A Palace for a Peppercorn: A Post-BFP Proposal to Resurrect Section 548(a)(2)(A)

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A PALACE FOR A PEPPERCORN: A POST-BFP PROPOSAL TO RESURRECT SECTION 548(A)(2)(A)

I. INTRODUCTION

As counsel for Octopus National Bank ("ONB"), you must prepare a bidding strategy for an upcoming mortgage foreclosure. The mortgaged property is a piece of commercial real estate upon which a debtor operates a parking garage. The property’s fair market value is one million dollars. The garage is the debtor’s sole asset, and foreclosure will render the debtor bankrupt. What should ONB bid in order to protect its interest in the property?1

Prior to the 1994 Supreme Court decision in BFP v. Resolution Trust Corp.,2 a foreclosing lender, or mortgagee,3 would bid less than seventy percent of the fair market value of the property. Seventy percent of the fair market value was a judicial benchmark4 that satisfied the Bankruptcy Code ("the Code") requirement that all involuntary transfers of assets during the year preceding the bankruptcy filing receive "reasonably equivalent value."5

1. The hypothetical is loosely modeled after In re Winshall Settlor's Trust, 758 F.2d 1136 (6th Cir. 1985). In Winshall Settlor's Trust, the Sixth Circuit allowed the creditor bank to foreclose on commercial real estate valued between $1 and $1.8 million for a purchase price of $400,000. Id. at 1138.


3. A mortgagee is a “[p]erson that takes or receives a mortgage.” BLACK'S LAW DICTIONARY 1012 (6th ed. 1990). The mortgagor is “[o]ne who, having all or some part of title to property, by written instrument pledges that property for some particular purpose such as security for a debt.” Id.

4. The Court in Durrett v. Washington Nat'l Ins. Co. adopted the rule that purchasers at foreclosure sales must pay at least 70 percent of the property's fair market value. 460 F. Supp. 52, 54 (Bankr. N.D. Tex. 1978), aff'd, 621 F.2d 201 (5th Cir. 1980). For a discussion of the judicial development of the Durrett Rule, see infra notes 34-41 and accompanying text.

In the dissenting opinion to BFP, Justice Souter commented on the Durrett Rule: "To the extent, moreover, that Durrett is said to have announced a 'rule,' it is better understood as recognizing a 'safe harbor' or affirmative defense for bidding mortgagees or other transferees who paid 70% or more of a property’s appraised value at the time of the sale.” BFP, 114 S. Ct. at 1773.

5. The “reasonably equivalent value” requirement in 11 U.S.C. § 548(a) provides:

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 the 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 reasonably equivalent value in exchange for such transfer or
Codified in § 548(a)(2)(A) of the Code, the requirement that transfers yield “reasonably equivalent value” is used to preserve the property of the bankruptcy estate. Section 548(a)(2)(A) empowers the trustee in bankruptcy (“TIB”) to set aside pre-filing transfers exchanged for less than 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.


From a bankruptcy perspective, however, a foreclosure sale on the eve of bankruptcy, at which the debtor's interest is sold for a fraction of its true market value, constitutes an estate-depleting windfall to the purchaser at the expense of the debtor's creditors. The long history of fraudulent conveyance provisions strongly support an interpretation of section 548(a)(2) that permits the trustee to recapture such a loss.

Id. at 935-36. The authors of the 1973 Report of the Commission on Bankruptcy Laws of the United States also commented on the purpose of the fraudulent conveyance provision:

Without such provisions, the estate available for distribution to creditors in the bankruptcy proceedings could be seriously depleted (or perhaps eliminated) by the transfer of most or all of the assets to favored creditors or to friends or relatives or simply to those creditors who exert the most pressure on the debtor.

REPORT OF THE COMMISSION ON BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. 18 (1973) (emphasis added). Allowing over-zealous creditors estate depleting windfalls is inconsistent with the Code's goal to ensure equitable distribution of the assets of the bankruptcy estate. See 3 DANIEL R. COWANS, BANKRUPTCY LAW AND PRACTICE § 12.22, at 74-77 (6th ed. 1994) (discussing the basic concept of equal treatment of creditors); see also Robert F. Finke et al., Undoing the Excesses of the 1980s: Avoidance Actions and Equitable Subordination, C880 ALI-ABA 197, *348 (1994), available in WESTLAW, TP-ALL database (noting "the Bankruptcy Code's purpose in a fair and equitable distribution among creditors."). Thus, § 548(a)(2) provides a tool by which the TIB may prevent such windfalls and preserve the assets of the estate. See Ehrlich, supra, at 935-36.

8. In their treatise on bankruptcy, Professors Warren and Westerbrook artfully explain the concept of the “bankruptcy estate.”

At the moment a bankruptcy petition is filed (voluntary or involuntary) an “estate” is created by operation of law, just as if a new corporation had been established or a new trust created. The most direct analogy is with the decedent's estate created by law upon someone's death. Bankruptcy is in a sense a financial demise, which creates an estate consisting of all the interests in property previously owned by the debtor.


9. The TIB is the “person in whom the property of a debtor is vested in trust for the creditors.”


10. “Set aside” is a bankruptcy term of art meaning “[t]o reverse, vacate, cancel, annul, or revoke a judgment, order, etc.” BLACK'S LAW DICTIONARY 1372 (6th ed. 1990). Under § 550 of the Code, the TIB “may recover, for the benefit of the estate, the property transferred, or . . . the value of such property” that is voidable under § 548. 11 U.S.C. § 550(a) (1993).

Section 544 authorizes TIBs to set aside such voidable transfers and allows the TIB to “avoid any transfer . . . incurred by the debtor that is voidable” and to “avoid any transfer of an interest of the
reasonably equivalent value and to bring the transferred assets back into the bankruptcy estate. This ensures that all creditors will benefit from the debtor's assets.

In bankruptcy parlance, transfers for less than reasonably equivalent value under § 548(a)(2)(A) are termed "fraudulent conveyances." Although a transfer for less than reasonably equivalent value may not rise to the level of actual fraudulent conduct, the lack of reasonably equivalent value triggers a presumption of fraud, under which the debtor's actual intent is irrelevant. Because transfers exchanged for less than reasonably equivalent value within one year of the bankruptcy filing are constructively fraudulent conveyances, § 548(a)(2)(A) allows the TIB to set aside such transfers.

Warren and Westerbrook comment on the distinction between actual fraudulent intent and constructive fraud:

The most important aspect of the original 1915 statute [the Uniform Fraudulent Conveyance Act] was that it codified in fraudulent conveyance law a concept usually called "constructive fraud" or "presumptive fraud." Both terms are misnomers because the new concept permitted a creditor to avoid—to set aside—a transfer even though the debtor was entirely innocent of any fraudulent intent. The statute defined circumstances in which the transfer was regarded as unfairly disadvantageous to the debtor's creditors, regardless of intent. Such a transfer could be avoided without any showing of fraud, constructive or otherwise, so there was no need for any "presumption" and there was nothing to rebut.
transfers just as if the debtor had engaged in actual fraud.

Before BFP, debtors or TIBs could move the bankruptcy court to review foreclosure sale transfers that yielded inadequate value and depleted the bankruptcy estate. However, under BFP, bankruptcy courts may no longer review or set aside such transfers. The price paid at a regularly-conducted, noncollusive foreclosure sale is presumed to be the reasonably equivalent value.

Thus, BFP allows mortgage lenders such as ONB to bid any amount so long as they comply with state foreclosure law. BFP represents a huge victory for mortgage lenders. So long as lenders follow the state process for properly conducting foreclosure sales, BFP allows them to repossess collateral by bidding the mortgage balance regardless of the fair market value of the property. BFP allows mortgagees to purchase valuable real estate for mere pocket change, or for a “peppercorn” as Justice Souter so

notes 25-27 and accompanying text.


16. For a discussion of BFP and the irrebuttable presumption rule, see infra part III.

17. BFP, 114 S. Ct. at 1758.

18. The state foreclosure sale process is inadequate and shocking. One commentator criticized the system:

[T]he state-mandated procedure is intrinsically defective and has caused imperfect market results . . . . In an age of computer data accessibility, sophisticated and widespread brokerage listing services, available credit financing, easily accessible title insurance, and reliable escrow companies, state-foreclosure laws are woefully inadequate, occasionally shocking, and in drastic need of upgrading.

Ehrlich, supra note 7, at 961-62.

The foreclosure process does not yield equitable results. One study concluded that “[i]n 99.3% of ‘public’ sales, the mortgagee is the buyer.” William C. Prather, A Realistic Approach to Foreclosure, 14 BUS. LAW. 132, 135 (1958). Subsequent studies reinforce these statistics. Steven Wechsler, Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure-An Empirical Study of Mortgage Foreclosure and Subsequent Resale, 70 CORNELL L. REV. 850, 896 (1985) (concluding that judicial foreclosures are a “meaningless charade” in which the mortgagee forecloses, purchases the property at the sale and resells it at a significant profit).

Frequently, mortgagees are the only bidders at foreclosure sales because the process discourages third-party bidders. GRANT S. NELSON & DALE S. WHITMAN, REAL ESTATE FINANCE LAW 622-26 (3d. ed. 1994). Third parties are reluctant bidders because at a foreclosure sale they must pay in cash. However, mortgagees receive a credit for the outstanding mortgage debt and thus do not have to pay this amount in cash. Id. at 623. Additionally, foreclosure statutes only require limited notice and sale publication. Most often, such notice is published in newspapers with low circulation. Id. Further, state foreclosure laws do not provide third-party purchasers with a warranty of good title. Id. Finally, third-party purchasers are rarely given an opportunity to physically inspect the property. Id. Either the debtor in possession refuses access or the foreclosing mortgagee discourages such access by limiting the information available on the property. Id. See also UNIF. LAND TRANS. ACT, 13 U.L.A. §§ 3-501 to 3-513 (setting forth a model for state foreclosure law).
artfully termed it in his dissent to _BFP_.

The difficulty with the irrebuttable presumption rule becomes apparent when applied to our hypothetical. Without any standard for reasonably equivalent value or fear of a subsequent set aside, _ONB_ has no incentive to bid more than the outstanding balance of the mortgage. If the balance was $250,000, _ONB_’s bid would represent only one quarter of the property’s fair market value. Thus, _ONB_ would satisfy its mortgage, deplete the bankruptcy estate of seventy-five percent of the debtor’s equity in the property, and gain a windfall profit upon resale of the property. Because

19. _BFP_, 114 S. Ct. at 1767. Justice Souter summarizes the majority’s opinion saying, “[t]oday the Court holds that by the terms of the Bankruptcy Code Congress intended a peppercorn paid at a noncollusive and procedurally regular foreclosure sale to be treated as the ‘reasonab[e] equivalent’ of the value of a California beachfront estate.” _Id._

Although technically a “peppercorn” is a “dried berry of Black Pepper,” _The Oxford English Dictionary_ explains that the term is also used colloquially to connote a “very small, insignificant[, or] trivial” amount of rent or payment for an interest in real estate. 11 _THE OXFORD ENGLISH DICTIONARY_ 510 (2d ed. 1989).


Bankruptcy law supplements the state law process to secure the assets of the bankruptcy estate. The inadequacy of the foreclosure system necessitates § 548. On this issue, Professor Lynn LoPucki concluded that sales procedures used by bankruptcy courts are “vastly superior to those employed in the state remedies subsystem . . . . In bankruptcy sales it is usual to receive more than 75 percent of the appraised value of the property.” Lynn M. LoPucki, _A General Theory of the Dynamics of the State Remedies/Bankruptcy System_, 1982 _Wis. L. Rev._ 311, 320-21 & n.52 (1982).

This Note acknowledges that reforming state foreclosure law is essential. However, this Note does not attempt to duplicate existing reform proposals. For a sample of such proposals, see Michael H. Schill, _An Economic Analysis of Mortgagor Protection Laws_, 77 _Va. L. Rev._ 489 (1991); Michael L. Walcott, _Avoidance of Foreclosure Sales As Fraudulent Transfers Under Section 548(a) of the Bankruptcy Code: An Impetus to Changing State Foreclosure Procedures_, 66 _Neb. L. Rev._ 383 (1987).

Instead, this Note proposes that Congress must amend § 548 to allow bankruptcy courts to review the state foreclosure process to ensure that foreclosure sale prices are reasonably equivalent to fair market value.

21. Justice Souter predicted similar bidding strategies in his dissent in _BFP_:

At a typical foreclosure sale, a mortgagor has no incentive to bid any more than the amount of the indebtedness, since any “surplus” would be turned over to the debtor (or junior lienholder), and, in some states it can even be advantageous for the creditor to bid less and seek a deficiency judgement. And where property is obviously worth more than the amount of the indebtedness, the lending mortgagor’s interests are served best if the foreclosure sale is poorly attended; then, the lender is more likely to take the property by bidding the amount of the indebtedness, retaining for itself any profits from resale.

_BFP_, 114 S. Ct. at 1775 (citations omitted).
a bankruptcy court would be powerless to review the sale and recapture the property, BFP legalizes constructively fraudulent conveyances.

This Note assesses BFP's impact on the balance of power between federal bankruptcy courts and state foreclosure law. Part II analyzes the historical development of bankruptcy law as a vehicle to set aside foreclosure sales. Part III analyzes and critiques BFP. Part IV proposes amending the Code to allow bankruptcy courts to review constructively fraudulent transfers. Alternatively, Part IV proposes a narrow judicial interpretation of BFP. Finally, Part V concludes that the use of fraudulent conveyance law to set aside state foreclosure sales complements federal bankruptcy policy.

II. BACKGROUND ON SECTION 548 CONFLICT

Members of the legal community have hotly contested the use of fraudulent conveyance law to set aside foreclosure sales that transfer property for less than "reasonably equivalent value."22 Historically, lawyers used fraudulent conveyance law to prevent debtors from transferring assets with the "intent to hinder, delay or defraud" their creditors.23 Because actual intent is difficult to prove, courts developed "badges of fraud" or factual settings that were presumptively fraudulent.24

Supplementing federal bankruptcy law, state statutes constitute the primary source of fraudulent conveyance law. State statutes developed simultaneously with the federal provisions and reflect similar policy considerations. In 1918, constructive fraud was codified in the Uniform Fraudulent Conveyance Act ("UFCA").25 The Conference of Commissioners on Uniform Laws adopted the UFCA to provide a model for state

23. This language originated in the Statute of 13 Elizabeth. 13 Eliz., ch. 5 (1570), cited in BFP, 114 S. Ct. at 1763. The Statute of 13 Elizabeth allowed "covinous and fraudulent" transfers made with the intent to "delay, hinder or defraud creditors and others" to be set aside. Id.
24. Twyne's Case, 3 Coke 806, 76 Eng. Rep. 809 (Star Chamber, 1601) (invalidating gift made with the "mark of fraud" as a fraudulent conveyance), cited in WARREN & WESTERBROOK, supra note 8, at 137-38.
fraudulent conveyance statutes.26 The UFCA grants creditors standing to challenge debtor conveyances incurred without “fair consideration.”27

Over the next sixty years, Congress incorporated the UFCA’s constructive fraud standards into the federal Bankruptcy Code. In 1938, Congress enacted the Chandler Act, removing the intent requirement from the section on fraudulent conveyances and adopting the UFCA’s “fair consideration” language.28 Ultimately, the 1978 Bankruptcy Act removed the “good faith” transfer requirement.29 These amendments removed the historical limits on fraudulent conveyance law by allowing transfers to be set aside for constructive fraud.30 The adoption of the presumptive fraud provision placed foreclosure sales within the reach of the TIB’s avoidance powers.31

Through these amendments, Congress shifted the focus from the debtor’s mental state to the transfer’s impact upon creditors and the bankruptcy estate.32 However, Congress did not remove the term “fraudulent.” The use of fraudulent conveyance law to regulate non-fraudulent behavior has created a confusing paradox that has sparked scholarly and judicial criticism.33


30. For a discussion of the distinction between actual fraudulent intent and constructive fraud, see supra notes 12, 14.

31. Discussing the impact of the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"), Justice Souter addressed his apprehension in the dissenting opinion saying, “whether or not one believes (as the majority seemingly does not) that foreclosure sales rightfully belong within the historic domain of ‘fraudulent conveyance’ law, that is exactly where Congress has not put them, and our duty is to give effect to these new amendments along with every other clause of the Bankruptcy Code.” BFP, 114 S. Ct. at 1770 (citations omitted). See also Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 463(a), 98 Stat. 333, 378 (1984).

32. BFP, 114 S. Ct. at 1769 n.5 (discussing the impact of the Chandler Act and the 1978 Bankruptcy Amendments).

33. Discussing this paradox, Judge Schermer of the United States Bankruptcy Court for the Eastern District of Missouri argued that if § 548(a)(2) were extracted from § 548(a) and renamed “The Estate Preservation Provision,” the distinction between fraudulent transfers, prohibited under 548(a)(1), and
After the 1978 Bankruptcy Act, the courts divided over the application of fraudulent transfer law to foreclosure sales. The first case to apply fraudulent transfer law to foreclosure sales was *Durrett v. Washington National Insurance Co.* In *Durrett*, a case brought under the 1978 version of the Code, the Chapter XI debtor in possession petitioned the court to set aside or void a nonjudicial property foreclosure for 57.7 percent of the fair market value. The Fifth Circuit Court of Appeals held that the foreclosure price paid did not constitute a “fair equivalent” for the transfer of the property.

Courts interpreting *Durrett* have focused on the seventy percent dictum, rather than the whole opinion. The *Durrett* court noted that it was, “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.” Courts and mortgage lenders interpreted this language as a mandate of the “Seventy Percent Rule” or “Durrett Rule,” which requires that mortgagees bid seventy percent of the fair market

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34. *Durrett*, 621 F.2d at 203. The fair market value of Durrett’s property on January 4, 1977, the date of the foreclosure sale, was $200,000. *Id.* Durrett had executed a note in the amount of $180,000 on the property in 1969. *Id.* at 202. The balance owed to the mortgagee, Washington National Insurance Company, was $119,278.38. *Durrett*, 460 F. Supp. 52, 53. The third party purchaser bid $115,400 at the foreclosure sale. *Id.*

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

36. *Durrett*, 621 F.2d at 202. The fair market value of Durrett’s property on January 4, 1977, the date of the foreclosure sale, was $200,000. *Id.* Durrett had executed a note in the amount of $180,000 on the property in 1969. *Id.* at 202. The balance owed to the mortgagee, Washington National Insurance Company, was $119,278.38. *Durrett*, 460 F. Supp. 52, 53. The third party purchaser bid $115,400 at the foreclosure sale. *Id.*

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

38. *Id.* This statement is criticized in subsequent case law because the *Durrett* court cited a single case as precedent for this bald assertion. *Id.* The case, *Schafer v. Hammond*, 456 F.2d 15 (10th Cir. 1972), involved a prepetition conveyance of assets from a debtor corporation to the mother of the principal stockholder of the debtor corporation. *Id.* at 16.
value. Despite criticism that it "cast a cloud upon mortgages and deeds of trust" which would "inhibit a purchaser other than the mortgagee from buying at foreclosure ... [and] depress further the prices of foreclosure sales," the Durrett Rule set the industry standard for foreclosure bidding in the Fifth Circuit until BFP. In 1984, the Ninth Circuit Court of Appeals rejected the Durrett Rule in Madrid v. Lawyers Title Insurance Corp. The Madrid court set forth the "Irrebuttable Presumption Rule" or "Madrid Rule," which presumes that, so long as the sale is noncollusive and regularly conducted, the foreclosure price constitutes "reasonably equivalent value."

39. See, e.g., In re Cole, 81 B.R. 326, 331 (Bankr. E.D. Pa. 1988) (avoiding foreclosure sale yielding between 47.7 and 65.1% of the fair market value); In re New Yorketown Assocs., 40 B.R. 701, 706-07 (Bankr. E.D. Pa. 1984) (avoiding forced sale of commercial realty with fair market value in excess of $2 million for bid price of $297,000); In re Berge, 33 B.R. 642, 649-50 (Bankr. W.D. Wis. 1983) (avoiding strict foreclosure of farm for 44.9% of the $2,555,000.00 market value); In re Wheeler, 34 B.R. 818, 821 (Bankr. N.D. Ala. 1983) (avoiding forced sale of debtor's residence for 62.7% of fair market value); In re Richardson, 23 B.R. 434, 448-49 (Bankr. D. Utah 1982) (avoiding forced sale of debtor's residence for 21% of fair market value); In re Ocean Dev. of America, Inc., 22 B.R. 834, 835-37 (Bankr. S.D. Fla. 1982) (avoiding fraudulent transfer on half-interest in Palm Beach mansion to debtor's girlfriend for 65% of the fair market value); In re Coleman, 21 B.R. 832, 834 (Bankr. S.D. Tex. 1982) (avoiding forced sale of debtor's residence for 28% of fair market value); In re Thompson, 18 B.R. 67, 70 (Bankr. E.D. Tenn. 1982) (upholding forced sale of debtor's residence for 80.8% of the fair market value).

40. Justice Clark penned this commonly cited critique in the dissenting opinion in Abramson v. Lakewood Bank and Trust, 647 F.2d 547, 549 (5th Cir. 1981). In Abramson, the Fifth Circuit employed the Durrett rationale and held that a nonjudicial foreclosure sale was a "transfer" within the Bankruptcy Code. Further, the court determined that a sale could be set aside as fraudulent if it was made without fair consideration. Id. at 547. Many subsequent foreclosure sale opinions and bankruptcy treatises have cited Justice Clark's famous "cloud" dissent:

By our decision here and in Durrett we cast a cloud upon mortgages and trust deeds. Foreclosure within twelve months before a filing creates a sale voidable by a trustee in bankruptcy if the public sale did not bring a "fair consideration" . . . . The cloud created over mortgages and trust deeds by making foreclosure sales subject to being voided by a bankruptcy trustee will naturally inhibit a purchaser other than the mortgagee from buying at foreclosure. This tends to depress further the prices of the foreclosure sales and thus increase the potential size of the deficiency in each foreclosure in all six states comprising this circuit.

It is interesting to me that Durrett is the first case treating this problem—after 90 years of bankruptcy law and mortgages of a time greater than the memory of man. It again establishes what an imaginative lawyer can do when he adds persuasion. Id. at 550.

41. For a discussion of case law following Durrett, see supra note 39.


43. Madrid, 725 F.2d at 1199-1203. Madrid represents policy driven legal interpretation. In granting an irrebuttable presumption of validity to the price paid at a foreclosure sale, the Ninth Circuit Bankruptcy Appellate Panel explained:

We decline to follow Durrett's 70% fair market value rule for the reason that a regularly
debtor sought to rescind a nonjudicial foreclosure sale of her beachfront property. At the foreclosure sale, the bona fide purchaser bought the house for between sixty-four and sixty-seven percent of the fair market value. The court in Madrid never resolved whether the sale price constituted reasonably equivalent value. Instead, the court held that because the foreclosure sale did not constitute a "transfer" under § 548(a), the court did not need to reach the issue of reasonably equivalent value. Despite this holding, the Ninth Circuit addressed the debate surrounding "reasonably equivalent value" in dicta. In Madrid, the majority of the Bankruptcy Appellate Panel rejected the Durrett court's reasoning, fearing the adverse effect of such a rule on commercial and real estate law. The majority criticized the Durrett Rule conducted sale open to all bidders and all creditors, is itself a safeguard against the evils of private transfers to relatives and favorites. Madrid, 21 B.R. at 426-27. 44. Id. at 425. 45. Id. at 424, 429 n.3. The property's fair market value was estimated between $380,000 and $400,000. Madrid, 10 B.R. at 798. At the time of the January 9, 1981 foreclosure sale, the debtor owed $175,000 on the first deed of trust and $80,224.39 on the second deed of trust. Id. at 797. The third-party purchaser bought the property for $256,000. Id. 46. Madrid, 725 F.2d at 1197. 47. Id. at 1199. The court concluded: [T]he foreclosure sale was not a transfer under § 548(a), and [we] do not decide whether the amount paid at foreclosure was a reasonably equivalent value. . . . [T]he transfer of Madrid's property interest under § 548(a)(2)(A) occurred at the time the second deed of trust was perfected under Nevada law. That transfer was carried out more than one year prior to filing of the bankruptcy petition. Thus, the transfer was not voidable as a § 548(a)(2)(A) fraudulent conveyance. Id. This argument is erroneous. Prior to Congress' 1984 amendment to § 101, defining transfers to include involuntary dispositions, critics debated whether or not a foreclosure sale constituted a transfer. Alden, supra note 17, at 1608-13. Concluding that foreclosures were not transfers, the Ninth Circuit based its determination on the "One Transfer Rule." Id. at 1609 (citing In re Also, 14 B.R. 982 (Bankr. D. Alaska 1981)). The "One Transfer Rule" posits that the date of the foreclosure should relate back to the date of the underlying security interest. In re Also, 14 B.R. at 986. Thus, for purposes of § 548, there is only a single transfer of the property interest. So long as the mortgage agreement occurred outside the one year avoidance period, the foreclosure sale cannot be challenged. Steven M. Alden, et al., Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the Durrett Problem, 38 BUS. LAW 1605, 1608-13 (1983). See also Robert M. Zinman et al., Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits, 39 BUS. LAW 977 (1984). However, following the Madrid decision, Congress amended the definition of transfer, clarifying its application to foreclosure, sales and implicitly rejecting the "One Transfer Rule." For a discussion of the 1984 amendments to the Bankruptcy Code, see infra notes 60-67 and accompanying text. 48. Madrid, 725 F.2d at 1202. 49. However, little or no empirical data has been collected to legitimize this "adverse effect." In fact, one commentator's empirical study concluded that although Durrett "was expected to wreak havoc
as inappropriately extending federal bankruptcy law into the domain of state foreclosure law. The court argued that Durrett's interpretation of § 548(a)(2)(A) created a de facto right of redemption. The court reasoned that a federally-imposed right of redemption contravened state property law.

Further, the Madrid court feared that such judicial innovation would "chill participation at foreclosure sales" and inhibit creditors from lending funds secured by a mortgage or deed of trust. The Madrid majority endorsed an irrebuttable presumption of reasonably equivalent value when a judicial foreclosure sale is both noncollusive and complies with state law. Numerous courts, as well as the real estate lending community, endorsed this policy.

Just four months later, in In re Hulm, the Eighth Circuit rejected the

on the mortgage credit markets . . . the anticipated harms did not materialize . . . ." Philip Schuchman, Data On the Durrett Controversy, 9 CARDOZO L. REV. 605, 607 (1987). Professor Schuchman studied the effects of the Durrett and Madrid decisions on national, Texas, and California mortgage interest rates and on total mortgage loans created between 1979 and 1985. Id.

50. Madrid, 725 F.2d at 1202. Judge Volinn's dissent in the Ninth Circuit Bankruptcy Appellate Panel Madrid opinion refuted this criticism:

Section 548 transcends the dispute between this debtor and the secured creditor. It brings into focus the claims of the debtor's other creditors that they have been deprived of recourse to an asset by an improvident sale. The majority would hold that despite the widespread differences in law and practices relating to foreclosure, no bankruptcy court may entertain the factual issue of whether, under § 548, the consideration paid was reasonably equivalent value. By concluding that a regularly conducted sale in absence of collusion satisfies the "reasonably equivalent value" test, the majority has excised vital language from § 548 in order to create an exception to the statute where a forced sale of the debtor's property is involved. There is nothing in the Code nor its legislative history to suggest that such an exception was intended. . . . I would hold that the price paid at a regularly conducted foreclosure sale should be given, at best, a strong presumption of adequacy.

Madrid, 21 B.R. at 428.

51. Madrid, 725 F.2d at 1202.

52. Id.

53. Id. at 1203. Specifically, the court stated: "[W]e do not add to the arsenal of bankruptcy powers the right to avoid a nonjudicial, regularly conducted foreclosure sale of real property." Id.

54. See, e.g., In re Ehring, 900 F.2d 184, 187 (9th Cir. 1990) (discussing the impact of the 1984 Bankruptcy Amendments and Federal Judgeship Act on the Madrid Rule); In re Winshall Settlor's Trust, 758 F.2d 1136, 1138-40 (6th Cir. 1985) (refusing to set aside forced sale of commercial realty for 22 to 40% of the fair market value); In re Kachanizadeh, 108 B.R. 734, 738 (Bankr. C.D. Cal. 1989) (refusing to set aside forced sale of a debtor's residence for 71% of the fair market value); In re Verna, 58 B.R. 246, 252 (Bankr. C.D. Cal. 1986) (refusing to set aside forced sale of a debtor's residence for 44% of the fair market value); In re Ristich, 57 B.R. 568, 580 (Bankr. N.D. Ill. 1986) (refusing to set aside forced sale of undeveloped realty for 70.9% of the debtor's equity); In re Upham, 48 B.R. 695, 697 n.1 (Bankr. W.D.N.Y. 1985) (refusing to set aside forced sale of a debtor's residence for 71 to 78% of fair market value).

Madrid court's assumption that a regularly conducted foreclosure sale automatically provided reasonably equivalent value. In Hulm, the foreclosing mortgagee purchased the property, a single-family home, for $64,443.64 and resold it nine months later for $95,000. Thus, the mortgagee deprived the bankruptcy estate and the unsecured creditors of $30,556.36. Criticizing the Madrid Rule as a policy determination which Congress alone should address, the court declared that an evidentiary hearing was necessary to determine reasonably equivalent value.

Immediately following the Hulm decision, Congress debated the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). BAFJA proposed three changes to address the conflict between the circuits. First, it proposed amending the definition of transfer in § 101 of the Code to specifically include foreclosure sales. By including foreclosure sales as voidable transfers within the purview of § 548, Congress accepted Durrett's analysis of the "transfer" issue. Second, BAFJA proposed that Congress include the language "voluntarily or involuntarily" in § 548 to emphasize its applicability to foreclosure sales. This would bring involuntary transfers within the TIB's avoidance

56. 738 F.2d at 327. For an interesting discussion of the Hulm decision's impact on the development of fraudulent transfer law, see Frank W. Koger & Paula C. Acconcia, The Hulm Decision: A Milestone for Creditors, 91 Com. L. J. 301 (1986).


58. Id. at 529. On remand, the United States Bankruptcy Court for the District of North Dakota ordered that the mortgagee, First Federal Savings & Loan, pay the trustee $35,556.36, which represented "the value of the interest transferred which was not represented in the price bid in by First Federal.

59. Id. at 327. In support of this assertion, the court explained:

We do not believe that the sale price at a regularly conducted foreclosure sale, although absent fraud or collusion, can automatically be deemed to provide a reasonably equivalent value in exchange for the interest of the debtor transferred within the meaning of section 548(a). . . .

We are aware of expressed concern that the result we have reached will affect the strategies of purchasers at judicial foreclosure sales. The Bankruptcy Code provisions are clear, however, and direct the result we have reached. Hence, policy considerations cannot affect the outcome in this case, but must be addressed, if at all, by Congress.


62. Id.

63. Id. For the current statutory text of § 548, see supra note 5.
power under § 548 and overrule Madrid. Ultimately, Congress codified both of these proposals in BAFJA.\textsuperscript{64}

The third BAFJA proposal adopted the language of the Madrid Rule. The proposed amendment read, "A secured party or third party purchaser who obtains title to an interest of the debtor in property pursuant to a good faith prepetition foreclosure . . . takes for reasonably equivalent value."\textsuperscript{65} However, Congress deleted this provision before enactment.\textsuperscript{66} Congress refused to resolve the Madrid/Durrett problem,\textsuperscript{67} leaving the issue open to further judicial interpretation.

In the same year, the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Fraudulent Transfer Act ("UFTA")\textsuperscript{68} to clarify, improve and replace the UFCA.\textsuperscript{69} The UFTA adopted the language of § 548, which allowed parties to challenge and set aside transfers for less than reasonably equivalent value.\textsuperscript{70} However, the Commissioners also incorporated the Madrid Rule into the UFTA definition

\begin{footnotes}
\item[65] S. 445, 98th Cong., 1st Sess., § 360(c) (1983) (proposing the inclusion of this amendment in § 548(d)(2)). See also Verna, 58 B.R. at 250.
\item[66] However, the provision was not deleted before a lengthy debate. In 1984, Senators Robert Dole (R. Kan.) and Dennis DeConcini (R. Ariz.) "inserted into the Congressional Record a scripted colloquy . . . in which Senator Dole reported that the statute was amended 'to delete . . . all provisions dealing with the Durrett issue.'" Verna, 58 B.R. at 250. In this colloquy, Senator Dole stated, Consequently, no provision of the bankruptcy bill as passed by the this body was intended to intimate any view one way or the other regarding the correctness of the position taken by the U.S. Court of Appeals for the Fifth Circuit in the Durrett case, or regarding the correctness of the position taken by the U.S. Court of Appeals for the Ninth Circuit in Lawyer's Title Insurance Co. v. Madrid, which reached a contrary result.\textsuperscript{Id.} (citing 130 Cong. Rec. S13771-72 (daily ed. Oct. 5, 1984) (statement of Sen. Dole)) (citations omitted). Senator DeConcini questioned. "Then I am correct in concluding that parties in bankruptcy proceedings who seek avoidance of pre-petition foreclosure sales would find no support for their arguments in these amendments?" \textsuperscript{Id.} at 13772 (statement of Sen. DeConcini). Senator Dole responded, “The Senator’s conclusion is correct.” \textsuperscript{Id} (statement of Sen. Dole).

In BFP, the dissent also emphasized Congress’ inaction, noting that “Congress considered, but did not enact, an amendment that said precisely what the majority now says the current provision means.” \textsuperscript{BFP}, 114 S. Ct. at 1767.
\item[69] Carey, supra note 26, at 693-94. In his 1994 study of the UFCA and the UFTA, Carey found that 29 states had adopted variations of the UFTA, while nine states still retain the UFCA. \textsuperscript{Id.} For a discussion of the UFCA’s initial adoption, see supra notes 25-27 and accompanying text.
\item[70] UFTA § 4 provides that “(a) A transfer made . . . by a debtor is fraudulent as to a creditor . . . if the debtor made the transfer . . . (2) without receiving reasonably equivalent value[.]” U.F.T.A., \textsuperscript{supra} note 68, at 652-53.
\end{footnotes}
of value. This definition precludes state law challenges to prepetition foreclosure sales.

Despite contrary UFTA amendments, the Seventh Circuit endorsed the use of fraudulent conveyance law to set aside a forced sale. In 1988, in Bundles v. Baker, the Seventh Circuit adopted a case-by-case analysis looking at the "totality of the circumstances." In Bundles, the debtor-appellant sought to set aside foreclosure of his residence. The property, valued at $15,500, was sold for $5,066.80, barely covering the balance of the mortgage. After refuting both Madrid and Durrett, the court adopted a middle ground approach, setting aside the foreclosure sale. The Seventh Circuit required that the bankruptcy court examine the

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71. In fact, the language of the UFTA is more expansive than that of the Madrid court. UFTA § 3(b) defines "value" as:

(b) For purposes of Sections 4(a)(2) and 5 [the fraudulent transfer provisions], a person gives a reasonable equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

U.F.T.A., supra note 68, § 3(a), at 650. The Madrid Rule involved a third-party purchaser at a judicial foreclosure sale. Madrid 21 B.R. at 426. The UFTA uses "person" broadly, granting mortgagees as well as third-party purchasers an irrebuttable presumption of adequate value. U.F.T.A., supra note 68, § 3(a), at 650. Further, the UFTA extends this presumption to involuntary transfers by means of the non-judicial power of sale agreements and Article 9 security interests. Id. § 3(b). Thus, the UFTA protects more transactions from challenge under state fraudulent transfer law.

72. Id.
73. Bundles v. Baker, 856 F.2d 815 (7th Cir. 1988).
74. Id.
75. Id. at 824. Many other courts have utilized variations of the case-by-case analysis. See, e.g., In re Littleton, 888 F.2d 90, 92-94 (11th Cir. 1989) (refusing to set aside nonjudicial foreclosure sale of debtor's residence that realized 63.49% of the fair market value); In re Bates, 32 B.R. 40 (Bankr. E.D. Cal. 1983) (avoiding forced sale of debtor's residence for 5 percent of fair market value); In re Richard, 26 B.R. 560 (Bankr. D.R.I. 1983) (avoiding forced sale of debtor's residence for less than one percent of debtor's equity).

76. Under § 522(h), a debtor may file a motion asking the court to set aside the foreclosure. Section 522(h) provides:

(h) The debtor may avoid a transfer of property of the debtor or recover a setoff to the extent that the debtor could have exempted such property under subsection (g)(1) of this section if the trustee had avoided such transfer, if—

(1) such transfer is avoidable by the trustee under section 544, 545, 547, 548, 549, or 724(a) of this title or recoverable by the trustee under section 553 of this title; and

(2) the trustee does not attempt to avoid such transfer.

77. Bundles, 856 F.2d at 817.
78. Id.
79. Id. at 824.

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http://openscholarship.wustl.edu/law_lawreview/vol73/iss4/8
"foreclosure transaction in its totality" by focusing on the property's fair market value and determining how the foreclosure affected this value.

The Seventh Circuit admonished the district court for using the actual intent to defraud requirement. The court noted that the focus in bankruptcy law has shifted from subjective intent to objective results. Further, the Bundles court found that § 548, "makes no distinction between sales that do and sales that do not comply with state law. If we take the statute at face value, we must conclude that its unambiguous language requires the reviewing court to make an independent assessment of whether reasonable equivalence was given." The Bundles court declined to consider the policy implications of its holding. The court concluded that Congress, not the judiciary, is the proper forum for changing bankruptcy laws. The Bundles court contended that granting an irrebuttable presumption of reasonableness improperly engrafted a good faith requirement onto § 548(a)(2)(A). The Bundles court also found that the Madrid Rule "renders section 548(a)(2) merely duplicative of other Code provisions."

Finally, several courts have applied a "commercial reasonableness" standard in adjudicating fraudulent transfer challenges under § 548. The United States Bankruptcy Court for the District of Massachusetts adopted this novel standard in In re General Industries, Inc. In General Indus-

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80. The court considered many factors, including:
whether the [foreclosure] procedures were calculated not only to secure for the mortgagee the value of its interest but also to return the debtor-mortgagor his equity in the property....
whether there was a fair appraisal of the property, whether the property was advertised widely, and whether competitive bidding was encouraged.

82. Id. at 818.
83. Id. at 821.
84. Id. at 823.
85. Id. at 823.
86. The court noted:
[i]t 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 this court. Our duty is to simply interpret the language of the statute.

87. Id.
88. See, e.g., In re Lindsay, 98 B.R. 983, 992-93 (Bankr. S.D. Cal. 1989) (setting aside a deed of trust foreclosure sale under commercial reasonableness standard); In re General Industries, Inc., 79 B.R. 124, 134 (Bankr. D. Mass. 1987) (holding that a sale price constituting only 53% of the property's value did not establish a "reasonably equivalent value").
The Chapter 11 Creditor's Committee brought an action to set aside a real property prepetition foreclosure for fifty-three percent of the fair market value. The court examined Massachusetts state foreclosure procedures and concluded that they were "inherently ineffective in producing equivalent value." Thus, the court found the Madrid Rule inappropriate because it shielded all foreclosure sales from fraudulent transfer attack. The court also rejected the Durrett Rule because it improperly equated value with sale price, rather than focusing on whether the sale process was conducted in a commercially reasonable manner. In adopting the commercial reasonableness standard, the court emphasized the reasonableness of the "sales efforts made rather than the price achieved." 

91. 79 B.R. at 127, 129. In General Industries, the real property was a manufacturing plant with a fair market value of $90,000. Id. at 129. The mortgagee bid the amount of the mortgage, plus taxes—a sum of $36,952.16. Id. at 127. The mortgagee asserted that the possibility of environmental damage should be considered when determining the value of the property. Id. However, the court refused to speculate on such damages. Id.

In addition to the real property issue, the court in General Industries considered what constitutes reasonably equivalent value for personal property under Article 9 of the Uniform Commercial Code. In General Industries, the Creditor's Committee objected to the foreclosure of business equipment, valued at $20,000, for $5,000—only 25% of the fair market value. Id. at 127. The court applied the commercial reasonableness standard set forth in U.C.C. § 9-504(3) and concluded that the transfer had not yielded a reasonably equivalent value. Id. at 131, 134.

92. Id. at 132. Emphasizing the lackluster statutory notice requirements under state foreclosure law, the court stated "the Massachusetts procedural requirements for real estate foreclosure are too minimal to control the question of reasonably equivalent value under § 548." Id.

93. Id. at 131. The court identified three prongs to the Madrid argument: (1) that fraudulent transfer law is intended to address debtor's conduct; (2) that state foreclosure procedures provide debtors and creditors with ample protection; and (3) that set aside will chill the foreclosure and mortgage lending markets. Id. The court critiqued this three-pronged argument:

All of these arguments have a common flaw: they assume that state foreclosure procedures are designed to attract bidders and to bring the highest price possible under the circumstances for real property. Quite often the opposite is true. Most state real estate foreclosure laws require little in the way of advertising or other promotional efforts, regardless of whether or not sales are judicially supervised. Id. at 131-32.

94. Id. at 130-31.

95. See also In re Lindsay, 98 B.R. 983 (Bankr. S.D. Cal. 1989). In Lindsay, the United States Bankruptcy Court for the Southern District of California adopted the General Industries commercial reasonableness standard. Id. Lindsay involved a fraudulent transfer attack upon a Texas real estate foreclosure for 64% of the fair market value. Id. at 992. Finding ambiguity in Ninth Circuit law, the court adopted a commercial reasonableness standard that "examine[s] the price obtained at a foreclosure sale only when we are persuaded that the foreclosing creditor failed to take commercially reasonable efforts to achieve the best price." Id. at 990. The court utilized a three part inquiry:

(1) whether the foreclosure sale was properly conducted; (2) whether the totality of the circumstance indicate that commercially reasonable steps were taken to achieve the best price at the foreclosure; and (3) whether a lack of commercial reasonableness had a negative effect of the price achieved.
III. BFP AND THE IRREBUTTABLE PRESUMPTION RULE

A. BFP v. Resolution Trust Corp.

In 1994, in *BFP v. Resolution Trust Corp.*, the Supreme Court rejected the use of fraudulent conveyance law to set aside a foreclosure sale. The Court adopted the Ninth Circuit’s reasoning in *Madrid*. In *BFP*, the Chapter 11 debtor petitioned the United States Bankruptcy Court for the Central District of California to set aside a prepetition foreclosure sale of a beachfront estate. The property, worth in excess of $725,000, was sold at a nonjudicial foreclosure sale to a third-party purchaser for $433,000, or approximately sixty percent of the fair market value. The Court concluded that the price received at a noncollusive, regularly conducted foreclosure sale irrefutably constitutes...
reasonably equivalent value.\textsuperscript{104}

The Court could not locate a clear definition of "reasonably equivalent value" within the Code and therefore, deferred to state law.\textsuperscript{105} The majority considered three possible interpretations of "reasonably equivalent value": fair market value, reasonable forced-sale price, and foreclosure sale price.\textsuperscript{106} Ultimately, the Court defined "reasonably equivalent value" as the price actually received at the foreclosure sale.\textsuperscript{107} The Court reasoned that a per se validity rule avoids judicial interference with state regulation and inappropriate judicial policy determinations.\textsuperscript{108} Further, the Court determined that granting an irrebuttable presumption prevents judicial disruption of stable and secure real property titles.\textsuperscript{109}

The Court rejected fair market value because it "has no applicability in the forced sale context."\textsuperscript{110} It further asserted that fair market value cannot be the standard in the foreclosure sale context because of the "strictures of state-prescribed foreclosure."\textsuperscript{111} The Court also rejected the reasonable foreclosure sale price proffered in Bundles, because defining "reasonable" would require policy judgments that would inappropriately extend federal bankruptcy law into an area of state regulation.\textsuperscript{112}

Finally, the Court suggested that its holding did not render § 548 superfluous.\textsuperscript{113} The majority asserted that reasonably equivalent value "will continue to have independent meaning (ordinarily a meaning similar to fair market value) outside the foreclosure context."\textsuperscript{114} The Court explained that its interpretation of reasonably equivalent value only applies to real estate foreclosures, indicating that "considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different."\textsuperscript{115} The Court asserted that such a legal interpretation did not create two different and inconsistent meanings or carve out a foreclosure

\textsuperscript{104}\hspace{1em} 114 S. Ct. at 1765.
\textsuperscript{105}\hspace{1em} Id. at 1766.
\textsuperscript{106}\hspace{1em} Id.
\textsuperscript{107}\hspace{1em} Id. at 1767. The Court emphasized that "[a]ny irregularity . . . 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)." Id. at 1765.
\textsuperscript{108}\hspace{1em} Id. at 1761-62.
\textsuperscript{109}\hspace{1em} Id. at 1758.
\textsuperscript{110}\hspace{1em} Id. at 1761.
\textsuperscript{111}\hspace{1em} Id. at 1762.
\textsuperscript{112}\hspace{1em} Id.
\textsuperscript{113}\hspace{1em} Id.
\textsuperscript{114}\hspace{1em} Id. at 1765 (emphasis added).
\textsuperscript{115}\hspace{1em} Id. at 1761 n.3.
sale exception to § 548.\textsuperscript{116} The Court reasoned that the real estate foreclosure construct has "altered reality," replacing the rules of free-market exchange with more restrictive rules governing state foreclosure sales.\textsuperscript{117}

B. Analysis

The majority's logic alters reality. The Court asserts that it is not creating a real estate foreclosure sale exception, but that is exactly what it has done. Creating a distinct legal interpretation of "reasonably equivalent value" in the foreclosure context is judicial innovation at its worst.\textsuperscript{118} \textit{BFP}'s holding creates a "foreclosure-sale exemption" to the trustee's avoidance powers in derogation of congressional intent.\textsuperscript{119} Further, \textit{BFP} renders § 548(a)(2)(A) superfluous and restricts the bankruptcy courts' review to a checklist of state foreclosure procedure.\textsuperscript{120}

Furthermore, the Court uses circular logic. First, the Court determined that state foreclosure processes do not yield fair market value and therefore, bankruptcy courts should just defer to such inadequacy.\textsuperscript{121} Second, the Court implies that because § 548 interferes with state property law, this provision should be excised from the Code. Third, the Court found that § 548 interferes with secure title to real property and thus, determined that

\begin{itemize}
\item \textsuperscript{116} 114 S. Ct. at 1767.
\item \textsuperscript{117} Id.
\item \textsuperscript{118} Id. at 1771 (citing Bray v. Alexandria Women's Health Clinic, 113 S. Ct. 753, 765 (1993)). The dissent notes the "common rule of construction calls for a single definition of a common term occurring in several places within a statute." Id. Appalled by the majority's novel statutory interpretation, Justice Souter declared that "to give a single term two different and inconsistent meanings (one procedural, one substantive) for a single occurrence is an offense so unlikely that no common prohibition has ever been thought necessary to guard against it." Id.
\item \textsuperscript{119} For a discussion of § 548's development, see \textit{supra} notes 22-33, 60-67 and accompanying text.
\item \textsuperscript{120} The United States Bankruptcy Court for the Eastern District of New York recently applied \textit{BFP} in \textit{In re Barr}, 170 B.R. 772 (Bankr. E.D.N.Y. 1994). In \textit{Barr}, a foreclosing lender purchased land worth approximately $156,000 for a bid of approximately $72,000, including assumed mortgages. Id. at 773-74. The court did not analyze the sale pursuant to § 548. Instead, citing \textit{BFP}, the court reasoned that "the disposition of the case depends on whether the foreclosure sale sub judice was accordant procedurally and substantively with applicable South Carolina state foreclosure law." Id. at 776. The Bankruptcy Court concluded that under South Carolina law, "inadequacy of price was not so gross as to shock the conscience." Id. at 777 (citation omitted).
\item \textit{Barr} exemplifies \textit{BFP}'s impact on § 548. If the debtor had brought a state court action, the court's analysis would not differ. \textit{BFP} completely guts § 548(a)(2)(A). The courts are now powerless to review cases such as \textit{Barr}.
\item Furthermore, the state standard of price inadequacy—"so gross as to shock the conscience"—is not even analogous to the concept of reasonably equivalent value. See \textit{supra} note 20. Equating the two is absurd.
\item \textsuperscript{121} \textit{BFP}, 114 S. Ct. at 1765-66.
\end{itemize}
it should not be applied to real property transfers.\textsuperscript{122}

Having identified tensions between bankruptcy and state law, the Court errs by following state law without any deference to federal policy or the Code's straightforward import. In carving out an exception for real property foreclosures, the majority suggests that "the 'important' policy favoring security of title should count more and the 'important' bankruptcy policies should count less."\textsuperscript{123} This rationale is illogical and unprecedented. The majority circumvents the statute's straightforward language\textsuperscript{124} to the benefit of the mortgage lending community and the real estate bar.

The majority criticizes the use of fraudulent conveyance law in the foreclosure sale context as a radical interference with state regulation.\textsuperscript{125} However, such interference is not uncommon or inappropriate.\textsuperscript{126} For example, the Code commonly interferes with state regulation of tort law and criminal restitution.\textsuperscript{127} Similarly, the Code permits the TIB to set aside transfers consummated within ninety days of filing as preferential transfers.\textsuperscript{128} Yet, the Court has not carved out an exception for preferential transfers. Interference with state interests constitutes an essential component of the bankruptcy system—allowing the TIB to recapture improvidently transferred assets for the benefit of the estate.\textsuperscript{129}

\textsuperscript{122} 114 S. Ct. at 1758.
\textsuperscript{123} Id. at 1777 (Souter, J., dissenting opinion).
\textsuperscript{124} Id. at 1766-67. In fact, Justice Scalia interprets "reasonably equivalent value" as ambiguous language. Id. at 1766. However, Scalia engrafts policy issues upon the statute before analyzing the language. He argues that the "highly generalized reformulation of the 'plain meaning' of reasonably equivalent value" continues to leave unanswered the one question central to this case, wherein the ambiguity lies: \textit{What is the foreclosed property worth?} Id. (emphasis added). Scalia recognizes that fair market value is the widely accepted benchmark for determining reasonably equivalent value, but he refuses to apply it to real property foreclosures. Under § 548, it is clear that the value of foreclosed property equals fair market value. Scalia's argument constitutes artful dodging rather than sound legal reasoning.
\textsuperscript{125} Id. at 1766-67.
\textsuperscript{126} The dissent indicates that "[the Court has], on many prior occasions, refused to depart from plain Code meaning in spite of arguments that doing so would vindicate ... equally 'important' state interests." Id. at 1776 (citations omitted).
\textsuperscript{127} See, e.g., \textit{In re Hartley}, 869 F.2d 394, 395 (8th Cir. 1989) (discharging debtor's state law intentional tort judgment); Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 564 (discharging Chapter 13 debtor's criminal restitution for welfare fraud); \textit{see also BFP}, 114 S. Ct. at 1777 (Souter, J., dissenting) (noting how federal bankruptcy law already preempts state domestic relations law by allowing TIBs to set aside transfers by marital dissolution decree).
\textsuperscript{128} Under § 547 of the Code, the TIB may avoid preferential transfers incurred by the debtor within 90 days of her bankruptcy filing. 11 U.S.C. § 547(b)(4)(A) (1993). For a discussion of the TIB avoidance powers, see supra note 10.
\textsuperscript{129} For a discussion of the TIB avoidance powers, see supra note 10.
The *BFP* decision shifts the emphasis away from preservation of the bankruptcy estate, and forces rigid adherence to state foreclosure law, which is outdated, ineffective and overly formalistic.\textsuperscript{130} *BFP* equates reasonably equivalent value with state fraudulent conveyance standards, which require only that the price be "so gross as to shock the conscience."\textsuperscript{131} It is absurd to equate these standards.

Blind deference to state procedure prevents equal distribution of the estate as mandated by the Code.\textsuperscript{132} By granting procedural compliance per se validity, the Court engrafts a good faith presumption upon the foreclosing mortgagee in direct opposition to the purpose of § 548.\textsuperscript{133} *BFP* deprives the bankruptcy estate, junior lienors, and unsecured creditors of the value of the foreclosed property and effectively legalizes constructively fraudulent transfers.

**IV. PROPOSALS**

The judicial legalization of constructively fraudulent conveyances is a victory for the mortgage lending community. Although bothered by the absence of "clearer textual guidance" on what constitutes reasonably equivalent value, the *BFP* Court crafted a foreclosure sale exception supported solely by policy arguments.\textsuperscript{134} Nothing in § 548(a) or its legislative history supports the outcome in *BFP*.\textsuperscript{135} Nor does the Code require compliance with state law.\textsuperscript{136} In fact, Congress explicitly rejected the irrebuttable presumption rule during the 1984 BAFJA debates.\textsuperscript{137} The *BFP* dissent aptly noted that "Congress, and not this Court, is the

\textsuperscript{130} For a discussion of the structural inadequacies of state foreclosure law, see *supra* note 18.

\textsuperscript{131} *BFP*, 114 S. Ct. at 1775 n.16 (citations omitted). The majority discusses "black letter" state foreclosure law, stating:

When these [state] procedures have been followed, however, it is "black letter" law that mere inadequacy of the foreclosure price is no basis for setting the sale aside, though it may be set aside (under state foreclosure law, rather than fraudulent transfer law) if the price is so low as to "shock the conscience or raise a presumption of fraud or unfairness."

*Id.* at 1763-64 (citations omitted).

\textsuperscript{132} For a discussion of the bankruptcy goal of equitable distribution, see *supra* note 7.

\textsuperscript{133} For a discussion of the removal of the good faith requirement, see *supra* note 29 and accompanying text.

\textsuperscript{134} *BFP*, 114 S. Ct. at 1764.

\textsuperscript{135} For the text of § 548(a), see *supra* note 5. For a discussion of § 548's legislative history, see *supra* notes 22-33, 60-67 and accompanying text.

\textsuperscript{136} See Bundles v. Baker, 856 F.2d at 821.

\textsuperscript{137} For a discussion of the impact of BAFJA on the *Durrett/Madrid* conflict, see *supra* notes 61-68 and accompanying text.
Application of BFP clarifies the need for a legislative response to this statutory derogation. Suppose you are counsel representing a junior lienor, Second National Bank ("SNB"), on the commercial real estate discussed at the outset of this Note. The fair market value of the property is one million dollars. SNB holds a $50,000 second mortgage on the property. ONB is foreclosing the first mortgage of $500,000 in a judicial sale conducted under state law.

At the properly conducted public sale, ONB is the high bidder and purchases the property for $500,000. The sale discharges all subsequent liens including SNB’s second mortgage. One month later, ONB resells the asset under commercially reasonable terms for one million dollars and captures $500,000 of the debtor’s equity. May SNB challenge the adequacy of the sale?

Under BFP, so long as ONB complies with state law governing the foreclosure procedure, SNB is powerless to upset the sale. BFP renders bankruptcy courts powerless to review the sale process and equates reasonably equivalent value with the price actually received. Ultimately, ONB pockets $500,000 of equity as a windfall, and SNB, as well as the estate, receives nothing.

To prevent such estate depletions, Congress should amend § 548 to allow bankruptcy courts to review foreclosure sale transfers. Congress should create a definition of reasonably equivalent value that establishes fair market value as the benchmark, without designating a percentile cut-off, as in Durrett.

In order to apply this definition of reasonably equivalent value, Congress

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138. BFP, 114 S. Ct. at 1777.

139. Conceivably, SNB could bring a state action. However, under state law, price inadequacy alone is not sufficient to void a sale. Absent other factors, SNB would not prevail. See supra note 18 (setting forth the state avoidance standards).

140. Durrett v. Washington Nat’l Ins. Co., 621 F.2d 203 (5th Cir. 1980). See also William H. Henning, An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications, 63 N.C. L. REV. 257 (1985). Written immediately after Madrid and BAFJA, Professor Henning’s proposal stands alone in its support of Durrett. Henning encourages parties to use fraudulent conveyance law to set aside inadequate real property foreclosure sales. Id. at 284-85. However, Henning opposes the 70% benchmark. Id. at 285. Henning proposes significant limitations on Durrett’s application, such as: a three month rather than the one year avoidance period; a nine month statute of limitations; limited monetary rewards; a provision protecting good faith purchasers of residential property; and a prohibition on the recovery of collateral from parties other than the secured lender. Id.
should include a provision incorporating the Bundles case-by-case rule. 141

The rule should require bankruptcy courts to conduct evidentiary hearings on prepetition foreclosures when a transfer deprives the bankruptcy estate of the approximate fair market value.

Incorporating the rationale of General Industries, 142 courts should measure such deprivation by analyzing the sale process and the diminution of the debtor’s equity. The fact-specific test for reasonably equivalent value should be whether or not the foreclosing lender took commercially reasonable 143 steps to preserve the debtor’s equity in the property.

Alternatively, courts should narrowly construe BFP. BFP should only apply where there is a third party purchaser or a bona fide purchaser for value. Where the foreclosing lender is also the purchaser, there should be a higher level of judicial scrutiny. At most, foreclosing lenders should be given a rebuttable presumption of reasonably equivalent value. 144

Finally, BFP should be limited to real estate foreclosures. 145 Courts

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141. Bundles, 856 F.2d at 824. See also supra notes 73-88 and accompanying text (discussing Bundles).

142. See supra notes 90-95 and accompanying text (discussing the commercial reasonableness standard).

143. Section 9-504(3) of the Uniform Commercial Code (“UCC”) requires that a secured party dispose of collateral in a “commercially reasonable” manner. U.C.C. § 9-504(3) (1993). However, the UCC does not define “commercially reasonable,” acknowledging that such an issue is fact specific. Id. at § 9-504(3) (c. 1).

144. Alden, supra note 47, at 1624. In his analysis of Durrett, Alden concluded: “In order to harmonize the distinct policies underlying foreclosure and fraudulent conveyance laws, the courts should consider awarding an irrebuttable presumption of reasonably equivalent value to a third-party purchaser while granting no more than a rebuttable presumption to the mortgagee which bids in its debt.” Id.

145. Despite the argument that bankruptcy law should not interfere with the Uniform Commercial Code, many courts have applied the § 548 analysis to foreclosures of personal property under U.C.C. § 9-504. See Covey v. Commercial Nat’l Bank, 960 F.2d 657, 663 (7th Cir. 1992) (rejecting a Chapter 7 ‘‘§ 548(a)(2) challenge to the fraudulent conveyance of a collections guarantee); In re Jeffrey Bigelow Design Group, 956 F.2d 479, 485 (4th Cir. 1992) (applying a depletion-of-the-estate test to payments fraudulently conveyed under a line of credit); In re Morris Communications, 914 F.2d 458, 424-45 (4th Cir. 1990) (challenging allegedly fraudulent transfer of stock in partnership); In re Roco Corp., 701 F.2d 978, 984-85 (1st Cir. 1983) (challenging redemption of corporate stock and note given as a security interest in a constructively fraudulent conveyance); In re Royal Coach Country, 125 B.R. 668, 674 (Bankr. M.D. Fla. 1991) (setting aside foreclosure of a used car for less than reasonably equivalent value, which the court equated with fair market value in the used car market); In re Corp. Jct. Aviation, 57 B.R. 195, 197 (Bankr. N.D. Ga. 1986) (rejecting application of Durrett in stock sale); In re Join-in Int’l, 66 B.R. 555, 560 (Bankr. S.D.N.Y. 1986) (applying a reasonableness test to the bulk transfer of inventory challenged as a fraudulent conveyance).

Similar policy arguments can be made for the application of BFP to personal property sales under Article Nine of the UCC. Henning, supra note 140, at 278. However, the majority specifically limits BFP to real property foreclosures. BFP, 114 S. Ct. at 1765. See also supra note 112 and accompanying text. One court followed this limiting language. In re Pajaro Dunes Rental Agency, 1994 WL 575445
applying a per se validity rule to the foreclosure of personal property would further derogate congressional intent by creating another judicial exception where no statutory distinction exists. Under § 548 courts should continue to review personal property foreclosures that fail to yield reasonably equivalent value.146

Under the first proposed amendment, the junior lienor in our hypothetical, SNB, could challenge the adequacy of the foreclosure sale. The bankruptcy court would conduct an evidentiary hearing to determine whether the parties conducted the sale in a commercially reasonable manner. If the court determines the sale was not commercially reasonable, ONB would be forced to reconduct the foreclosure sale, obtain a sale price reasonably equivalent to the fair market value, and allow the bankruptcy estate to recapture the surplus equity.

Under the second proposal, a narrow interpretation of BFP, SNB could still challenge the sale’s adequacy because ONB is the foreclosing lender and the purchaser. The court would only grant a rebuttable presumption of equivalent value. Thus, ONB would have the burden of proving the sale was commercially reasonable.

However, the second proposal does not rectify price inadequacies when a bona fide third party purchases the property. Further, administering the implementation of a narrow judicial interpretation would be much more difficult. For these reasons, a congressional amendment is the best solution to the BFP problem.

The proposed amendments provide the bankruptcy court with flexibility to determine when circumstances require review of state procedures. Not

(Bankr. N.D. Cal. 1994). In Pajaro Dunes, the United States Bankruptcy Court for the Northern District of California refused to apply BFP to a Chapter 11 debtor's challenge to the satisfaction of a $1 million note for $541,895.55. Id. at 30. The court recognized that "neither the majority nor the dissent [in BFP] outlined any benchmarks ... as to what [reasonably equivalent value] should normally be." Id. at 30. However, the court concluded that it need not choose between the Durrett Rule or the Bundies Rule because under either rule "PDRA's receipt of $541,895.55 in value in return for its one million dollar obligation ... would not be held as reasonably equivalent." Id.

Pajaro Dunes exemplifies the inconsistencies in BFP. Why should courts scrutinize real property foreclosures less stringently than personalty foreclosures? Why is reasonably equivalent value not applicable inside the foreclosure context? The majority fails to answer these questions.

146. One commentator argues that because "personal property sold in a commercially reasonable manner obtains reasonably equivalent value with no more certainty than real property sold in accordance with state foreclosure laws, sales pursuant to U.C.C. section 9-504 should be no less subject to scrutiny under section 548 of the Bankruptcy Code." Alden, supra note 47, at 1624.
all state foreclosure statutes are inadequate. Not all sales necessitate review. However, when state law is particularly deficient, judicial intervention by the federal bankruptcy courts is appropriate.

Further, given the diverse nature of real property, the case-by-case evidentiary review is essential. In order to determine whether the procedure was commercially reasonable, the courts must examine the unique characteristics of the collateral. Courts should consider factors such as use, location, and surrounding market. Additionally, an evidentiary hearing is necessary to preserve the assets of the estate.

The proposed amendments to § 548 rectify state law inadequacies where necessary. Section 548’s purpose is not to preempt state procedure or to impose federal reform of the state foreclosure system. The structural deficiencies in the state foreclosure system will not be solved via federal bankruptcy law. However, the proposed amendments provide a means for challenging those sales which comply with state procedure but contradict federal bankruptcy policy.

V. CONCLUSION

BFP legalizes constructively fraudulent conveyances, leaving the bankruptcy courts powerless to preserve the assets of the estate from over-zealous creditors. The use of fraudulent transfer law to set aside irregular foreclosure sales furthers federal bankruptcy policy. If state foreclosure laws are so inadequate as to “alter[] reality,” the courts must be allowed to review and set aside such transfers. Bankruptcy courts must be allowed to review foreclosure sales when such sales result in an unjust diminution of the bankruptcy estate. Congress did not intend to allow mortgagees to purchase palaces (valuable real estate) for a “peppercorn.” Adoption of these amendments will resurrect § 548(a)(2)(A), allowing TIBs, unsecured creditors, and debtors to recapture equity lost to the improvident state foreclosure process.

147. See Woodruff, supra note 97, at 798. Woodruff suggests that the Illinois foreclosure procedures, modeled after the Uniform Land Transaction Act, adequately address the common deficiencies of the state system. Id.

148. See supra notes 26-65 and accompanying text (discussing federal bankruptcy policy).

149. BFP, 114 S. Ct. at 1767. Justice Scalia notes that “[u]nlike most other legal restrictions, however, foreclosure has the effect of completely redefining the market.” He then concludes that “[g]iven 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 . . . is the foreclosure sale price itself.” Id. (emphasis added).

150. Id. at 1767. See supra note 19.
By amending the Code to define reasonably equivalent value as proposed in Part IV, Congress would provide TIBs with a useful tool to preserve the assets of the estate. Allowing the bankruptcy courts to review and set aside state foreclosures via federal fraudulent transfer law is an effective and beneficial method of ensuring the equitable distribution of the debtor’s assets.

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