appeal for further proceedings.[71]

The cautious creditor whose notice of lis pendens has been removed may want to cite *Dawsey v. Gruber* as authority to appellate courts that writs should be granted as a matter of course when an erasure of a notice of lis pendens has occurred.

It can be anticipated that the issue of due process will continue to occupy the Supreme Court's attention. Justice Thomas, in his partial concurrance in

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68. 416 U.S. 600, 94 S. Ct. 1895 (1974).
69. *See, e.g.*, Wyatt v. Cole, 112 S. Ct. 1827 (1992).
70. 629 So. 2d 402 (La. 1993).
71. *Id.* at 402 (citation omitted).

James Daniel Good Real Property, spoke about a trend that he sees in the Court's approach:

> Like the majority, I believe that "[i]ndividual freedom finds tangible expression in property rights." In my view, as the Court has increasingly emphasized the creation and delineation of entitlements in recent years, it has not always placed sufficient stress upon the protection of individuals' traditional rights in real property. Although I disagree with the outcome reached by the Court, I am sympathetic to its focus on the protection of property rights—rights that are central to our heritage.[72]

V. DEFICIENCY JUDGMENTS

Louisiana law has always reflected the tension between allowing a creditor to collect the debt when owed, including foreclosure and sale of collateral, and protecting the debtor's right to a fair valuation of the collateral. If every sheriff's sale always brought a fair price, then there would be no need to worry about either the appraisal process or the bid amount. On the other hand, because of the foreclosures during the Great Depression, the legislature became concerned about whether sheriff's sales and the bidding process actually elicited both competitive bids and a price that was fair and reasonable to the debtor. Thus, the Deficiency Judgment Act was enacted.[73] As originally written, the function of the Deficiency Judgment Act was narrow: if a creditor proceeded to judicial foreclosure without appraisal, the creditor was prohibited from obtaining a deficiency. Whatever the collateral brought, the creditor could not obtain more from the debtor after the sale. The scope of the act was quickly expanded from solely judicial sales to any kind of sale, private or public, judicial or nonjudicial.[74]

When the Code of Civil Procedure was created in 1960, its rules were meshed with those of the Deficiency Judgment Act. Since appraisals are required in all ordinary proceedings,[75] and since deficiency judgments are prohibited following sales without appraisals,[76] both the appraisal process and the appraisal amount become critical. However, prior to 1988, there were not a large number of cases dealing with the appraisal process because the Louisiana Supreme Court had held in *League Central Credit Union v. Montgomery*[77] that "fundamental" defects in executory proceedings (meaning defects in the pleadings) could bar a deficiency. Thus, *League Central Credit Union* produced

72. United States v. James Daniel Good Real Property, 114 S. Ct. 492, 515 (1993) (Thomas, J., concurring in part) (citation omitted).

73. 1934 La. Acts No. 28, § 1 (codified as amended at La. R.S. 13:4106 (1991)).

74. *See, e.g.*, Home Fin. Serv. v. Walmsley, 176 So. 415 (La. App. Orl. Cir. 1937).

75. La. Code Civ. P. art. 2332.

76. La. R.S. 13:4106 (1991).

77. 251 La. 971, 207 So. 2d 762 (1968).

a slew of cases trying to determine whether an alleged defect in the proceedings was so "fundamental" as to bar a later deficiency judgment. *League Central Credit Union* also led to a situation in which debtors did not contest anything in executory proceedings, preferring to wait until the deficiency judgment action was brought. If the debtor contested the executory proceeding as defective prior to the judicial sale, the creditor either would correct the proceeding or convert it to an ordinary suit, thereby "curing" the defects. On the other hand, if the debtor waited until the deficiency judgment action was brought, the debtor always had a chance of preventing any further deficiency action, because at that point it would be too late to "correct" the defect in the executory proceeding, for the seizure and sale already would have occurred.[78]

Baton Rouge Petroleum Center[79] put an end to what some had termed the "ambush" tactics of debtor's counsel—waiting for the deficiency action to raise the potential defect. *Baton Rouge Petroleum Center* used a "raise it or waive it" approach; unless the debtor raised the defect in the executory proceedings, the debtor could not raise it later as a bar to the deficiency judgment action.[80] Thus, *League Central Credit Union* was overruled. *Baton Rouge Petroleum Center*, however, specifically emphasized that the integrity of the appraisal process remained crucial:

> Although [the public policy behind the Deficiency Judgment Act] is broad and strong, there is nothing in its history or expression that indicates an intention to bar a creditor who *fully complies with appraisal requirements* from obtaining a deficiency judgment simply because of a lack of authentic evidence in the executory proceeding.[81]

Therefore, *Baton Rouge Petroleum Center* refocused the attention of courts away from "defects" in executory proceedings and onto the appraisal process itself.[82] This is not to say that courts have not been concerned with other defects in executory proceedings; the focus, however, has been on the appraisal process itself.[83]

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78. It is interesting to speculate whether *League Central Credit Union* and its rationale played any role in the Louisiana Supreme Court's upholding of the validity of the executory process in Buckner v. Carmack, 272 So. 2d 326 (1973), *appeal dismissed*, 417 U.S. 901, 94 S. Ct. 2594 (1974). Although *League Central Credit Union* is not cited in *Buckner*, some have argued that because defects in the executory proceedings would prevent a deficiency judgment, this may have made it easier for the court to sustain the validity of Louisiana's executory process against constitutional challenges. There is no direct evidence, however, to support this line of thought.

79. First Guar. Bank v. Baton Rouge Petroleum Ctr., Inc., 529 So. 2d 834 (La. 1988).

80. *Id.* at 841-44.

81. *Id.* at 844 (emphasis added).

82. For a discussion of *Baton Rouge Petroleum Center* and the past jurisprudence under *League Central Credit Union*, see Rubin, *supra* note 44.

83. *See, e.g.*, Samco Mortgage Corp. v. Armstrong, 582 So. 2d 848 (La. 1991), *rev'g* 579 So. 2d 521 (La. App. 4th Cir.) (concerning a "notice of private sale" issued by a creditor); Citicorp Acceptance Co. v. Roussell, 601 So. 2d 350 (La. App. 1st Cir.), *writ denied*, 608 So. 2d 177 (1992)

While lower courts during the last few years have struggled with issues involving the appraisal process, the matter appears destined for future clarification by the Louisiana Supreme Court, although several recent cases show the court's approach. The recent battle lines have involved how the Deficiency Judgment Act and the appraisal process interact with in globo sales.

The Civil Code allows a creditor to conduct an in globo sale. Louisiana Code of Civil Procedure article 2295 provides:

> If several items of property have been seized, or if one item of property which is divisible into portions has been seized, the judgment debtor, at any time prior to the first advertisement, may designate the order in which the items or portions of property will be sold, except that the judgment creditor can direct the sale of property on which he has a mortgage, or a privilege other than that resulting from the seizure.
>
> If the judgment debtor does not designate the order of sale, the order of sale shall be at the discretion of the sheriff.
>
> When property is offered by items or portions and the total price bid is insufficient to satisfy the judgment, with interest and costs, or if the judgment debtor so requests, the property shall be offered in globo and thus sold if a higher bid is obtained.

The language of Article 2295 appears to be clear. If the judgment creditor has a mortgage or a privilege other than that resulting from a seizure, i.e., a conventional mortgage, then the judgment creditor ought to be able to direct the order of sale. No court has expressly reached this decision, although the supreme court has held creditors who foreclose by executory process are entitled to direct the order of sale.[84] Obviously, the creditor who employs executory proceedings must have a conventional mortgage or security interest containing a confession of judgment clause.[85]

Given that Article 2295 both allows the creditor to direct the order of sale and allows property to be offered in globo, two questions have arisen concerning in globo sale procedures: first, when can a debtor direct the in globo sale or claim prejudice from an in globo sale; and second, is the right to conduct an in globo sale equivalent to the right to conduct an in globo appraisal?

(using language about fundamental defects in the appraisal process and dealing with notice to appoint appraisers); Cenval Leasing Corp. v. Nunnery, 577 So. 2d 1042 (La. App. 4th Cir. 1991) (holding the Deficiency Judgment Act does not apply to items governed by the Lease of Movables Act, La. R.S. 9:3301-:3342 (1991)); Citicorp Acceptance Co. v. Gelpi, 563 So. 2d 427 (La. App. 1st Cir.), *writ denied*, 567 So. 2d 111 (1990) (applying *Baton Rouge Petroleum Center* retroactively).

84. First Fin. Bank, FSB v. Hunter Forest Ltd. Partnership, 456 So. 2d 1380 (La. 1984).

85. Louisiana Code of Civil Procedure articles 2631 and 2635 require that, in order for executory process to be available, there must be a document creating the mortgage or privilege that contains a confession of judgment. Thus, this can only be done through a conventional mortgage or a vendor's privilege; it cannot arise through a legal or judicial mortgage.

In *First Federal Savings & Loan Ass'n v. Moss*,[86] in globo sales were held to be prohibited on separately mortgaged properties when there is no cross-collateralization clause in the documentation. In this case, the Mosses and others placed two separate mortgages on two separate lots; the Mosses ended up with ownership of both of the lots. The mortgages were executed in 1982. In 1988 the creditor filed a single petition for executory process, foreclosing on both mortgages and requesting the properties be sold at judicial sale with appraisal. The petition did not request the properties be sold either separately or together. None of the notices the Mosses received indicated the properties would be sold together; they merely indicated the properties would be sold "in accordance with law." Although the Mosses were provided with a notice of sale and a notice to appoint an appraiser, they failed to appoint an appraiser and one was appointed by the sheriff. The properties were sold for 70% of the appraised value. The sale of the two lots, each of which contained four-plex units, was in globo.[87]

The supreme court found that the in globo sales were "unauthorized."[88] The *Moss* court specifically noted that if the debtor had "cross-collateralized" the various properties, then an in globo sale would have been acceptable.[89] The lack of cross-collateralization allowed the court to distinguish the case before it (where there were two separate mortgages) from both *Baton Rouge Petroleum Center* and *First Bank & Trust Co. v. Chenault*.[90]

It is interesting to note *Moss* did not use as its rationale a discussion of whether the debtor was actually prejudiced; rather, it was the "substantive defect in the executory proceeding"[91] that prevented the deficiency. This phrase, "substantive defect," seems to have echoes of the old "fundamental defect" language of *League Central Credit Union*, which *Baton Rouge Petroleum Center* overruled. Therefore, on the one hand, it might be argued the procedural niceties of the foreclosure process are more important than whether the debtor can show prejudice. If so, this type of argument is supported by Justice Scalia's concurring opinion in *United States v. Carlton* that "the Due Process Clause guarantees no substantive rights, but only (as it says) process."[92] On the other hand, if the function of the Deficiency Judgment Act is to protect the creditor from obtaining windfall at the foreclosure sale to the debtor's detriment,[93] then perhaps the underlying substance of the foreclosure sale (i.e., the true value of

86. 616 So. 2d 648 (La. 1993).

87. *Id.* at 649-50. Apparently the "70% bid" was because of the *Durrett* rule, a rule established in Durret v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), and having a basis in the "common law" of attorneys, but not necessarily in federal jurisprudence. For a further discussion of *Durrett* and the fact it has now been overruled, see *infra* notes 130-144 and accompanying text.

88. *Moss*, 616 So. 2d at 654.

89. *Id.* at 653-56.

90. 576 So. 2d 1123 (La. App. 3d Cir. 1991).

91. *Moss*, 616 So. 2d at 656.

92. United States v. Carlton, 114 S. Ct. 2018, 2027 (1994) (Scalia, J., concurring).

93. For a discussion of the possibility of a windfall during the deficiency judgment process, see Rubin, *supra* note 44, at 501-03.

the property (not merely its appraised value) and whether the bid price approached the true value) should be the focus.

It is possible, however, this latter point, although not directly addressed, underlies the recent decision in *Williams v. Perkins-Siegen Partnership*.[94] In *Williams*, three separate tracts were mortgaged in a single act. The tracts had been acquired for different prices and had different tax values and different characteristics; however, the tracts adjoined one another. The creditor's appraiser did not appraise each tract "with such minuteness that it can be sold together or separately" under Louisiana Revised Statutes 13:4365(C), but rather reached an in globo value for all three tracts and then gave one third of this aggregate amount to each tract. The debtors did not appoint an appraiser for themselves, and therefore the sheriff appointed one for them pursuant to Louisiana law. The sheriff-appointed appraiser used the creditor's appraiser's approach and reached identical numbers. A later suit was filed for a deficiency judgment, and it was in this second action that the appraisal process was challenged.[95]

The supreme court, after having ruled originally for the debtor,[96] withdrew its opinion, granted a rehearing, and then ruled unanimously for the creditor.[97] The narrow result of the case is that there is no prohibition against an in globo appraisal on cross-collateralized tracts if the appraisal form gives a value for each tract. The practical result appears to be a debtor must appoint an appraiser or challenge the appraisal prior to sale in order to maintain a later claim in the deficiency judgment action.

Because *Baton Rouge Petroleum Center* focused attention on the appraisal process, not only is the appraisal important, but also the procedure by which the appraisal occurs and the debtor's right to know about it become crucial. It should be remembered the notice of a sale itself is a federal constitutional due process rule under *Mennonite* and its progeny. Louisiana procedural rules, however, also play an important role.

What kind of notice is sufficient? *Citizens Savings & Loan Ass'n v. Kinchen*[98] addresses the issue from the viewpoint of the Deficiency Judgment Act. Hart purchased two commercial properties secured by a mortgage on the property; Citizens Savings & Loan Association (Citizens) was the holder of the note and mortgage. Hart sold the properties to Ritter who assumed the obligations and bound himself in solido with Hart to Citizens. Ritter sold the properties to Kinchen who "likewise assumed all the obligations imposed on Hart."[99] Citizens filed an executory process suit but only Kinchen was made a defendant and received the demand for payment, notice to appoint an appraiser, and notice of seizure. "Hart was not made a defendant, and no formal notices

94. 649 So. 2d 367 (La. 1995).
95. *Id.* at 368-69.
96. Williams v. Perkins-Siegen Partnership, 633 So. 2d 1247 (La. 1994).
97. *Williams*, 649 So. 2d at 371.
98. 622 So. 2d 662 (La. 1993).
99. *Id.* at 663.

were served upon him[,]"[100] although Hart had actual notice. Following the sale a deficiency was sought in which Hart was named as a defendant.

The Louisiana Supreme Court found that, to obtain a deficiency judgment, the creditor must assure that the debtor receives the notice prescribed by statute, notwithstanding the debtor's actual notice of the right to appoint an appraiser. The court went out of its way to limit an earlier holding concerning what type of notices a debtor must receive; however, it is important to note the court's language is perhaps more expansive than it intended:

> On the other hand, there is no statutory provision requiring the creditor to prove service of any other notice or process on a debtor prior to the judicial sale as a condition precedent to a deficiency judgment. Accordingly, we reject as incorrect the statement by the court of appeal in the present case that a mortgagee, in order to recover a deficiency judgment against an original mortgagor, is required to make him a party to the executory proceeding or to have him served with notice of demand or notice of seizure. For the same reason we are required to remove from this court's opinion in *Security Homestead Ass'n v. Fuselier* the implication that [Louisiana Code of Civil Procedure article] 2721 or due process requires service of notice of seizure upon the debtor as a condition precedent to a deficiency judgment. The foregoing statements were neither required by the Deficiency Judgment Act nor necessary to the analytical foundations of the holdings in those cases.[101]

It is interesting to note that, while attempting to limit *Fuselier*, the Court uses the language "due process requires service of notice of seizure." It may be difficult to reconcile the language of *Kinchen*, requiring notice of a right to appoint an appraiser, with the language of *Mennonite*. *Mennonite*'s language about constitutionally required notice is:

> Notice by mail or other means as certain to ensure actual notice [of the sale] is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interest of any party, whether unlettered or well versed in commercial practice, if its name and address are reasonably ascertainable.[102]

Thus, it is the notice of sale, not the notice to appoint an appraiser, which is required for constitutional due process.[103] Therefore, whether an appraisal

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100. *Id.*

101. *Id.* at 664-65 (citation omitted).

102. Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 800, 103 S. Ct. 2706, 2712 (1983).

103. Therefore, the language of the *Kinchen* court equating due process requirements with the Deficiency Judgment Act may be subject to future clarification, for *Kinchen* stated:

is sought and whether an appraisal is timely does not necessarily relate to due process requirements. Indeed, it could be argued due process has nothing to do with the appraisal process itself, but only the sale. It may well be that a judicial sale could be held in accordance with due process procedures (because the debtor had actual notice of the sale) even though a deficiency would not be allowed because the procedural appraisal requirements of Louisiana law had not been met. Likewise, one could envision a situation in which notice to appoint an appraiser was given, but the sale date was moved and the debtor did not receive a notice of the new sale date. In such an instance, the required appraisal notice might have been given under the Deficiency Judgment Act and Louisiana Code of Civil Procedure, but nonetheless an allegation is raised that due process might have been violated. It can be anticipated there will be further litigation clarifying this issue and making a distinction between those rights necessary for the exercise of a deficiency judgment under Louisiana law and those required for due process guarantees.

A second holding of *Kinchen* is worthy of special notice. As originally enacted, the Deficiency Judgment Act was so narrowly drawn it discouraged creditors and debtors from voluntary work-out arrangements by which the debtor would give property to the creditor and agree to be bound for a deficiency, even if the purpose of this was merely to avoid the costs and expense of a sheriff's sale. Therefore, parties who might otherwise have worked out their differences were prohibited from doing so and forced to resort to litigation because, otherwise, the debtor could not obtain the deficiency judgment. As a result of this narrow approach, which forced parties to court, the legislature enacted two special provisions on commercial and consumer transactions allowing the parties to agree to a deficiency if certain safeguards were in place. Louisiana Revised Statutes 13:4108.1 (involving commercial transactions) and 13:4108.2 (involving consumer transactions) contain the same requirement. The debtor cannot be liable for a deficiency beyond the reasonably equivalent value (as defined in the statute) of the property.[104] A finding of "reasonably equivalent value" requires a prior agreement between debtors and creditors. This is the express holding of *Kinchen*. In order to take advantage of the statute and pursue the debtor for a deficiency following a private sale or an invalid appraisal, the creditor must have had an agreement with the debtor as to value. This agreement probably can take place only after default, for Louisiana has long eschewed procedures that are thinly-disguised methods for creditors, at the inception of a loan, to become owners of the collateral.[105] Absent consent by both creditor and debtor on the reasonably

> Consequently, the statutory requirement that the debtor be served with written notice of his right to appoint an appraiser to value the property prior to its sale affords him fairness and due process by assuring him notice and an adequate opportunity to see that the protections of the Deficiency Judgment Act are fully asserted in his behalf.

Citizens Sav. & Loan Ass'n v. Kinchen, 622 So. 2d 662, 665 (La. 1993).

104. *See* La. R.S. 13:4108.1-:4108.2 (1991).

105. Since the edict of Constantine annulling and prohibiting what was known as the lex

equivalent value prior to the sale, the statute cannot be used, for "in the absence of such an agreement the statute is inoperative."[106]

Given the importance of the notice for a deficiency judgment under *Kinchen*, and given that, under *Wyatt v. Cole*,[107] a foreclosing creditor (perhaps a creditor's attorney) can be liable for a wrongful seizure, the method of giving notice is important. In *Central Progressive Bank v. St. Tammany Parish Sheriff's Office*,[108] a plaintiff who had been prevented from obtaining a deficiency because of an invalid service by the sheriff filed suit against the sheriff. The court held the sheriff was not liable, reasoning "it is incumbent on the creditor to exercise reasonable diligence to assure strict compliance with every legal formality to guarantee for itself a deficiency judgment."[109] Apparently the court would find a creditor liable for failing to recognize and check on improper service. Such a holding is curious because it relieves the sheriff of his strong statutory duty to make proper service. Further, the court apparently would make the creditor some type of insurer of the sheriff, because the court indicated, in *obiter dicta*, that even if the return was false (even if the sheriff did not make the return at all), the creditor would be liable.[110] It can be argued this type of rationale misconstrues the relationship between the creditor and the sheriff. All the creditor can do is put into motion the state statutes. The creditor cannot direct the sheriff in the sheriff's duties and, it can be argued, should not be imputed with knowledge of deficiencies in the sheriff's procedures or incorrect actions by the sheriff. On the other hand, when the creditor does discover a mistake has been made, a remedy is available. In *Louisiana Gear Manufacturing, Inc. v. Burney*,[111] a creditor filed an action to annul a sheriff's sale and reinstate its encumbrances when it discovered a sheriff's return indicated both movables and immovables had been seized. In fact, only movables had been seized, but this was not discovered until after the sale. The court allowed the creditor to nullify the judgment and the sale it had obtained and to start over.

> commissoria and the stipulation in the contract of pledge which it authorized, whereby, in default of payment by the pledgor, the thing pledged became the property of the pledgee without further action on his part, such stipulations have been prohibited in all countries where the civil law prevails, and the prohibition has long since become part of the common law, the commentators on both systems agreeing that they are contra bonos mores and oppressive; that they involve the abuse of the power of the strong over the weak, represent odious speculations by those who have money, at the expense of those who need it, and are unconscionable.

Alcolea v. Smith, 150 La. 482, 488, 90 So. 769, 771 (1921) (citations omitted).

106. Citizens Sav. & Loan Ass'n v. Kinchen, 622 So. 2d 662, 665 (La. 1993).

107. 112 S. Ct. 1827 (1992).

108. 618 So. 2d 986 (La. App. 1st Cir.), *writ denied*, 620 So. 2d 851 (1993).

109. *Id.* at 989.

110. The court stated, "[l]ikewise, if the return was false, i.e., service was never made but was returned, falsely indicating personal service of the Appraiser Notice, defendant is still entitled to summary judgment in its favor." *Id.* at 990.

111. No. 92-CV-1386 (W.D. La. Feb. 11, 1994).

VI. COLLATERAL MORTGAGES—IN PERSONAM OR IN REM?

Bankers Trust v. Smith[112] dealt with a number of issues. One result of the case was an in rem seizure and sale of property was allowed and the court determined a judgment could only be awarded in rem because of the procedural posture and facts of the case. Not specifically addressed by the case, but raised by implication, is whether collateral mortgages are in rem or in personam.

Whether a collateral mortgage note imparts personal liability to the maker of the note is not an academic question when the maker of the collateral mortgage note and the maker of the handnote are two different individuals.[113] While it may be true that collateral mortgages eventually will sink into oblivion because of the ease with which Louisiana Civil Code article 3298 now allows a "noteless" or "multiple indebtedness" mortgage to secure all loans without the necessity of the complications of a collateral mortgage,[114] it is clear, at least for the next ten years or so, that collateral mortgages may be used by practitioners and will continue to be the subject of judicial decisions.

Every Louisiana court that has squarely addressed the issue (although the Louisiana Supreme Court has not had an opportunity to do so) has held a collateral mortgage is an in personam obligation, although at least one federal court has reached a contrary conclusion.[115] Consider the following example: Nephew goes

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112. 629 So. 2d 525 (La. App. 5th Cir. 1993), *writ denied*, 634 So. 2d 393 (1994).

113. There is no requirement that there be a "handnote" at all. *See* New Orleans Silversmith, Inc. v. Toups, 261 So. 2d 252 (La. App. 4th Cir.), *writ refused*, 263 So. 2d 47 (1972). For a discussion of collateral mortgages, see Malcolm A. Meyer, Meyer's Manual on Louisiana Real Estate (1992); Peter S. Title, Louisiana Real Estate Transactions (1991); William E. Crawford, *Executory Process and Collateral Mortgages—Authentic Evidence of the Hand Note*, 33 La. L. Rev. 535 (1973); Max Nathan, Jr. & Anthony P. Dunbar, *The Collateral Mortgage: Logic and Experience*, 49 La. L. Rev. 39 (1988); Max Nathan, Jr. & H. Gayle Marshall, *The Collateral Mortgage: A Reassessment and Postscript*, 36 La. L. Rev. 973 (1976); Max Nathan, Jr. & H. Gayle Marshall, *The Collateral Mortgage*, 33 La. L. Rev. 497 (1973); Michael H. Rubin et al., *Is the Collateral Mortgage Obsolete?*, 41 La. B.J. 529 (1994); Rubin & Grodner, *supra* note 44; Bernard Keith Vetter, *The Validity and Ranking of Future Advance Mortgages in Louisiana*, 21 Loy. L. Rev. 141 (1975); David S. Willenzik, *Future Advance Priority Rights of Louisiana Collateral Mortgages: Legislative Revisions, New Rules, and a Modern Alternative*, 55 La. L. Rev. 1 (1994). *See also* La. R.S. 9:5386-:5394 (1991 & Supp. 1994). The authors do not agree with Professor Crawford's conclusions that the handnote is the "evidence" of the debt secured by the mortgage; it is the collateral mortgage note that represents the debt the collateral mortgage secures.

114. For a discussion of this issue, see Rubin et al., *supra* note 113, at 531.

115. *See, e.g.*, Kaplan v. University Lake Corp., 381 So. 2d 385 (La. 1979) (holding a collateral mortgage note can prescribe); First State Bank & Trust Co. v. Seven Gables, Inc., 501 So. 2d 280 (La. App. 1st Cir. 1986) (holding a collateral mortgage can be assumed—an assumption is personal liability), *writ denied*, 502 So. 2d 103 (1987); Louisiana Nat'l Bank v. O'Brien, 439 So. 2d 552 (La. App. 1st Cir.) (holding the use of phrases like "sole and absolute security," "sole security," and "in rem" throughout both the note and pledge agreement at least create ambiguity as to parties' intent about personal liability), *writ denied*, 443 So. 2d 590 (1983); Central Bank v. Bishop, 375 So. 2d 149 (La. App. 2d Cir.) (holding a collateral mortgage note bears interest from its date), *writ denied*, 378 So. 2d 435 (1979); Central Progressive Bank v. Doerner, 365 So. 2d 263 (La. App. 1st Cir. 1978)

to Lender to obtain a $100,000 loan. Lender wants security. The only security Nephew has to offer is help from his rich Uncle X. Uncle X refuses to sign Lender's continuing guaranty document but is agreeable to giving a separate negotiable note for $100,000. Uncle X will not co-sign or become an accommodation endorser on Nephew's note. The separate note given by Uncle X to Lender is valid and enforceable,[116] although it does not represent money the lender has advanced or will advance. It is given for value.[117] It has been given for consideration.[118] If Nephew defaults, Lender has two options. First, it could sue Nephew on Nephew's note. Second, it could sue Uncle X on Uncle X's note. Clearly Uncle X has personal liability under his note.

Now assume Lender asks Uncle X not merely for his own note but for additional security. Uncle X now gives the same $100,000 note, but this time it is paraphed for identification with an act of mortgage on Uncle X's property and the mortgage is properly recorded.[119] The only difference now is Uncle X's note has been paraphed for identification with an act of mortgage. No other change has been made. It is submitted that Uncle X's note is not somehow transformed magically

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(holding a collateral mortgage package secured the creditor to the lesser of (a) principal plus interest on the principal obligation or (b) principal plus interest on the pledged note; the parties can by agreement and with specific language create an in rem note, but this requires specific language). For Louisiana's lower court cases holding the collateral mortgage note does create a personal obligation, see Concordia Bank & Trust Co. v. Lowry, 533 So. 2d 170 (La. App. 3d Cir. 1988), *rev'd in part on other grounds*, 539 So. 2d 46 (1989); Bank of Lafayette v. Bailey, 531 So. 2d 294 (La. App. 3d Cir.), *modified*, 533 So. 2d 5 (1988) (limiting mortgagor's personal liability to the mortgaged property and community property). For a federal court case holding a collateral mortgage note is by nature in rem, see Pontchartrain State Bank v. Lybrand, 799 F. Supp. 633 (E.D. La. 1992). *See also* Michael H. Rubin, *Security Devices, The Work of the Louisiana Appellate Courts For the 1978-1979 Term*, 40 La. L. Rev. 572, 582 (1980). I have committed myself previously in writing to why a collateral mortgage should be seen as an in personam obligation and I remain committed to this view.

116. Lender would hold the note pursuant to a security interest under Article 9 of the U.C.C., as adopted in Louisiana. *See* La. R.S. 10:9-101 to :9-605 (1993 & Supp. 1994). The note is an "instrument" under the U.C.C., La. R.S. 10:9-105(1)(i) (1993), and a security interest is perfected by delivery to the creditor. La. R.S. 10:9-304(1) (1993).

117. As defined in the U.C.C., "value" clearly encompasses a note given as security for the debt of another.

> Except as otherwise provided with respect to negotiable instruments and bank collections, a person gives "value" for rights if he acquires them
>
> (a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a chargeback is provided for in the event of difficulties in collection;
>
> (b) *as security for* or in total or partial satisfaction of *a preexisting claim*;
>
> (c) by accepting delivery pursuant to a preexisting contract for purchase; or
>
> (d) generally, in return for any consideration sufficient to support a simple contract.

La. R.S. 10:1-201(44) (1993) (emphasis added).

118. "'Consideration' means any consideration sufficient to support a simple contract. . . . If an instrument is issued for value . . . the instrument is also issued for consideration." La. R.S. 10:3-303(b) (1993). Thus, a note given as security for another is given for consideration.

119. For the rules relating to collateral mortgages after 1990 and perfection as to third parties, see La. R.S. 9:5550-:5557 (1991 & Supp. 1994).

from an in personam obligation to an in rem obligation merely because of the paraph. Uncle X's note is negotiable and remains negotiable. Lender still has several options if Nephew defaults. First, Lender can sue Nephew on Nephew's note. As a second alternative, Lender can sue Uncle X on Uncle X's note. Third, as an additional option, Lender can sue Uncle X to seize and sell the mortgaged property and obtain a privilege on the proceeds of the sale. The proceeds of the sale would then be applied to Uncle X's note. If the proceeds of the sale are insufficient to pay off Uncle X's note (assume, for example, the proceeds of the sale bring only $80,000), then Uncle X's note is extinguished only to the extent of the value obtained at the sheriff's sale ($80,000). Therefore, $20,000 remains extant on Uncle X's note and Uncle X can be sued for the difference, just as Uncle X could be sued for the $100,000 before the paraph was put on the note, or in lieu of pursuing the mortgaged property. It is submitted that cases finding collateral mortgages are in rem by nature misconstrue the collateral mortgage device. Perhaps it is the name "collateral mortgage" that causes the problem. If it were referred to as a "security-interest-in-a-note-secured-by-a-mortgage," maybe the analysis would be easier to see. Nonetheless, its form demonstrates that a collateral mortgage package is primarily one of a security interest in a note, with additional rights against mortgaged property.

This is not to say a collateral mortgage cannot be made into an in rem obligation. Clearly the parties can disclaim liability in the collateral mortgage note itself by using language of "non-recourse" or other "in rem" terminology.[120] Furthermore, the Civil Code expressly provides that parties, by contract, may grant a mortgage even though there is no personal liability for the underlying obligation.[121] Finally, there are a number of ways to grant a mortgage securing the obligation of another without executing a separate collateral mortgage note. For example, Uncle X might give a mortgage in which the principal obligation would be described not as Uncle X's note, but as Nephew's note. Similarly, a spouse might give a mortgage on the spouse's community property interest securing only the property and disclaiming any personal liability for the granting of the mortgage.

The solution for those who wish to have in rem collateral mortgages is simple—contract for it expressly. Merely granting a collateral mortgage, without more, however, should not be seen as an express agreement to be bound only in rem.

VII. COLLATERAL MORTGAGES AND INTERRUPTION OF PRESCRIPTION

A collateral mortgage package (the collateral mortgage note secured by the collateral mortgage) is, at its most basic, the granting of a security interest in a

120. For a case containing a note in which the parties disclaimed personal liability and which was enforced as an in rem obligation, see Louisiana Nat'l Bank v. O'Brien, 439 So. 2d 552 (La. App. 1st Cir.), *writ denied*, 443 So. 2d 590 (1983).

121. La. Civ. Code art. 3297.

note to secure another, underlying obligation. Prior to the advent of Chapter 9 of the Louisiana Commercial Laws,[122] the security interest in the collateral mortgage note was obtained through a pledge. The underlying obligation does not prescribe while the pledge is in existence.[123] On the other hand, while the underlying obligation (sometimes referred to euphemistically as the "handnote") does not prescribe, the pledged collateral mortgage note can prescribe.[124]

Because the pledged obligation (the collateral mortgage note) can prescribe, and because, normally, the pledged collateral mortgage note is a "demand" instrument which normally prescribes in five years, careful lenders have debtors acknowledge the collateral mortgage note every five years. Further, some creditors even have documents allowing the creditor, as agent and attorney-in-fact for the debtor, to acknowledge it for prescriptive purposes. In addition, Louisiana Revised Statutes 9:5807 allows a mechanism for acknowledgement of the collateral mortgage note if payment is made on the underlying obligation by the debtor.[125]

The latest case to interpret Louisiana Revised Statutes 9:5807 is *Manuel Tire Co. v. J.W. Herpin, Inc.*[126] The case involved the pledge of a collateral mortgage to secure an open account. The court held payment on the open account was an interruption of prescription on the collateral mortgage note.

Careful attention should be paid to the language of Louisiana Revised Statutes 9:5807—only payment by "the debtor" or the "co-debtors in solido" will interrupt prescription, not payment by any other person. Therefore, knowing who has made the payment is important for a determination of whether prescription has been interrupted. Since 1988 and the amendments to the Louisiana Civil Code articles on suretyship,[127] a creditor who knows persons

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122. La. R.S. 10:9-101 to :9-605 (1993 & Supp. 1994).

123. Succession of Picard, 238 La. 455, 115 So. 2d 817 (1959); Scott v. Corkern, 231 La. 368, 91 So. 2d 569 (1956).

124. Kaplan v. University Lake Corp., 381 So. 2d 385 (La. 1979); Succession of Picard, 238 La. 455, 115 So. 2d 817 (1959); Bank of New Orleans & Trust Co. v. H.P.B., Jr. Dev. Co., 427 So. 2d 486 (La. App. 5th Cir. 1983).

125. La. R.S. 9:5807 (Supp. 1994) provides:

> § 5807. Interruption of prescription on pledged obligations by payment on obligation secured by pledge
>
> A payment by a debtor of interest or principal of an obligation shall constitute an acknowledgement of all other obligations including promissory notes of such debtor or his codebtors in solido pledged by the debtor or his codebtors in solido to secure the obligation as to which payment is made. In all cases the party claiming an interruption of prescription of such pledged obligation including a promissory note as a result of such acknowledgement shall have the burden of proving all of the elements necessary to establish the same. For purposes of this Section, a "pledged obligation" shall include any obligation, including a promissory note, in which a security interest has been granted under Chapter 9 of the Louisiana Commercial Laws or the corresponding provisions of the Uniform Commercial Code as adopted in any other state, to the extent applicable.

126. 620 So. 2d 526 (La. App. 3d Cir. 1993).

127. 1987 La. Acts No. 409, § 1 (eff. Jan. 1, 1988).

are merely secondarily liable cannot treat them as solidary obligors, notwithstanding language of "solidarity" in a continuing guaranty or the document.[128]

It is interesting to note that the collateral mortgage device probably came into existence originally as a mechanism for financing open account lending. The earliest cases on collateral mortgages, while cryptic, lead one to the conclusion that what we term a "collateral mortgage package" was developed as a way to secure a fluctuating line of credit directly to a borrower, or to secure a surety's obligation to a lender who was giving open account credit to the debtor.[129]

VIII. BANKRUPTCY AND SECURITY DEVICES ISSUES[130]

A discussion of the new Bankruptcy Code amendments[131] is beyond the scope of this article. One important case for Louisiana lawyers, however, must be noted.[132] *BFP* overrules *Durrett*.[133]

A. *The ABC's of* BFP v. Resolution Trust Corp.[134]

1. *Introduction*

Perhaps no other area of civil law presents as many clashes between federal and state law as bankruptcy. The struggle between competing interests and policies takes on many faces: federal versus state exemptions, rejection of executory contracts and unexpired leases, recovery of payments as preferences, the avoidance of security interests, foreclosure rights versus the automatic stay, and characterization of rights under federal versus state law. One such clash is the right of a bankruptcy trustee to recover the equity which may have been lost by a debtor in a pre-petition foreclosure sale of the debtor's property under Section 548 of the Bankruptcy Code.[135]

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128. La. Civ. Code art. 3037.

129. *See, e.g.*, Levy v. Ford, 41 La. Ann. 873, 6 So. 671 (1889); Merchants' Mut. Ins. Co. v. Jamison, 25 La. Ann. 363 (1873); Succession of Dolhonde, 21 La. Ann. 3 (1869). Compare this situation with Pickersgill & Co. v. Brown, 7 La. Ann. 297 (1852), a case often cited with respect to the "future advance mortgage," but which case may involve what is now termed a collateral mortgage package.

130. This portion of the article was derived from a paper and presentation made by Stephen P. Strohschein and Michael H. Rubin to the American Bar Association, Business Law Committee and Litigation/Bankruptcy Committee at the American Bar Association's Annual Meeting held in New Orleans on August 8, 1994.

131. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 1994 U.S.C.C.A.N. (108 Stat.) 4106.

132. BFP v. Resolution Trust Corp., 114 S. Ct. 1757 (1994).

133. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980).

134. 114 S. Ct. 1757 (1994).

135. *See* 11 U.S.C. § 548 (1988 & Supp. V 1993). Section 548(a) provides:

§548. Fraudulent transfers and obligations

The policy behind Section 548 is clear—preservation (or recovery) of the debtor's assets for the equitable distribution of that property to unsecured creditors. Towards this end, Congress has enabled the trustee to look back at the pre-petition activities of the debtor and recover property transferred either with fraudulent intent under Section 548(a)(1) (intent to "hinder, delay, or defraud" the creditors), or where the transfer was "constructively" fraudulent under Section 548(a)(2). Section 548(a)(2) sets forth four elements required before a transfer may be set aside:

(1) the transfer must be of property in which the debtor had an interest;
(2) the debtor must have been insolvent at the time of the transfer, or have become insolvent as a result of the transfer;
(3) the transfer must have occurred within one year of the filing of the bankruptcy petition; and,
(4) the transfer must have been for less than a "reasonably equivalent value."

A competing policy is the protection of the rights of creditors lending money secured by the property of the borrower. Although creditors rarely loan money strictly for the right to foreclose upon the collateral obtained, most transactions are dependent upon the creditor's assurance that, if payment is not made, there is collateral that can be seized and sold to pay the debt. Indeed, for many lenders subject to state or federal regulation, such as banks, making loans without adequate collateral can lead to regulatory criticism.

Not only the right to foreclose upon collateral is important to the creditor. The value of the foreclosure depends in large part upon the creditor being able to quickly market and transfer the property to third persons, since most creditors are in the business of lending money, not owning foreclosed property for investment purposes. The creditor's ability to resell the property depends upon obtaining valid title through the foreclosure process. The protection of lenders who place their money at risk in loans secured by real estate and the related

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

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

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

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

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

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

issue of certainty of real estate titles are of vital importance to the economy, although regulation of these rights largely has been within the dominion of the states.

For at least fourteen years the federal courts have struggled with these competing interests in the context of a trustee's right to recover the equity lost by the debtor in a pre-petition foreclosure sale. The Supreme Court, in *BFP v. Resolution Trust Corp.*,[136] has resolved the conflict in favor of the state's interests in protecting creditors' foreclosure rights and the related concern regarding certainty of title resulting from foreclosure sales.

2. *The Conflicts Among the Courts of Appeals*

At least three distinct approaches to Section 548(a)(2) were developed by the courts of appeals from 1980 until *BFP* was decided. A review of their holdings and rationale is appropriate to reach an understanding of the Supreme Court's decision.

a. *The* "Durrett *Rule"*

A trustee's right to avoid a foreclosure sale was first reviewed at the appellate level by the Fifth Circuit in *Durrett v. Washington National Insurance Co.*[137] The case was decided under the precursor to Section 548 of the Bankruptcy Code, Section 67(d) of the Act.[138] *Durrett* involved the attack by a bankruptcy trustee of a pre-petition foreclosure sale under a deed of trust. The sale generated $115,400. The district court found the "fair market value" of the property on the date of sale was $200,000. Thus the price paid at the foreclosure sale was 57.7% of the fair market value.[139]

The language of Section 67(d) required a finding that the price paid was a "fair equivalent" for the property, and the court's simple holding was that 57.7% of the fair market value was not the "fair equivalent" for the transfer of the property—a seemingly innocuous result. However, in support of its holding, the court went on to state:

> We have been unable to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the Act, which has approved the transfer for less than 70 percent of the market value of the property.[140]

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136. 114 S. Ct. 1757 (1994).

137. 621 F.2d 201 (5th Cir. 1980).

138. Act of July 1, 1898, ch. 541, § 67, 30 Stat. 544, 564, *as amended by* Act of June 22, 1938, Pub. L. No. 696, 52 Stat. 840 (repealed 1978).

139. *Durrett*, 621 F.2d at 203.

140. *Id.* The court went on to state:

> Our review of the entire evidence leaves us with a definite and firm conviction that the price [paid by Mitchell] was not a "fair equivalent" for the property. Under such

Although this language appears to have been no more than an observation, a 70% minimum foreclosure sale price soon became "codified" as the "*Durrett* Rule" by the lower courts that chose to "follow" the decision.[141] The "*Durrett* Rule," however, was by no means a magical test.[142] Many cases citing and relying upon *Durrett* realized that a case-by-case analysis was still required. Some cases rejected a "bright line" rule of 70% in favor of a weighing of facts that included: (1) the fair market value at the time of the sale versus the sales price; (2) the nature of the property; (3) the relative marketability of the property; and (4) the number of bidders appearing and bidding at the sale.[143] Some courts that followed *Durrett* even have noted that, in some cases, "no less than 100 percent of the fair market value may be a reasonable price."[144]

b. Madrid *and the Irrebuttable Presumption*

A result and approach that differed completely from *Durrett* emerged in the Ninth Circuit, the circuit from which the controversy would ultimately be resolved twelve years later. In *In re Madrid*,[145] the Ninth Circuit Bankruptcy Appellate Panel (BAP) was confronted with a pre-petition foreclosure sale under a deed of trust that generated "64% to 67% of the property's market value at the time of sale."[146] The BAP panel expressed the opinion that a distinction should be made between private transfers by bankruptcy debtors and "regularly conducted public sales." The panel stated: "We decline to follow *Durrett*'s 70% fair market value rule for the reason that a regularly conducted sale, open to all bidders and all creditors, is itself a safeguard against the evils of private transfers to relatives and favorites."[147] After reviewing the situations under which

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> circumstances, it is our duty to declare the transfer voidable under section 67(d).

Id. at 204 (citations omitted).

141. *See, e.g.*, Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 B.R. 818 (Bankr. N.D. Ala. 1983); Berge v. Sweet (*In re* Berge), 33 B.R. 642 (Bankr. W.D. Wis. 1983).

142. *See In re* Fairchild Aircraft Corp., 6 F.3d 1119, 1126 n.7 (5th Cir. 1993):

> In *Durrett* we held that receipt of 57.4% of the consideration given could not constitute reasonably equivalent value, but implied in dictum that receipt of 70% might constitute such value. Many bankruptcy courts have construed *Durrett* as espousing a mechanical test with a 70% cut-off point, although this is clearly incorrect. Other circuits have rejected any mechanical test to ascertain the lower limit of reasonably equivalent value, opting instead for a "totality of the circumstances" approach.

(citations omitted).

143. *See, e.g.*, Christian v. Ryan (*In re* Christian), 48 B.R. 833 (Bankr. D. Colo. 1985); Hoffman v. Heritage Sav. & Loan Ass'n (*In re* Garrison), 48 B.R. 837 (Bankr. D. Colo. 1985).

144. Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 448 (Bankr. D. Utah 1982).

145. Lawyers Title Ins. Corp. v. Madrid (*In re* Madrid), 21 B.R. 424 (Bankr. 9th Cir. 1982), *aff'd sub nom.* Madrid v. Lawyers Title Ins. Corp., 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833, 105 S. Ct. 125 (1984).

146. *Id.* at 425.

147. *Id.* at 426-27.

foreclosure sales would be upset under state law, and observing that the mere inadequacy of price was insufficient, the panel held:

> The law of foreclosure should be harmonized with the law of fraudulent conveyances. Compatible results can be obtained by construing the reasonably equivalent value requirement of Code § 548(a)(2) to mean the same as the consideration received at a non-collusive and regularly conducted foreclosure sale. Thus, in the absence of defects, such foreclosure withstands avoidance as a fraudulent conveyance.[148]

Although the panel decision was appealed, the Ninth Circuit held the transfer of the debtor's property interest occurred at the time the deed of trust was granted, not at the time of the foreclosure sale.[149] As a result, the court found the transfer occurred more than one year prior to the debtor's bankruptcy filing and, therefore, was not avoidable as a fraudulent conveyance.[150] Although it affirmed the panel decision, the Ninth Circuit's failure to adopt the reasoning of the panel perhaps caused more delay in the ultimate resolution of the dispute than might otherwise have been experienced.

c. The Bundles *"Middle Ground"*

A third position was taken by the Seventh Circuit in *In re Bundles.*[151] In this case the debtor filed a Chapter 13 petition two weeks after the sheriff's sale of his home. The value of the home was stipulated to be $15,500 at the time of the sale; the property was sold for $5,066.80, or approximately 33% of its value. The Seventh Circuit criticized the *Madrid* approach of deference to state law: "[W]e must reject the view that state law, either directly or as the federal rule of decision, should determine the outcome of a bankrupt's complaint under section 548(a)(2)(A). Here, Congress has set forth a federal standard."[152] The court was also critical of supplanting a statutory analysis with "policy considerations":

148. *Id.* at 427.

149. Congress effectively, if not intentionally, overruled the Ninth Circuit's holding in *In re Madrid* in the 1984 BAFJA amendments. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(i), 98 Stat. 333, 368 (1984). The definition of transfer was expanded to include the "foreclosures upon the debtor's equity of redemption." *Id.* The impact of this amendment upon the controversy has itself been controversial and subject to differing interpretations. For example, see footnote 7 of the majority opinion in *BFP v. Resolution Trust Corp.*, as compared to footnote 8 of the dissent's opinion. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1764 n.7, 1770 n.8 (1994).

150. Madrid v. Lawyers Title Ins. (*In re* Madrid), 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833, 105 S. Ct. 125 (1984).

151. Bundles v. Baker (*In re* Bundles), 856 F.2d 815 (7th Cir. 1988). Although *Bundles* is given more attention as the genesis of the "middle ground" approach, the Eighth Circuit reached a similar result four years earlier in First Fed. Sav. & Loan Ass'n v. Hulm (*In re* Hulm), 738 F.2d 323 (8th Cir.), *cert. denied*, 469 U.S. 990, 105 S. Ct. 398 (1984).

152. *Bundles*, 856 F.2d at 822.

> It is beyond our scope of review to consider the policy implications of permitting the debtor to set aside the foreclosure of his home. Any change deemed desirable on policy grounds should be addressed to Congress rather than to this court. Our duty is simply to interpret the language of the statute.[153]

Noting that an irrebuttable presumption in favor of foreclosure sales would create, in effect, an exception where there was none, and that adoption of the state law would create a test of "good faith" where there was none, the Seventh Circuit concluded "section 548(a)(2)(A) establishes a federal basis—independent of state law—for setting aside a foreclosure sale."[154]

The Seventh Circuit then turned its attention to what the federal standard should be. After discussing the difficulties interpreting the phrase "reasonably equivalent value," the court stated:

> If anything is clear from the various uses of the word "value" in the Code, it is that Congress did not mean fair market value when it used the term reasonably equivalent value. On the other hand, Congress' conscious use of a federal standard suggests that it did not believe that the expedient of relying entirely on state foreclosure law would protect adequately federal interests.[155]

Thus, the Seventh Circuit found the correct result to be somewhere between a *Durrett* dependence on fair market value and a *Madrid* reliance upon state law and policy. The middle ground it found was in a case-by-case analysis:

> In our view, in defining reasonably equivalent value, the court should neither grant a conclusive presumption in favor of a purchaser at a regularly conducted, non-collusive foreclosure sale, nor limit its inquiry to a simple comparison of the sale price to the fair market value. Reasonable equivalence should depend on all the facts of each case.[156]

The analysis, according to the Seventh Circuit, may begin with consideration of the fair market value as a "starting point," but the court also should not lose focus of the impact of the context, that is the foreclosure, suggesting perhaps a "rebuttable" presumption in favor of the foreclosure sale is appropriate. The presumption could be rebutted by evidence regarding the "totality" of the transaction—suggesting the procedures used should be "calculated" to "return to the debtor-mortgagor his equity in the property" and also directing the bankruptcy courts to "consider such factors as whether there was a fair appraisal of the

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153. *Id.* at 823 (citations omitted).

154. *Id.*

155. *Id.* at 824.

156. *Id.*

property, whether the property was advertised widely, and whether competitive bidding was encouraged."[157]

The Eleventh Circuit, in *In re Littleton*[158] and *In re Grissom*,[159] followed the *Bundles* analysis, holding foreclosure sales were entitled to a presumption that the reasonably equivalent value was achieved but the bankruptcy courts should review the totality of the circumstances when the presumption was challenged. Other circuits also chose to follow *Bundles*, which became the "majority" view among the courts of appeals, and probably the lower courts as well.[160]

B. BFP—*Resolution of the Controversy*

Against this backdrop of various disputes among the circuits, the *BFP* case began working its way up the appellate ranks within the Ninth Circuit. The Ninth Circuit Court of Appeals had not considered the issue since its decision in *Madrid*.

1. BFP *in the Lower Courts*

Though arising from a convoluted factual and procedural morass, simply put the facts of *BFP* are as follows. BFP was a partnership formed to purchase a beachfront residence in California. The purchase was financed in part by a loan from Imperial Savings and Loan Association (Imperial), which took a first deed of trust against the home in the amount of $356,250, and by a second deed of trust in favor of the vendor of the property in the amount of $200,000. Upon a later default in the payments, Imperial instituted foreclosure proceedings and the property was sold to a third person for $433,000. A few months later, BFP filed for relief under Chapter 11 of the Bankruptcy Code and also filed an adversary proceeding seeking to avoid the foreclosure sale as not having been for the reasonably equivalent value. BFP alleged the property was worth over $700,000 at the time of the sale.[161]

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157. *Id.* The Seventh Circuit's reasoning may have reflected a "middle of the road" analysis between *Durrett* and *Madrid*, but the ultimate implementation of that approach may have led to a far greater intrusion into state law foreclosure procedures. Few state foreclosure laws are designed to protect a debtor's equity. Across the country many state procedures, it appears, seem designed only to give the minimal due process necessary to debtors in order to grant the creditors relief. In many states, foreclosing creditors would have been required routinely to go to much greater lengths to protect their foreclosure sales from attack under *Bundles* than the 70% bid required by *Durrett*. For an overview of state laws, see Baxter Dunaway, The Law of Distressed Real Estate (1991).

158. Walker v. Littleton (*In re* Littleton), 888 F.2d 90 (11th Cir. 1989).

159. Grissom v. Johnson (*In re* Grissom), 955 F.2d 1440 (11th Cir. 1992).

160. *See, e.g.*, Barrett v. Commonwealth Fed. Sav. & Loan Ass'n, 939 F.2d 20 (3d Cir. 1991); Cooper v. Ashley Communications, Inc. (*In re* Morris Communications NC, Inc.), 914 F.2d 458 (4th Cir. 1990).

161. BFP v. Imperial Sav. & Loan Ass'n (*In re* BFP), 132 B.R. 748, 749-50 (Bankr. 9th Cir. 1991), *aff'd*, 974 F.2d 1144 (9th Cir. 1992), *aff'd sub nom.* BFP v. Resolution Trust Corp., 114 S. Ct. 1757 (1994).

The bankruptcy court granted Imperial's motion for summary judgment on the basis of *Madrid*, finding the "reasonably equivalent value was received at the foreclosure sale and that the foreclosure sale was 'regularly conducted.'"[162] On appeal to the Bankruptcy Appellate Panel, the majority opinion affirmed the decision of the bankruptcy court and reaffirmed the rationale of *Madrid* with little new analysis,[163] despite the immense body of law which had arisen between the earlier *Madrid* decision and the instant case.[164]

On appeal to the Ninth Circuit,[165] the panel of the court of appeals noted the issue was a "close one."[166] Reviewing the positions of the courts under *Madrid*, *Durrett*, and *Bundles*, the panel expressed difficulty in deciding between the irrebuttable presumption in *Madrid* and the rebuttable presumption in *Bundles*. The court concluded:

> The *Bundles* analysis (and implicitly that of the *Durrett* approach) rests on a plain-language interpretation of § 548(a)(2). Granting an *irrebuttable* presumption of reasonable equivalence under a noncollusive foreclosure sale, the *Bundles* court argues, effectively creates a judicial exception to the trustee's avoiding powers under § 548. In turn, an irrebuttable presumption undermines the ability of the trustee or debtor to recover lost equity, which is the purpose of the § 548 avoiding powers. The position is persuasive, but we think that broader considerations require a different result.[167]

The "broader considerations" discussed by the Ninth Circuit were the same concerns expressed by the other courts following *Madrid*—the stability of mortgage foreclosures and the resulting impact on real estate title issues. Thus, the Ninth Circuit adopted the bankruptcy appellate panel's *Madrid* approach as its own.

2. *The Supreme Court*

Perhaps the Ninth Circuit's observation that the issue was a "close one" was prophetic of how the Supreme Court would decide the issue when *BFP* came before it. In a 5-4 decision,[168] Justice Scalia, joined by Chief Justice Rehnquist and Justices O'Connor, Kennedy, and Thomas, affirmed the Ninth Circuit's decision.

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162. *Id.* at 749.

163. *Id.* at 750-51.

164. The dissenting opinion by Judge Volinn noted the "substantial body of case law" that had developed in this context and noted his support of a *Bundles* analysis. *Id.* at 751-52 (Volinn, J., dissenting).

165. BFP v. Imperial Sav. & Loan Ass'n (*In re* BFP), 974 F.2d 1144 (9th Cir. 1992), *aff'd sub nom.* BFP v. Resolution Trust Corp., 114 S. Ct. 1757 (1994).

166. *Id.* at 1148.

167. *Id.* (citation omitted).

168. BFP v. Resolution Trust Corp., 114 S. Ct. 1757 (1994).

The majority opinion was accompanied by a sharply worded dissent by Justice Souter, who was joined by Justices Blackmun, Stevens, and Ginsburg.

a. The Majority Opinion

After reviewing the facts, the statutory provision, and the splits among the courts of appeals, Justice Scalia began his analysis of the phrase "reasonably equivalent value" with an examination of the relevance of "fair market value" in the context of a foreclosure sale. He noted both *Durrett* and *Bundles* adopted fair market value as the benchmark for considering whether the reasonably equivalent value was given, whereas the Bankruptcy Code failed to use fair market value as the benchmark in Section 548(a)(2)(A), despite its use elsewhere within the Bankruptcy Code.

> Section 548, on the other hand, seemingly goes out of its way to avoid that standard term ["fair market value"]. It might readily have said "receives less than fair market value in exchange for such transfer obligation," or perhaps "less than a reasonable equivalent of fair market value." Instead, it used the (as far as we are aware) entirely novel phrase "reasonably equivalent value."[169]

Noting that Congress did not dictate the use of a fair market value analysis, and opining that, factually, foreclosure sales are the "antithesis" of a fair market, Justice Scalia concluded "[m]arket value cannot be the criterion of equivalence in the foreclosure-sale context."[170]

Justice Scalia next reviewed the possibility of deciphering a "fair" foreclosure sale price, as opposed to a fair market price, and pronounced it "another artificially constructed criterion."[171] Noting each state has its own laws regulating foreclosure procedure, he found the adoption of a federal standard for a fair foreclosure price to be too intrusive into the realm of state law. "To specify a federal 'reasonable' foreclosure-sale price is to extend federal bankruptcy law well beyond the traditional field of fraudulent transfers, into realms of policy where it has not ventured before. Some sense of history is needed to appreciate this."[172]

Justice Scalia engaged in a lengthy discussion of the history of fraudulent conveyance law and the history of foreclosure remedies, noting the two have "enjoyed over 400 years of peaceful coexistence in Anglo-American jurisprudence,"[173] or at least until *Durrett*. The historical analysis closed with reflections on the importance of certainty of title to the "general welfare of society"[174] and

169. *Id.* at 1761.
170. *Id.* at 1761-62.
171. *Id.* at 1762.
172. *Id.* at 1763.
173. *Id.* at 1764.
174. *Id.* (quoting American Land Co. v. Zeiss, 219 U.S. 47, 60, 31 S. Ct. 200, 204 (1911)).

with a caveat that any other decision would place "every piece of realty purchased at foreclosure . . . under a federally created cloud."[175] The majority concluded: "a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with."[176]

b. The Dissent

The dissent began its critique of the majority decision by characterizing the majority's holding as allowing a "peppercorn paid at a . . . foreclosure sale to be treated as the 'reasonably equivalent' value of a California beachfront estate." Furthermore, this was being done, according to the dissent, in derogation of the plain language of the Bankruptcy Code.[177] With regard to the statutory language, the dissent pointedly argued:

> [A]n ordinary speaker of English would have no difficulty grasping its basic thrust: the bankruptcy court must compare the price received by the insolvent debtor and the worth of the item when sold and set aside the transfer if the former was substantially ("[un]reasonabl[y]") "less than" the latter. Nor would any ordinary English speaker, concerned to determine whether a foreclosure sale was collusive or procedurally irregular (an enquiry going exclusively to the process by which a transaction was consummated), direct an adjudicator, as the Court now holds Congress did, to ascertain whether the sale had realized "less than a reasonably equivalent value" (an enquiry described in quintessentially substantive terms).[178]

The dissent also looked to the "text, structure, and history" of Section 548(a)(2)(A) to support the "soundness of the plain reading," being particularly persuaded by the 1984 BAFJA amendments expanding the definition of transfer to include "involuntary" transfers and the "foreclosure on the debtor's equity of redemption."[179]

Justice Souter argued: "If a property's 'value' is conclusively presumed to be whatever it sold for, the 'less than reasonabl[e] equivalen[ce]' question will never be worth asking, and the bankruptcy avoidance power will apparently be a *dead letter* in reviewing real estate foreclosures."[180] Instead, contended Justice Souter, the bankruptcy courts should be allowed to analyze what is "reasonably equivalent

175. *Id.* at 1765.

176. *Id.*

177. *Id.* at 1767 (Souter, J., dissenting).

178. *Id.* at 1768-69 (Souter, J., dissenting) (footnotes omitted).

179. *Id.* at 1769 (Souter, J., dissenting). *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-355, §§ 421(i), 463(a)(1), 98 Stat. 368, 378 (1984).

180. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1770 (1994) (Souter, J., dissenting) (emphasis added).

value" as they do under other Section 548(a)(2) cases. He contended that not only does this plain reading of the statute not lead to an absurd result, the plain reading fulfills the policy of recovery of lost equity for all of the creditors of the estate. With regard to the "important" state interests of the stability of real estate titles, the dissent refers this policy consideration to Congress. Justice Souter examined the Supreme Court's previous decisions and found no burden had been placed upon Congress to adopt clearer language than was present in Section 548(a)(2) in order to override these state interests. Thus, the dissent concluded that the Court's "obligation is to apply the statute as Congress wrote it. Doing that in this case would produce no frustration or absurdity, but quite the opposite."[181]

c. The Majority's Rebuttal

The majority took the opportunity to respond to the dissent within its opinion. Stating it had no problem with giving the statute its "plain meaning," the majority chided the dissent for failing to answer the ultimate question: "*What is a foreclosed property worth?*"[182] Other than stating that the bankruptcy courts are capable of undertaking the task of determining the issue, the majority stated that the dissent failed to give any guidance regarding what "value" received in a foreclosure sale is "reasonably equivalent."

Concerning the dissent's argument that it was creating an exception to Section 548(a)(2)(A), Justice Scalia responded that the consideration regarding foreclosure sales and other transfers was still the same, but the context within which the decision is made requires a different factual analysis:

> [F]oreclosure has the effect of completely redefining the market in which the property is offered for sale; normal free-market rules of exchange are replaced by the far more restrictive rules governing forced sales. Given this altered reality, and the concomitant inutility of the normal tool for determining what property is worth (fair market value), the only legitimate evidence of the property's value at the time it is sold is the foreclosure sale price itself.[183]

C. Unresolved Issues

BFP is not a pure and unequivocal win for creditors. It does *not* validate every foreclosure sale, whether by judicial process or otherwise. Rather, the only type of sale *BFP* expressly covers are "non-collusive real estate mortgage foreclosure sales conducted in conformance with applicable state law." Thus, several issues are potentially ripe for attack by debtors/trustees under *BFP*:

181. *Id.* at 1778 (Souter, J., dissenting).
182. *Id.* at 1766.
183. *Id.* at 1767.

(1) Was it a "real estate mortgage foreclosure sale"?
(2) Was the sale "non-collusive"?
(3) Was the sale "conducted in conformance with applicable state law"?
(4) Was the mortgagee the successful bidder?

1. Non-Real Estate Foreclosure Sales

At footnote 3 of the majority's opinion, Justice Scalia "emphasized" the opinion covered "only mortgage foreclosures of real estate," stating, "[t]he considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different."[184] Indeed, given the importance placed by the majority on giving deference to the "important state interests" regarding regulation of foreclosures and the certainty of real estate title, it is not difficult to envision a different result in a non-real estate context. Certainly, some of the arguments would be as applicable in the context of foreclosure sales of movables as they are in foreclosure sales of real estate. It can be argued that a "redefinition" of the market occurs with foreclosure sales of chattels, just as Justice Scalia noted it did with sales of real estate. This fact, however, ultimately may not be determinative if the sanctity of land titles is deemed to be the overriding local issue. Given the close vote in *BFP*, it is possible a case involving chattels only would lead to a different result.

Also, the Court does not answer the following scenarios which, although not involving solely real estate, involve similar issues of "value" and state law procedures:

(1) What about foreclosures on mixed assets, such as real estate, leases, equipment, goods, inventory, and accounts receivable, particularly in states where there is a "one action" rule under which a creditor cannot proceed separately against the assets. If they are all included in the same action, then it is not solely a real estate case. Will *BFP*'s protection apply?

(2) Consider also, foreclosure on collateral where it is not clear under state law whether the property is "real estate." Specifically, many states have varied and uneven approaches to leases. Are they purely real estate related, are they purely contractual, or are they mixed use? How is the *BFP* analysis to be applied on lease foreclosures? Further, when there are leases involved, frequently the lender puts a receiver in place. The receiver's actions can have an impact on the property's value. Will the receiver's actions, which may or may not be attributable to the foreclosing creditor, play into a "non-collusive" analysis?

184. *Id.* at 1761 n.3.

(3) Finally, consider items that are subject to U.C.C. Article 9. There are many situations in which there is foreclosure, or taking in the nature of foreclosure, under Article 9 of the Uniform Commercial Code. Although these are not strictly real estate, and in many cases occur through private sales, the "non-collusive" use of "state law procedures" may be involved. Is there any protection for creditors under *BFP*?

2. "Collusive" Foreclosure Sales

When addressing the argument that the majority's opinion rendered Section 548 superfluous in the context of foreclosure sales, Justice Scalia described how it would continue to be used. According to Justice Scalia, Section 548(a)(1) will be applicable in the context of collusive foreclosure sales.[185] Section 548(a)(1) authorizes the avoidance of transfers "made . . . with actual intent to hinder, delay, or defraud."[186] Is there an opportunity to find "collusion" outside of the intentional fraud elements of Section 548(a)(1)? Or put another way, could there be situations deemed "constructively collusive"?

The term "non-collusive" sale was not defined by the majority. Whether a sale is "non-collusive" may thus become a mixture of both state law and federal law. If the federal preemption rules of the Bankruptcy Code apply, then theoretically a bankruptcy court may separately evaluate whether a sale that state law would otherwise approve might nevertheless be considered "collusive" for terms of the Bankruptcy Code. For example, what would a bankruptcy court deem the following:

(1) A private sale in strict foreclosure all in accordance with applicable state law where all notices are given, but the only bidder is the creditor.

(2) A private foreclosure sale in the nature of strict foreclosure under state law where all appropriate notices are given and the only bidder is the creditor. The debt is $1,000,000, and the property is bid in for $200,000 (allowing the creditor to obtain an $800,000 deficiency judgment) and the creditor then turns around and sells the property the same day for $600,000.

(3) A judicial foreclosure sale in which notices are published in local newspapers, although the property is a clearly major commercial property, and notices are not published in the applicable national journals (such as the *Wall Street Journal* or other national publications). The debtor can prove that if the publication had occurred more broadly, although not required by state law, there would have been other bidders at the sale.

185. *Id.* at 1765.

186. 11 U.S.C. § 548(a)(1) (1988).

(4) Foreclosure in accordance with state law, where a potential bidder approaches the lender prior to the sale. The lender asks the bidder not to bid at the sale (to avoid increasing the costs of the sale) but agrees to cut a separate deal with the bidder after the fact.

3. *"Irregular" Foreclosure Sales*

If not intentionally fraudulent, the trustee would be required to allege the sale "fail[ed] to comply with *all* governing state laws."[187] Should there be an emphasis upon the word *all* in this quote? It is not emphasized in the opinion, but it remains to be seen how strict the courts will be. In partial reply, Justice Scalia wrote:

> Any irregularity in the conduct of the sale that would permit judicial invalidation of the sale under applicable state law deprives the sale price of its conclusive force under § 548(a)(2)(A), and the transfer may be avoided if the price received was not reasonably equivalent to the property's actual value at the time of the sale (which we think would be the price that would have been received if the foreclosure sale had proceeded according to law).[188]

Thus, in order for the irregularity to form the basis for a complaint by the trustee under Section 548(a)(2)(A), it must be an irregularity that would invalidate the sale under the appropriate state law.

The Court also noted, under some state foreclosure laws, sales may be set aside if the price achieved was so low as to "shock the conscience." What if there is no such threshold in a particular state? Will there be no "federal conscience"? Are there no situations within which bankruptcy courts will be permitted to develop their own interpretations of what state law is or should be?

Invalidation of a sale under some state laws, however, may be due to procedural errors (e.g., the debtor or others had actual notice of the sale but the notice did not comply with state timing rules or wording rules) or substantive ones. An initial question may be whether it matters if the state law defect was procedural or substantive. This was an issue the majority opinion addressed only in passing. In footnote 5, the majority took issue with the dissent's characterization of state foreclosure law as "merely procedural."[189]

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187. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1765 (1994) (emphasis added).

188. *Id.* at 1765.

189. *Id.* at 1762 n.5. Footnote 5 reads, in pertinent part:

> The dissent characterizes foreclosure rules as "merely procedural," and asserts that this renders them, unlike "substantive" zoning regulations, irrelevant in bankruptcy. We are not sure we agree with the characterization. But in any event, the cases relied on for this distinction all address creditors' attempts to claim the benefit of state rules of law (whether procedural or substantive) as property rights, in a bankruptcy proceeding. None

If there is an irregularity that would invalidate the sale, would a court find the Trustee has the option of invalidating the sale and all further transactions under state law, of seeking damages or recompense from the creditor (using what measure of damages?), or of one or more combinations of remedies? Does the *BFP* language limit the trustee's recovery to the amount that would have been received at the foreclosure sale had the sale been appropriately handled? Section 550 states that when a trustee avoids a transfer under Section 548, the trustee may recover "the property transferred, *or, if the court so orders, the value of such property*."[190] Section 550 does not say the "fair market value." Should bankruptcy courts order that the "value" recoverable be only the difference between what was received at the sale and what would have been received if the sale had been appropriately conducted? It does not appear Justice Scalia was placing such a cap upon the recovery. The language appears to have been intended more to reveal the continued viability of Justice Scalia's "neologism," not the expression of an opinion regarding the trustee's theoretical recovery—but, the question remains.

4. Purchasing Mortgagees

BFP involved a third party bidder being made a defendant by the trustee for the avoidance of the foreclosure sale. In many foreclosure sales the mortgagee, rather than a third party, takes title to the property and then attempts to sell that property. Few if any foreclosing creditors seek to retain the foreclosed property for investment purposes. Indeed, federal rules regulating banks and those dealing with lender liability in the environmental field favor a quick resale. The credit required to be given to the borrower from that sale varies from state to state. Would a mortgagee's purchase of the property change the analysis? It did for the district court in *In re Bundles*.[191] That court found the irrebuttable presumption in favor of foreclosure sales was only applicable when a third party was the successful bidder. However, an exception running against mortgagees appears to be contrary to the *BFP* majority's opinion, which directs bankruptcy courts to state law.

A difference in results, depending upon who the successful bidder was, will certainly be appropriate where state law provides a different result. Additionally, a mortgagee's purchase of the collateral may very likely continue to be an important factor as courts examine the issues which are left open under *BFP*.

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of them declares or even intimates that state laws, procedural or otherwise, are irrelevant to prebankruptcy valuation questions such as that presented by § 548(a)(2)(A).

Id. (citations omitted).

190. 11 U.S.C. § 550(a) (1988) (emphasis added).

191. Bundles v. Baker (*In re* Bundles), 78 B.R. 203 (Bankr. S.D. Ind. 1987), *rev'd*, 856 F.2d 815 (7th Cir. 1988).

D. *Conclusion on* BFP

In an area of law that causes creditors so much "consternation" (in addition to pure economic loss), and where what makes normal commercial sense often seems to backfire, *BFP* represents some hope that in pure real estate foreclosure sales, one need only take those familiar steps dictated by state law and no harm will occur by a later bankruptcy filing. No doubt trustees and debtors will heighten their attention to state foreclosure procedures, and bankruptcy courts may be tempted to fashion new interpretations of state law—both actions endangering the "safe harbor" created by *BFP*. But in all events, the decision gives creditors either (1) something less to worry about or (2) something more to argue about in the event of an attack under Section 548(a)(2).

IX. SURETYSHIP AND CONTINUING GUARANTEES

Litigation involving guarantees and suretyship has been greatly diminished since the 1988 revisions to the Louisiana Civil Code articles on suretyship.[192] This is true partly because the confusion caused by some of the earlier jurisprudence[193] has been abolished by Article 3037, which provides that if a creditor knows the true relationship of the parties, the creditor cannot treat someone who is "ostensibly" bound as a principal as anything other than a surety.[194] Therefore, "solidarity" language in a continuing guaranty will not allow the creditor to treat the guarantor as a solidary obligor; rather, the rules of suretyship apply. Even among solidary obligors, rules of suretyship can apply "if the circumstances giving rise to the solidary obligation concern only one of the obligors."[195]

Normally, the release of a surety has no impact on the principal debtor but does release the co-sureties for the right of contribution to the extent the right of contribution has been impaired. The general rules are contained in Article 1892. Remission of the debt of the principal obligor releases the surety because the principal obligation has been extinguished. On the other hand, remission of the debt to the surety does not release the principal obligor because the principal obligor at all times remains bound. Finally, remission of a debt granted to one surety "releases the other sureties only to the extent of contribution the other sureties might have recovered from the surety to whom the remission was granted."[196] This right, however, may be waived by express language in the contract. That was the holding in *First National Bank v. Green Garden*

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192. 1987 La. Acts No. 409, § 1 (eff. Jan. 1, 1988).

193. *See, e.g.*, Aiavolasiti v. Versailles Gardens Land Dev. Co., 371 So. 2d 755 (La. 1979); Louisiana Bank & Trust Co. v. Boutte, 309 So. 2d 274 (La. 1975).

194. La. Civ. Code art. 3037.

195. La. Civ. Code art. 1804.

196. La. Civ. Code art. 1892.

Processing Co.,[197] which was relied upon recently in *FDIC v. Gilbert.*[198] If there is language in the contract in which the surety agrees to be bound, notwithstanding the release of other sureties, then a lender can settle with one surety without losing rights against another.[199]

It is important to note the "extent of contribution" referred to in Article 1892 is not necessarily easily ascertainable. For example, assume a situation in which Debtor is the maker of a note for $120,000. There are three sureties who all signed the same continuing guaranty, *S1*, *S2*, and *S3*. Assume that the creditor has released *S1* for $10,000. In this situation, the $10,000 would be attributed to the principal obligation ($120,000) and Debtor would still be liable for the remaining $110,000.

On the other hand, the release granted to *S1* would release *S2* and *S3* "only to the extent of the contribution the other sureties might have recovered from the surety to whom the remission was granted."[200] Assuming the sureties were liable for one-third each, then the release of *S1* would release *S1*'s virile share (one-third), thereby reducing the right of contribution (since the original debt was for $120,000) by that $40,000. Therefore, of the $110,000 that is outstanding now on the principal obligation ($120,000 minus the $10,000 payment), sureties *S2* and *S3* should be liable only for the principal obligation minus the virile share of *S1*, for a total of $80,000 (principal obligation of $120,000 minus the $40,000 virile share of *S1*). Therefore, the lender could collect $110,000 from Debtor, or $80,000 from *S2*, or $80,000 from *S3*.

On the other hand, it may be the virile share is not one-third. Under Article 3055, it is possible parol evidence could be used to show the parties were to be bound in a different fashion. Article 3055 provides:

> Co-sureties are those who are sureties for the same obligation of the same obligor. They are presumed to share the burden of the principal obligation in proportion to their number unless the parties agreed otherwise or contemplated that he who bound himself first would bear the entire burden of the obligation regardless of others who thereafter bind themselves independently of and in reliance upon the obligation of the former.[201]

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197. 387 So. 2d 1070 (La. 1980).

198. 9 F.3d 393 (5th Cir. 1993).

199. Although *FDIC v. Gilbert* involved co-makers, not guarantors, the rationale is the same—a release of one co-maker should not release the other if the remaining co-maker has agreed to be bound nonetheless. This is different than releasing all of the co-makers, in which case the principal obligation would be extinguished by confusion. La. Civ. Code arts. 1903-1904.

200. La. Civ. Code art. 1892.

201. Comment (b) to Article 3055 explains:

> The presumption provided in this Article is rebuttable. Parol evidence is admissible to overcome the presumption and to show that the sureties agreed among themselves that liability would be proportionately shared or that certain sureties were induced to make their contract with the understanding that others would entirely bear the burden.

If *S1* had signed the continuing guaranty at a time when he was 100% owner of Debtor and later sold a one (1%) percent stock interest to *S2* and one (1%) percent stock interest to *S3*, both of whom were then required to sign the continuing guaranty, it might be argued *S1*'s virile share is 98%. In such an instance, it may well be that the release of *S1* for $10,000, although it has no impact on Debtor's liability (Debtor would remain liable for $110,000) would have released 98% of the obligation as to *S2* and *S3* because that would have been the extent of the impairment of contribution rights. This makes it important that a creditor at least get a representation from the surety being released of that surety's virile share. Even more preferable from a creditor's standpoint is to have language stating that the release of a surety or the impairment of subrogation rights does not release co-sureties at all.