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Reestablishment of Bankruptcy Review of Oppressive Foreclosure Sales: The Interaction of Avoidance Powers as Applied to Creditor Bid-ins

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REESTABLISHMENT OF BANKRUPTCY REVIEW OF OPPRESSIVE FORECLOSURE SALES: THE INTERACTION OF AVOIDANCE POWERS AS APPLIED TO CREDITOR BID-INS

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I. INTRODUCTION

Real property foreclosures and the Bankruptcy Code make strange bedfellows. Despite 400 years of relatively peaceful coexistence between insolvency law and foreclosure law, the last two decades have witnessed the emergence of a tumultuous relationship.[1] The constant ebb and flow of each body of law has resulted in uncertainty regarding the bankruptcy impact on real property foreclosures.

Prior to the United States Supreme Court's opinion in *BFP v. Resolution Trust Corp.*,[2] circuit courts disagreed on whether a real property foreclosure constituted a fraudulent transfer.[3] This divisiveness may be traced to the Fifth Circuit's decision in *Durrett v. Washington National Insurance Co.*[4] In *Durrett* the Fifth Circuit held that a bid price less than seventy percent of the property's fair market value subjected the foreclosure sale to avoidance under § 548(a)(2) of the Bankruptcy Code.[5] In *BFP* the Supreme Court rejected the *Durrett* rule and held that the consideration received at a noncollusive, regularly conducted real estate foreclosure sale constituted a "reasonably equivalent value" under § 548(a)(2)(A) of the Bankruptcy Code as a matter of law.[6]

Despite the Court's pronouncement that a regularly conducted real

1. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) (resolving a split in the appellate courts over whether real property foreclosures constitute fraudulent transfers).

2. *Id.*

3. *See* Bundles v. Baker (*In re* Bundles), 856 F.2d 815 (7th Cir. 1988); Lawyers Title Ins. Corp. v. Madrid (*In re* Madrid), 21 B.R. 424 (B.A.P. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir. 1984); Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980).

4. 621 F.2d 201 (5th Cir. 1980); *see also* Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547, 548-49 (5th Cir. 1981) (following *Durrett* in examining a foreclosure sale as a possible fraudulent transfer).

5. 621 F.2d at 202-03.

6. *BFP*, 511 U.S. at 545. *But cf.* Basil H. Mattingly, *The Shift From Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77, 92-95 (1996) (noting that because foreclosure sales do not produce competitive bidding, the sale often results in inadequate sale proceeds).

property foreclosure does not constitute a fraudulent transfer,[7] an uneasy coexistence between the Bankruptcy Code and real property foreclosures continues. Specifically, *BFP* did not address the argument that unreasonable creditor bid-ins at a foreclosure sale may constitute a voidable preference under § 547 of the Bankruptcy Code.[8] This Article confronts this troubling issue and discusses whether the Supreme Court's reasoning in *BFP* precludes relief under § 547 of the Bankruptcy Code. After dispatching the Court's specious reasoning in *BFP*, this Article isolates the actual reasoning behind the holding—protection of good title to real estate from a potential fraudulent transfer cloud. The Article then shows that the Court's fear regarding any bankruptcy cloud on title was unfounded—buyers of real estate and title insurance companies had adjusted quite well to the *Durrett* rule.

The *BFP* Court's rejection of the *Durrett* rule deprived bankruptcy trustees of a potent mechanism to recover certain transfers of value for the estate to be

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7. Although no longer subject to traditional fraudulent transfer attack under § 548 of the Bankruptcy Code, a trustee may still challenge sales under an array of vehicles. *See* Debra Pogrund Stark, *The Emperor Still Has Clothes: Fraudulent Conveyance Challenges After the* BFP *Decision*, 47 S.C. L. REV. 563 (1996).

8. Section 547(b) of the Bankruptcy Code reads as follows:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
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> (1) to or for the benefit of a creditor;
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> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
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> (3) made while the debtor was insolvent;
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> (4) made—
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> (A) on or within 90 days before the date of the filing of the petition; or
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> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if—
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> (A) the case were a case under chapter 7 of this title
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (1994).

distributed among all the debtor's creditors.[9] Prior to *Durrett*, there were a sprinkling of decisions in which real property foreclosures were avoided on the basis of preferential transfer law.[10] One would expect that the rejection of *Durrett* would increase the use of § 547 of the Bankruptcy Code to challenge real property foreclosures as preferential transfers. However, an empirical examination of the real property foreclosure cases decided after *BFP* reveals only a few attacks on real property foreclosures based on § 547.[11] This Article examines the implications of these results. At bottom, this Article recognizes that conventional wisdom strongly suggests that a foreclosure sale is not subject to an avoidance action under § 547. Nonetheless, conventional wisdom gets it wrong. Compelling policy reasons and the actual language of § 547 join in condemning unreasonable creditor bid-ins.

Part I of this Article introduces the difficult issues posed by the application of fraudulent transfer law to real property foreclosures. In order to provide a proper backdrop to the issues posed by unreasonable creditor bid-ins at real property foreclosure sales, the Article examines the law on constructive fraudulent transfers[12] up to the Supreme Court's pronouncement in *BFP*. Part I concludes with an examination of the historic role of fraudulent transfer law and the application of § 548 of the Bankruptcy Code in the context of real property foreclosures.[13]

Part II sets forth the elements of an avoidable preference under § 547 of the Bankruptcy Code as those elements relate to creditor bid-ins. Part II concludes with a discussion centered on the conceptual interface between §§ 548 and 547 in the context of real property foreclosures.

Part III of this Article begins with a discussion of the problems and anomalies that arise in applying provisions of the Bankruptcy Code to real property foreclosures. Part III provides several permutations of the creditor bid-in scenario to set the stage for a preference attack. Part III also pushes the traditional legal models in an attempt to expose inconsistencies and weaknesses.

Part IV confronts the application of avoidable preference law to

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9. *See id.* §§ 550, 551 (granting the trustee the power to recover fraudulently transferred property); *see also id.* § 1107 (granting the debtor-in-possession most of the same powers allowed to the trustee).

10. *See* Winters v. First Union Nat'l Bank (*In re* Winters), 119 B.R. 283, 285 (Bankr. M.D. Fla. 1990); Park North Partners, Ltd. v. Park North Assocs. (*In re* Park North Partners, Ltd.), 85 B.R. 916, 918-19 (Bankr. N.D. Ga. 1988); Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 B.R. 818, 820-22 (Bankr. N.D. Ala. 1983).

11. *See* Cottrell v. United States (*In re* Cottrell), 213 B.R. 33, 43-44 (Bankr. M.D. Ala. 1997) (rejecting § 547(b) challenge where mortgagee acquired home at foreclosure for a bid amount that was 64.7% of the value alleged by debtor/mortgagor); O'Neill v. Dell (*In re* O'Neill), 204 B.R. 881, 891-93 (Bankr. E.D. Pa. 1997) (rejecting 547(b) challenge of foreclosure sale to third party.)

12. 11 U.S.C. § 548(a)(2)(A).

13. For an analysis of the historic role of fraudulent transfers, see Jack F. Williams, *Revisiting the Proper Limits of Fraudulent Transfer Law*, 8 BANKR. DEVS. J. 55 (1991).

foreclosures. It begins with a critical examination of present authorities, seeking to isolate several common themes embraced in both upholding and condemning real property foreclosures under § 547 of the Bankruptcy Code. It addresses the nuances and reasons why the interface of bankruptcy law and foreclosure law is so troubling. Furthermore, Part IV constructs a model of §§ 548 and 547 as applied to real property foreclosures that is rooted in tradition and in the language of the relevant provisions. Part IV concludes that the language of § 547(b)(5) strongly supports cases holding that unreasonable creditor bid-ins may constitute avoidable preferences. Nonetheless, the concern of the Court in *BFP* with the protection of good title in real property foreclosures may ultimately edge out the policy historically embodied in fraudulent transfer law of capturing value for the benefit of creditors. Consequently, it appears that the neglect of preference attacks on unreasonable creditor bid-ins uncovered by the empirical work reported in this Article may be nothing more than the trustees' interpretation of the Supreme Court's view on the subject.

II. FRAUDULENT TRANSFER LAW AS APPLIED TO REAL PROPERTY FORECLOSURES

Modern real property foreclosure law has been developed with several objectives in mind. Initially, the foreclosure sale was designed to produce an effective means of transferring title to real property from the defaulted debtor to the secured creditor.[14] This procedure theoretically keeps financing costs lower, increases the availability of funds for borrowers, and preserves good title to real property.[15]

Modern fraudulent transfer law, as incorporated in the Bankruptcy Code, developed from the English law of fraudulent conveyances dating back to a 1570 statute enacted by the Parliament of Queen Elizabeth I.[16] The purpose of fraudulent transfer (or conveyance) law was "to prevent the debtor from taking deliberate action to hinder, delay, or defraud his creditors."[17] However, American adaptation of this law in the Bankruptcy Code extended its reach "to cases where the objective result of the transaction is detrimental to creditors, whether or not the debtor actually intended such detriment."[18] The statute was passed for the protection of creditors and gave them, among other things, the power to avoid conveyances and transfers made with the intent to hinder, delay, or defraud creditors. The American codification of this bankruptcy law was set

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14. Mattingly, *supra* note 6, at 91 & n.66.

15. *Id.* at 80.

16. *See* 4 COLLIER ON BANKRUPTCY ¶ 67.29[1], at 471 (James Wm. Moore et al. eds., 14th ed. 1975); 4 HAROLD REMINGTON, A TREATISE ON THE BANKRUPTCY LAW OF THE UNITED STATES § 1638, at 110 (1957).

17. Stephen M. Alden et al., *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the* Durrett *Problem*, 38 BUS. LAW. 1605, 1605 (1983).

18. *Id.* at 1605-06.

forth in the Bankruptcy Act of 1898.[19] A review of section 67(e) of the 1898 Act demonstrates that it dealt only with conveyances made with actual intent to defraud.[20] The 1938 Act expanded the law of fraudulent conveyances by creating constructive fraudulent conveyances.[21] This expansion permitted the setting aside of conveyances made by a debtor without fair consideration, regardless of the debtor's actual intent.[22]

Historically, real property foreclosures and fraudulent transfer law were like two ships passing in the night. These venerable bodies of law developed without much overlap or consideration of each other's rationales. Therefore, it is not surprising that when the two bodies of law did meet, the collision produced considerable turbulence. The tension points between fraudulent transfer law and real property foreclosures are outlined below.

A. Fraudulent Transfer Law: Introduction

Sections 548(a) and 544(b) (which incorporate state fraudulent transfer law) of the Bankruptcy Code recognize the power of a trustee to challenge transfers made as fraudulent.[23] Section 548(a) provides:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
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> (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (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;

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19. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1938).

20. *Id.* at Stat. 564-65.

21. Chandler Act, ch. 575, § 67d(2), 52 Stat. 840, 877 (1938) (repealed 1978).

22. *Id.* § 67d(2)(a)-(c). The Chandler Act of 1938 replaced § 67e of the 1898 Act with § 67d.

23. Pursuant to § 544(b) of the Bankruptcy Code, the trustee can avoid any transfer made by the debtor that an unsecured creditor with an allowable claim could avoid under state fraudulent transfer law. *See, e.g., In re* Massey, 225 B.R. 887, 890 (Bankr. E.D. Va. 1998); Williams, *supra* note 13, at 57.

(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.[24]

Section 548 gives a trustee the power to avoid fraudulent transfers done with either actual or constructive fraudulent intent. The fraudulent transfer is a limitation on the creditor's right to realize upon the available assets of its debtor: "The law imposes a substantive prohibition—the debtor may not dispose of its property with the intent, actual or implied by law, of placing the property beyond the reach of its creditors."[25]

Although most authorities agree that one of the fundamental thrusts of fraudulent transfer law is to preserve the value of the debtor's estate for the benefit of creditors, authorities disagree about where the proper limits of fraudulent transfer law should be drawn.[26]

To make out a successful § 548(a)(2) claim, a trustee must prove the following elements: (1) a transfer[27] to the defendant of (2) an interest in property of the debtor[28] (3) during the year preceding the filing of the petition in bankruptcy[29] (4) without reasonably equivalent value[30] in exchange for such

24. Bankruptcy Code, 11 U.S.C. § 548(a) (1994).

25. Williams, *supra* note 13, at 58-59.

26. *See, e.g.*, Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 835 (1985); David Gray Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. 643, 645 (1987); Frank R. Kennedy, *The Uniform Fraudulent Transfer Act*, 18 UCC L.J. 195 (1986); Paul M. Shupack, *Confusion in Policy and Language in the Uniform Fraudulent Transfer Act*, 9 CARDOZO L. REV. 811 (1987); Williams, *supra* note 13, at 59; Jack F. Williams, *The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System*, 15 CARDOZO L. REV. 1403, 1457-62 (1994).

27. *See* 11 U.S.C. § 101(54) (defining the word "transfer"); *see also infra* Part I.A.1.

28. "Interest of the debtor in property" is not defined in the Bankruptcy Code. Though this is a question of federal law, the courts will consult state law in determining whether this element is satisfied. 1A Bankr. Service, Laws. Edition (West Publ'g Co.) § 5D:12, at 19 & n.1 (1990). The property requirement enjoys a broad scope and is generally construed in light of the purposes of fraudulent transfer law. Generally, the transfer must have depleted the debtor's estate. *Id.* § 5D:12, at 19-20 & n.2.

29. The date of the filing of the petition in bankruptcy is the timing reference under § 548. *See* Emerson v. Maples (*In re* Benskin & Co.), 161 B.R. 644, 650-51 (Bankr. W.D. Tenn. 1993); Bluford v. First Fidelity Mortgage Co. (*In re* Bluford), 40 B.R. 640, 644 (Bankr. W.D. Mo. 1984).

30. The Bankruptcy Act of 1898 used the phrase "fair consideration." It included a requirement of good faith that no longer exists under § 548(a)(2) or §§ 4 and 5 of the UFTA. *See* Carr v. DeMusis (*In re* Carr), 34 B.R. 653, 656 (Bankr. D. Conn. 1983).

transfer (5) while the debtor was insolvent.[31] Two elements—the timing of the transfer and the presence of reasonably equivalent value—are directly at play in the real property foreclosure context.

1. Definition of "Transfer"

Transfer is broadly defined in § 101(54) of the Bankruptcy Code to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."[32] However, the section does not fix the time a transfer takes place; rather, the time when a transfer is deemed made for purposes of fraudulent transfer actions depends on § 548(d)(1) of the Bankruptcy Code and applicable state law. Section 548(d)(1) states:

> For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.[33]

Consequently, under § 548 the fraudulent transfer is deemed to have occurred when the transfer became valid against a subsequent bona fide purchaser pursuant to applicable state law.[34] In the event the transfer is not perfected against a bona fide purchaser before the filing of the petition, the transfer is deemed to have occurred immediately before the date of the filing.[35] Section 548(d)(1) serves two purposes: first, it establishes the time of perfection as an objective point in computing the reach-back period of the trustee, and second, it discourages secret, unperfected liens.[36]

The following example shows several stages in the typical real estate

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31. *See, e.g.*, Murphy v. General Elec. Credit (*In re* Duque Rodriguez), 77 B.R. 939, 940 (Bankr. S.D. Fla. 1987).

32. 11 U.S.C. § 101(54).

33. *Id.* § 548(d)(1).

34. *See* Sandoz v. Bennett (*In re* Emerald Oil Co.), 807 F.2d 1234, 1237 (5th Cir. 1987); Madrid v. Lawyers Title Ins. Corp. (*In re* Madrid), 725 F.2d 1197, 1200 (9th Cir. 1984); Gennet v. Docktor (*In re* Levy), 185 B.R. 378, 382 (Bankr. S.D. Fla. 1995).

35. *See, e.g.*, Brown v. Vanguard Holding Corp. (*In re* Brown), 104 B.R. 609, 613 (Bankr. S.D.N.Y. 1989); Schatzman v. Campo (*In re* Oesterle), 2 B.R. 122, 124 (Bankr. S.D. Fla. 1979).

36. *See Madrid*, 725 F.2d at 1200; Nemeti v. Seaway Nat'l Bank (*In re* Nemeti), 65 B.R. 391, 395 (Bankr. N.D.N.Y. 1986); *see also* 4 COLLIER ON BANKRUPTCY ¶ 548.01-04 (Lawrence P. King et al. eds., 15th ed. 1996) (providing an overview of § 548).

finance scenario where a transfer may occur for fraudulent transfer purposes. Assume *A* seeks financing to purchase an office complex in Dallas, Texas. Bank *B* is willing to make the loan only on a secured basis. *A* borrows eighty percent of the purchase price from Bank *B* and grants Bank *B* a lien in the property pursuant to a deed of trust to secure repayment. At this point two significant legal events have occurred. First, *A* has incurred an obligation to Bank *B* to repay the borrowed amount. This obligation is not fraudulent under § 548(a)(2) of the Bankruptcy Code because *A* directly benefits from the borrowed funds.[37] Second, *A* transferred an interest in the real property to Bank *B* by granting a lien. The transfer is deemed made under § 548(d) when the deed of trust is recorded in the real property records of Dallas County, Texas. This transfer is for a "reasonably equivalent value" provided by Bank *B*.[38]

Some time later *A* defaults on the obligation, and Bank *B* forecloses on the property in accordance with Texas real property law. Shortly thereafter, Bank *B* prepares and files a trustee's deed of sale. Is the foreclosure of the lien a transfer under § 548(a)? To be sure, a foreclosure sale extinguishes *A*'s right of redemption. But is that enough? Courts disagree.

For example, in its determination of whether the "transfer" had occurred within the requisite time period of § 548, the *Durrett* court found that there were actually two transfers: the first occurring when a lien in the property was granted, and the second when the foreclosure sale itself was held.[39] Recall that a transfer must occur within one year of the filing of the petition to be subject to a fraudulent transfer attack. This second transfer, which foreclosed the debtor's equitable right of redemption,[40] was the transfer at issue in the court's opinion and clearly occurred within the limited reach-back period of § 548.[41]

> The comprehensive character of this definition [of "transfer"] leads us to conclude that the transfer of title to the real property of the debtor in possession pursuant to an arrangement under Chapter XI of the [Bankruptcy] Act, by a trustee on foreclosure of a deed of trust, to a purchaser at the sale constitutes a "transfer" by debtor in possession within the purview of § 67(d).[42] The actual transfer of title was made by Durrett to Fields, as trustee, via the deed of trust, executed April 7, 1969, to secure an indebtedness then owing to

37. Section 548(a)(2) encompasses both fraudulent transfers made and fraudulent obligations incurred. *See* Williams, *supra* note 26, at 1410-11.

38. *See* 11 U.S.C. § 548(a)(2)(A).

39. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 204 (5th Cir. 1980).

40. Equitable right of redemption refers to the mortgagor's right to pay the debt secured by the mortgage, after default under the mortgage, and any time prior to foreclosure. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 7.1, at 478-79 (2d ed. 1985).

41. *Durrett*, 621 F.2d at 204.

42. Section 548(d) is the current version of § 67d.

> Southern and thereafter assigned to Washington. Possession of the property was retained by Durrett subject to the power of the trustee to sell and deliver possession of the property, on default, at a foreclosure sale. While the actual conveyance of title by Durrett was made on April 7, 1969, possession was retained until foreclosure of the deed of trust. The "transfer" within the contemplation of the Act, was not final until the day of the foreclosure sale, January 4, 1977.[43]

In contrast, in *Madrid v. Lawyers Title Insurance Corp. (In re Madrid)*[44] the Ninth Circuit held that a real property foreclosure is not a transfer under § 548.[45] The court found that the foreclosure sale must be upheld because the transfer of the home occurred at the time of perfection of the trust deed, not upon foreclosure.[46] Thus, the Ninth Circuit found that the use of § 548 to set aside properly conducted foreclosure sales was simply inappropriate.[47] This would be the case even where the debtor acted with the intent "to hinder, delay, or defraud" its creditors.[48]

Consistent with the Ninth Circuit's decision in *Madrid* is the bankruptcy court's decision in *Alsop v. Alaska (In re Alsop)*.[49] In *Alsop* the court held that the Fifth Circuit in *Durrett* misapplied the time frame of § 548.[50] The *Alsop* court reasoned that the "transfer" in question occurred when the deed of trust was recorded and not when the foreclosure sale, which merely enforced an interest previously conveyed, occurred.[51] Because the lien in *Alsop* had been granted prior to the reach-back period of one year found in § 548, the "transfer" could not be challenged or set aside as a constructive fraudulent transfer.[52]

Subsequent to *Alsop* and *Madrid*, Congress amended the Bankruptcy Code through the Bankruptcy Amendments and Federal Judgeship Act of 1984.[53] The term "transfer" was amended specifically to include "foreclosure of the debtor's equity of redemption."[54] With this amendment, Congress clearly intended to encompass a real property foreclosure in the Bankruptcy Code's

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43. *Durrett*, 621 F.2d at 204.
44. 725 F.2d 1197 (9th Cir. 1984).
45. *Id.* at 1201-02.
46. *Id.* at 1200-01.
47. *Id.* at 1201.
48. Bankruptcy Code, 11 U.S.C. § 548(a)(1) (1994).
49. 22 B.R. 1017 (D. Alaska 1982).
50. *Id.* at 1018.
51. *Id.*
52. *Id.*
53. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(i), 98 Stat. 333, 338 (codified as amended at 11 U.S.C. § 101(54) (1994)).
54. The present definition of "transfer" reads "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101(54).

definition of transfer, thus rejecting the Ninth Circuit's opinion in *Madrid*.[55] However, after passage of the amendments, key senatorial sponsors made statements that the amendment was "not intended to have any effect one way or the other on the so called *Durrett* issue."[56] Consequently, courts were left to grapple only with what was meant by this statement[57] and whether it referred to the issue of timing of the transfer or to the issue of reasonably equivalent value.[58]

Subsequent to the amendment of the definition of "transfer," the Ninth Circuit addressed the issue again. In its decision in *Ehring v. Western Community Moneycenter (In re Ehring)*,[59] the Ninth Circuit disposed of its own theory, first set forth in *Madrid*, that a foreclosure sale is not itself a transfer.[60] Recognizing that a foreclosure sale extinguishes rights of a debtor while increasing rights of a buyer, the court, noting the 1984 amendments, ended the tenure of *Madrid* and held that the sale itself may constitute a transfer.[61]

2. *Failure of "Reasonably Equivalent Value"*

A constructive fraudulent transfer requires that the debtor receive less than a reasonably equivalent value for the transfer.[62] The determination of what constitutes reasonably equivalent value is an objective one and is generally a

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55. Madrid v. Lawyers Title Ins. Corp. (*In re* Madrid), 725 F.2d 1197, 1201-02 (9th Cir. 1984).

56. 130 CONG. REC. 30,648-49 (1984) (dialogue between Sen. DeConcini and Sen. Dole).

57. Post-enactment statements of legislators are generally accorded little, if any, deference. *See* Weinberger v. Rossi, 456 U.S. 25, 35 (1982) ("Such *post hoc* statements of a congressional Committee are not entitled to much weight."); Nevada Employees' Ass'n v. Bryan, 916 F.2d 1384, 1389 (9th Cir. 1990) ("[P]ost-enactment letters from Congress are afforded little deference.") (citing *Weinberger*, 456 U.S. at 35).

58. Apparently, it was initially proposed that the Bankruptcy Code be amended to deal with the *Durrett* issue specifically, and Senator Thurmond supported amendments to remove all doubt that § 548 applied to foreclosure sales. This removal would be accomplished by amending both the definition of "transfer" and the scope of fraudulent transfers to include both voluntary and involuntary transfers. However, a third part of the amendments associated with the *Durrett* issue would have provided a form of safe-harbor, and a creditor that bid-in the full amount at a regularly conducted and non-collusive foreclosure sale would, by definition, have given "reasonably equivalent value." In order to obtain expedited debate, Senator Thurmond agreed to drop all amendments pertaining to the *Durrett* issue; however, only the provision pertaining to the safe-harbor provision was dropped, and the remaining *Durrett* amendments were inadvertently left intact. *See* Vern Countryman, *The Concept Of A Voidable Preference In Bankruptcy*, 38 VAND. L. REV. 713, 743 n.168 (1985).

59. 900 F.2d 184 (9th Cir. 1990).

60. *Id.* at 187-89.

61. *Id.* at 187-88.

62. Bankruptcy Code, 11 U.S.C. § 548(a)(2)(A) (1994).

question of fact.[63] According to this approach,

> Reasonably equivalent value is not susceptible to simple formulation. Ideally, it should signify the reasonable estimate of what can be realized from the debtor's assets by converting them into cash under possibly guarded (but not forced-sale) conditions. The focus is on the consideration received by the debtor, not on the value given by the transferee. The purpose of fraudulent transfer law is the preservation of the debtor's estate for the benefit of its unsecured creditors. Consequently, what constitutes reasonably equivalent value must be determined from the standpoint of the debtor's creditors.[64]

Under the Bankruptcy Code, "value" is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."[65]

B. *The Origin of Constructive Fraudulent Transfer Challenges*

In *Durrett v. Washington National Insurance Co.*[66] the Fifth Circuit voided a prepetition real property foreclosure sale as a fraudulent transfer under § 548(a)(2) of the Bankruptcy Code.[67] Furthermore, the court suggested, in dicta, that any foreclosure and transfer of a debtor's interest in the real property for a bid price less than seventy percent of the property's fair value presumably constituted a lack of reasonably equivalent value.[68] This permitted the bankruptcy estate in *Durrett* to recover the property and capture the equity for the benefit of creditors.[69]

Durrett involved a prepetition foreclosure in which the property, having a fair market value of $200,000, was sold to a third-party purchaser for the exact

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63. *See* Klein v. Tabatchnick, 610 F.2d 1043, 1047 (2d Cir. 1979) (citing McNellis v. Raymond, 287 F. Supp. 232, 238 (N.D.N.Y. 1968)); Jacoway v. Anderson (*In re* Ozark Restaurant Equip. Co.), 74 B.R. 139, 143 (Bankr. W.D. Ark. 1987), *aff'd in part and rev'd in part*, 77 B.R. 686 (W.D. Ark. 1987), *aff'd in part and rev'd in part*, 850 F.2d 342 (8th Cir. 1988). *But see* BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994) (finding bid price constitutes reasonably equivalent value in noncollusive, nonjudicial foreclosure sale); Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 203 (5th Cir. 1980) (observing that the determination of reasonably equivalent value is a question of law in the mortgage foreclosure context).

64. Williams, *supra* note 13, at 80 (footnotes omitted).

65. 11 U.S.C. § 548(d)(2)(A).

66. 621 F.2d 201 (5th Cir. 1980).

67. *Id.* at 204.

68. *Id.* at 203.

69. *See generally* 11 U.S.C. § 551 ("Any transfer avoided under section . . . 548 . . . of this title . . . is preserved for the benefit of the estate but only with respect to the property of the estate.").

amount of the outstanding indebtedness secured by the property, $115,400.[70] Nine days after the foreclosure sale, the debtor filed a petition in bankruptcy seeking to have the transfer set aside as a constructive fraudulent transfer.[71] The debtor contended that the bid price of approximately fifty-seven percent of the fair market value of the property did not constitute a reasonably equivalent value.[72] Having determined when the transfer occurred,[73] the court focused on the amount received and determined that the bid amount was insufficient to constitute a reasonably equivalent value.[74] The court explained, "Here, Mitchell paid slightly more than 50 percent (57.7%) for the property involved. The sale, however, deprived the bankruptcy estate of an equity in the property of $84,600.00, if computed on the $200,000.00 market value fixed by the district court."[75]

Subsequent cases and the bankruptcy bar practice interpreted the court's dicta as suggesting that anything less than seventy percent of the fair market value of the property would fail to meet the "fair equivalent" standard under the then existing statute.[76] The court emphasized:

> 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 § 67(d) of the Act, which has approved the transfer for less than 70 percent of the market value of the property.[77]

The seventy percent bid rule quickly became the benchmark by which the Fifth Circuit, and to a large extent, other courts began to assess real property foreclosure sales.[78]

The *Durrett* decision set off a firestorm of debate as to whether the holding was a proper use of § 548.[79] Nonetheless, trustees commonly challenged real

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70. 621 F.2d at 203.
71. *Id.* at 202; *see* 11 U.S.C. § 548(a)(2).
72. 621 F.2d at 203.
73. *Id.* at 204.
74. *Id.* at 203-04.
75. *Id.* at 203.
76. *Id.*
77. *Id.*
78. *See, e.g.*, Berge v. Sweet (*In re* Berge), 33 B.R. 642, 649 (Bankr. W.D. Wis. 1983); Perdido Bay Country Club Estates, Inc. v. Equitable Trust Co. (*In re* Perdido Bay Country Club Estates, Inc.), 23 B.R. 36, 39 (Bankr. S.D. Fla. 1982); Home Life Ins. Co. v. Jones (*In re* Jones), 20 B.R. 988, 993-94 (Bankr. E.D. Pa. 1982); Wickham v. United Am. Bank (*In re* Thompson), 18 B.R. 67, 70 (Bankr. E.D. Tenn. 1982).
79. *See, e.g.*, Timothy J. Boyce, *The Supreme Court and the Death of* Durrett, 23 REAL EST. L.J. 205 (1995); Jeremy Galton, Durrett *Resolved*, 112 BANKING L.J. 270 (1995); 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); Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531 (1987); John P. Roberts & Stephen J. Moriarty, *Mortgage Foreclosure Sales as Fraudulent Conveyances: The* Durrett *Issue*, 10

property foreclosures as constructive fraudulent transfers. Other cases followed in which the *Durrett* holding was adopted, both in the Fifth Circuit and beyond.[80]

However, the *Durrett* rule was not universally accepted, and a split among the circuits ultimately developed.[81] One of the better known decisions rejecting *Durrett* is *Madrid v. Lawyers Title Insurance Corp. (In re Madrid).*[82] In fact, *Madrid* was the impetus for two divergent models of fraudulent transfer law—one model from the Bankruptcy Appellate Panel and another from the Ninth Circuit.[83]

In *Madrid*[84] the Bankruptcy Appellate Panel of the Ninth Circuit concluded that a nonjudicial foreclosure of a deed of trust would not be set aside as a fraudulent transfer, even though the foreclosure price was significantly less than the fair market value of the property.[85] The court held that the consideration received at a noncollusive, regularly conducted public sale satisfies the "reasonably equivalent value" requirement of § 548(a)(2).[86]

Madrid involved the purchase of real property at a foreclosure sale by an unrelated third party for a price of approximately sixty-four to sixty-seven percent of the property's market value at the time of sale.[87] Finding that the bid price was less than seventy percent of the fair market value of the property, the bankruptcy court voided the sale and ordered the property returned to the bankruptcy estate in accordance with the Fifth Circuit rule in *Durrett.*[88] However, the Bankruptcy Appellate Panel reversed and held, that for purposes of § 548, the term "reasonably equivalent value" simply means whatever value was received at a noncollusive and regularly conducted foreclosure sale.[89] The Bankruptcy Appellate Panel's decision rested, in part, on the settled state of law regarding inadequate foreclosure sale prices.

> If we consider the question of price adequacy in the context of foreclosure law we find, not surprisingly, that mere

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OKLA. CITY U. L. REV. 579 (1985); Howard A. Elliott, Comment, *Mortgage Foreclosure Sales as Fraudulent Conveyances: Living Under* Durrett, 13 OHIO N.U. L. REV. 631 (1986).

80. *See, e.g.*, First Fed. Sav. & Loan Ass'n v. Hulm (*In re* Hulm), 738 F.2d 323, 327 (8th Cir. 1984); Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 B.R. 818, 821 (Bankr. N.D. Ala. 1983); Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 448 (Bankr. D. Utah 1982).

81. *See, e.g.*, Harman v. First Am. Bank (*In re* Jeffrey Bigelow Design Group, Inc.), 956 F.2d 479, 485 (4th Cir. 1992); Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 824 (7th Cir. 1988).

82. 725 F.2d 1197 (9th Cir. 1984).

83. *Id.*

84. 21 B.R. 424 (B.A.P. 9th Cir. 1982).

85. *Id.* at 427.

86. *Id.*

87. *Id.* at 425.

88. *Id.*

89. *Id.* at 427.

> inadequacy will not upset a foreclosure sale. "[T]here must be in addition proof of some element of fraud, unfairness, or oppression as accounts for and brings about the inadequacy of price." The trial court's construction of §548 would radically alter these rules. Any foreclosure sale which failed to bring 70% of the property's market value could be set aside by a bankruptcy trustee or a debtor-in-possession for a period of one year.[90]

Ultimately, the court observed that the "law of foreclosure should be harmonized with the law of fraudulent conveyances"[91] and consequently construed the reasonably equivalent value requirement to mean the consideration received at a noncollusive, regularly conducted foreclosure sale. The Court of Appeals for the Ninth Circuit upheld the holding of the Bankruptcy Appellate Panel, but it did so on the basis that a "transfer" had not occurred within the one year reach-back period required by § 548.[92]

In 1988 the Seventh Circuit also addressed the issue of what constitutes a reasonably equivalent value in the context of a foreclosure sale. In *Bundles v. Baker (In re Bundles)*[93] the debtor had lived in the home for over twenty years.[94] At certain times, the debtor was unable to meet his mortgage payments because of health problems, and the mortgagee commenced an action in state court seeking foreclosure of the debtor's residence. The state court entered a default judgment against the debtor in the amount of $4,696.46,[95] and, after proper notice and in compliance with Indiana foreclosure law, a sheriff's sale of the debtor's residence was held.[96] At the sale, a third party unrelated to the foreclosing mortgagee purchased the property for $5,066.80.[97] At the time of the foreclosure sale the property was worth $15,500.[98] After the foreclosure and sale of his residence, the debtor filed a voluntary petition under Chapter 13 of the Bankruptcy Code and, shortly thereafter, sought to avoid the foreclosure sale as a fraudulent transfer.[99]

After rejecting the opinions of both the bankruptcy court and the district court on the proper approach to § 548 in the context of real property foreclosures, the Seventh Circuit relied on the plain language of the section coupled with the clear intent for a federal standard:

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90. *Id.* (citations omitted).
91. *Id.*
92. 725 F.2d at 1200-01.
93. 856 F.2d 815 (7th Cir. 1988).
94. *Id.* at 817.
95. *Id.* In addition, an IRS tax lien against the real estate was reduced to a personal judgment against the debtor in the amount of $2,666. *Id.*
96. *Id.* The debtor was insolvent at the time of the foreclosure sale. *Id.*
97. *Bundles*, 856 F.2d at 817.
98. *Id.*
99. *Id.*

> 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, noncollusive 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.[100]

Under *Bundles*, the federal standard rests on the "purpose of § 548's avoiding powers—to preserve the assets of the estate." Thus, a court must focus on what the debtor received in return for what he surrendered.[101]

> Consequently, it is appropriate to consider, as a starting point, the fair market value. However, the fact that the sale was the result of a foreclosure rather than an arm's length transaction between a willing buyer and a willing seller is also of considerable importance. Therefore, the bankruptcy court must focus ultimately on the fair market value as affected by the fact of foreclosure. As a practical matter, the foreclosure sale price is the only means of measuring the effect of foreclosure on the value of the property. Indeed, in usual circumstances, it would be appropriate to permit a *rebuttable* presumption that the price obtained at the foreclosure sale represents reasonably equivalent value. However, the bankruptcy court also must examine the foreclosure transaction in its totality to determine whether the procedures employed were calculated not only to secure for the mortgagee the value of its interest but also to return to the debtor-mortgagor his equity in the property. The bankruptcy

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100. *Id.* at 824; *see also* General Indus. v. Shea (*In re* General Indus.), 79 B.R. 124, 133 (Bankr. D. Mass. 1987) (indicating that the standards of value at public foreclosures are disputable; therefore, any rule tied only to value should not be applied); Ruebeck v. Attleboro Sav. Bank (*In re* Ruebeck), 55 B.R. 163, 168 (Bankr. D. Mass. 1985) (finding the proper inquiry regarding fair market value is a case-by-case analysis); Adwar v. Capgro Leasing Corp. (*In re* Adwar), 55 B.R. 111, 114-15 (Bankr. E.D.N.Y. 1985) (holding in accordance with the Second and Eighth Circuit that the question of value should be determined on a case-by-case basis); First Fed. Sav. & Loan Ass'n v. Hulm (*In re* Hulm), 45 B.R. 523, 528 (Bankr. D.N.D. 1984) ("[A]n absolute inflexible percentage benchmark should not be applied without regard to the facts of each case."); Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 448 (Bankr. D. Utah 1982) (holding that "reasonable equivalence will depend on the facts of each case"); Lawyer's Title Ins. Corp. v. Madrid (*In re* Madrid), 21 B.R. 424, 428 (B.A.P. 9th Cir. 1982) (Volinn, J., dissenting) (arguing that the concept of reasonably equivalent value requires that the trial court examine the consideration received in a foreclosure sale in the factual context of a particular case and concluding "that the price paid at a regularly conducted foreclosure sale should be given, at best, a strong presumption of adequacy").

101. *Bundles*, 856 F.2d at 824 (citing Martin v. Phillips (*In re* Butcher), 58 B.R. 128, 130 (Bankr. E.D. Tenn. 1986)).

> court therefore must consider such factors as whether there was a fair appraisal of the property, whether the property was advertised widely, and whether competitive bidding was encouraged.[102]

Thus, at one time, bankruptcy courts labored under four different approaches to the application of fraudulent transfer law to real property foreclosures. First, the *Durrett* rule replaced the vague "reasonably equivalent value" requirement with a bright-line rule.[103] If the bid price was less than seventy percent of the fair value of the property, then the foreclosure is a constructively fraudulent transfer.[104] No further thought or analysis was necessary. Second, the Bankruptcy Appellate Panel opinion in *Madrid* also replaced the vague standard in § 548(a)(2) with a bright-line rule.[105] If the real property foreclosure was conducted in a regular, noncollusive manner, then the bid price constituted reasonably equivalent value as a matter of law.[106] Third, the Ninth Circuit opinion in *Madrid* ignored the value issue altogether by concluding that a real property foreclosure sale did not constitute a transfer under §§ 101(54) and 548(a).[107] Finally, the Seventh Circuit in *Bundles* directly addressed the value issue by requiring bankruptcy courts to consider all the facts and circumstances in assessing whether a real property foreclosure constituted a fraudulent transfer.[108] Thus, the stage was set for the Supreme Court to resolve the debate.

In the aptly-named case of *BFP v. Resolution Trust Corp.*[109] a third party purchased property at a foreclosure sale for $433,000.[110] The debtor filed for relief under Chapter 11 of the Bankruptcy Code about three months after the foreclosure sale.[111] After the filing, the debtor sought to set aside the foreclosure sale, claiming that the fair market value of the property was $725,000 at the time of the sale.[112] Thus, according to the debtor-in-possession, the sale constituted a constructively fraudulent transfer.[113]

The Court, in its majority opinion by Justice Scalia, focused on the term

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102. *Id.*
103. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 203 (5th Cir. 1980).
104. *Id.*
105. *Madrid*, 21 B.R. at 427.
106. *Id.*
107. Madrid v. Lawyers Title Ins. Corp., 725 F.2d 1197, 1201-02 (9th Cir. 1984).
108. Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 824-25 (7th Cir. 1988). Other courts followed the Seventh Circuit approach. *See, e.g.*, Grissom v. Johnson (*In re* Grissom), 955 F.2d 1440, 1445 (11th Cir. 1992), *overruled by* BFP v. Resolution Trust Corp., 511 U.S. 531 (1994); Brown v. Goldome Realty Credit Corp. (*In re* Brown), 126 B.R. 481, 484 (Bankr. D. Md. 1991).
109. 511 U.S. 531 (1994).
110. *Id.* at 534.
111. *Id.*
112. *Id.*
113. *Id.*

"reasonably equivalent value."[114] After noting that the Bankruptcy Code did not define the term, the Court's analysis turned to the question: *reasonably equivalent to what?*[115] According to the Court, *Durrett* and *Bundles* answered this question by concluding that what the debtor received had to be reasonably equivalent to the fair market value of the property at the time of the foreclosure sale.[116] The Court determined that this was the wrong "benchmark against which determination of reasonably equivalent value is to be measured,"[117] and that absent some congressional indication to the contrary, the appropriate benchmark against which to measure reasonably equivalent value was the proceeds actually received at the foreclosure sale.[118]

Equating the proceeds received at foreclosure with reasonably equivalent value is troubling in two respects. First, if Congress intended the term "reasonably equivalent value" in the context of foreclosures to mean the amount received, the use of the word "reasonably" is rendered meaningless and tautological. The debtor will always receive the exact equivalent of the amount received at the foreclosure, either applied to a reduction of the debt or, in those rare instances in which the bid exceeds the debt, to be applied in satisfaction of the debt with the surplus returned to the debtor. Thus, the Court turned the test for reasonably equivalent value into a truism. In effect, the Court interpreted the statute to mean that § 548 of the Bankruptcy Code does not apply to foreclosure sales, at least not to properly conducted ones. The second troubling aspect of the *BFP* holding concerns the definition of "transfer" in the 1984 Amendments to the Bankruptcy Code.[119] The definition of transfer was modified expressly to include the "foreclosure of the debtor's equity of redemption,"[120] but the Court ignored this point entirely.

The Court justified its interpretation of the phrase "reasonably equivalent value" by stating that "[t]o say that the 'reasonably equivalent value' language in the fraudulent transfer provision of the Bankruptcy Code requires a foreclosure sale to yield a certain minimum price beyond what state foreclosure law requires, is to say, in essence, that the Code has adopted *Durrett* or *Bundles*."[121] Though the Court acknowledged that "Congress has the power pursuant to its constitutional grant of authority over bankruptcy"[122] to do just that, the Court declined to interpret the phrase absent "clearer textual guidance."[123] Consequently, the Court read "reasonably equivalent value" to

114. *Id.* at 542-43.
115. *Id.* at 543.
116. *Id.* at 536-37.
117. *Id.*
118. *Id.* at 545, 548-49.
119. *See supra* notes 54-55 and accompanying text.
120. *BFP*, 511 U.S. at 545, 548-49.
121. *Id.* at 542-43.
122. *Id.* at 543.
123. *Id.*

mean that the Bankruptcy Code had rejected *Durrett* and *Bundles*.[124]

For all practical purposes, *BFP* severely limited the use of § 548 challenges to real property foreclosure sales, regardless of the amount bid at such sales. In theory, § 548 continues to exist as a means to attack irregular or collusive foreclosures as well as foreclosures where the debtor had an actual intent to defraud his creditors. However, these attacks add little force because such sales could be set aside on the basis of state law even absent § 548.[125]

III. AVOIDABLE PREFERENCE LAW UNDER § 547 OF THE BANKRUPTCY CODE

Many practitioners perceive the avoidable preference power as one of the most used and most important powers possessed by a bankruptcy trustee.[126] The operative preference provision in the present Bankruptcy Code is § 547(b).[127] The preference power has a dual purpose: (1) furthering the policy of equality of distribution[128] (although a more accurate description is that the power protects the Bankruptcy Code's priority scheme)[129] and (2) dissuading opt-out behavior by creditors who hope to bypass the bankruptcy process by forcing the debtor to pay them before the commencement of the bankruptcy case.[130]

A. *Elements of an Avoidable Preference*

An avoidable preference is (i) any transfer of an interest of the debtor in property; (ii) to or for the benefit of a creditor; (iii) for or on account of an antecedent debt owed by the debtor before the transfer was made; (iv) made while the debtor was insolvent; (v) made on or within ninety days before the date of the filing of the petition (or within one year if the creditor is an insider); and (vi) that enables the creditor to receive more than it would have received under a Chapter 7 liquidation.[131] The trustee, or the debtor-in-possession in a Chapter 11 or Chapter 12 case, shoulders the burden of proof on all the elements of an avoidable preference action;[132] however, there is a statutory

124. *Id.* at 545.

125. *See* Bankruptcy Code, 11 U.S.C. § 541(c)(2) (1994).

126. *See* GEORGE M. TREISTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW § 4.03(c), at 153 (2d ed. 1988); Countryman, *supra* note 58, at 713.

127. 11 U.S.C. § 547(b). The genesis of the preference power is § 60 of the Bankruptcy Act of 1898, as amended.

128. *See* TREISTER ET AL., *supra* note 126, § 4.03(c), at 153.

129. *See* Countryman, *supra* note 58, at 715.

130. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 124-25 (1986).

131. 11 U.S.C. § 547(b). Section 550(a) of the Bankruptcy Code enables the trustee to recover the property transferred, or its value if the court so orders, when a transfer is avoided pursuant to § 547. *Id.* Section 541(a)(3) includes in the list of property comprising the estate any interest in property that the trustee recovers under § 550. *Id.* § 541(a)(3).

132. *Id.* § 547(g).

presumption that the debtor is insolvent on or within ninety days of filing a petition in bankruptcy.[133] Furthermore, if the creditor who received the alleged avoidable preference was an insider of the debtor,[134] then the operative period is extended from ninety days to one year before the filing of the petition in bankruptcy.[135] Following is a concise discussion of preference law to highlight the key provisions addressing unreasonable creditor bid-ins at foreclosure sales.

1. *Transfer of the Debtor's Property*[136]

"Transfer" is broadly defined in § 101(54) of the Bankruptcy Code to include every mode or disposition of an interest in property, voluntary or

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133. *Id.* § 547(f).

134. Section 101(31) defines "insider" to include:

(A) if the debtor is an individual—
- (i) relative of the debtor or of a general partner of the debtor;
- (ii) partnership in which the debtor is a general partner;
- (iii) general partner of the debtor; or
- (iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation—
- (i) director of the debtor;
- (ii) officer of the debtor;
- (iii) person in control of the debtor;
- (iv) partnership in which the debtor is a general partner;
- (v) general partner of the debtor; or
- (vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership—
- (i) general partner in the debtor;
- (ii) relative of a general partner in, general partner of, or person in control of the debtor;
- (iii) partnership in which the debtor is a general partner;
- (iv) general partner of the debtor; or
- (v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor.

Id. § 101(31).

135. *Id.* § 547(b)(4)(B).

136. *Id.* § 547(b).

involuntary, including the creation of a lien on the debtor's property and foreclosure under the real property laws.[137] Thus, not only is the payment of money by cash or check encompassed by the definition of "transfer," but also subject to scrutiny are actions such as filing an abstract of judgment or Article 9 financing statement.[138]

Once the triggering transfer has been identified, one must still determine whether the transfer is of a debtor's property.[139] If a debtor acts as a mere conduit of funds or if the funds that go from a third party to the debtor and subsequently to the creditor are earmarked, courts have consistently concluded that the transfer is not one of a debtor's property.[140]

As previously discussed, a real property foreclosure sale is a "transfer" under § 101(54). Furthermore, the foreclosure usually involves the property of the debtor. Thus, these elements of an avoidable preference are generally met and do not pose a problem in the bid-in scenario.

2. *To or for the Benefit of a Creditor*[141]

The Bankruptcy Code defines a creditor to include an entity that holds a claim against the debtor that, for preference purposes, arose before the filing of the petition in a bankruptcy case.[142] A claim is defined in § 101(5).[143] In the avoidable preference section, the drafters of the Bankruptcy Code included not only transfers to a creditor, but also for the benefit of a creditor.[144] Assume the debtor owes a debt to *A*, and *A* owes a debt to *B*. However, *B* is not a creditor of the debtor. If the debtor paid *A*, and then *A* paid *B*, assuming all other

137. *Id.* § 101(54).

138. *See* Williams, *supra* note 13, at 71-73.

139. *See* 11 U.S.C. § 547(b).

140. *See, e.g., In re* Maxwell Newspapers, Inc., 151 B.R. 63, 70 (Bankr. S.D.N.Y. 1993); Carson v. Federal Reserve Bank, 172 N.E. 475, 482 (N.Y. 1930).

141. 11 U.S.C. § 547(b)(1).

142. *Id.* § 101(10)(A).

143. Section 101(5) states:

> "Claim" means—
>
> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

Id. § 101(5).

144. *Id.* § 547(b)(1).

elements are met, the transfer is one between the debtor and its creditor *A*. However, if on directions from *A* the debtor pays *B*, assuming all other elements are met, the transfer is for the benefit of the debtor's creditor *A*. Either transfer satisfies the second element of an avoidable preference under § 547(b). Again, this element generally will not pose problems in the bid-in context.

3. *For or on Account of an Antecedent Debt*[145]

The third element of an avoidable transfer requires that the creation of the debt occur before the transfer was made. Usually this can be determined by a straightforward comparison of the date the debt arose to the date of the transfer. Nonetheless, in some circumstances this simple comparison can be deceptive because of the timing rules imposed by § 547(e).[146]

Section 547(e) employs an artificial test to establish when the transfer takes place: the general rule is that the transfer takes place when it becomes public knowledge through perfection rather than the actual date of the transfer. Section 547(e) is the drafters' attempt to protect against secret liens. It provides that as to real estate transfers, a transfer occurs when it is good against a bona fide purchaser of the real estate.[147] As to personal property transfers, the transfer occurs when it becomes perfected as against a judicial lien creditor.[148] Furthermore, a transfer perfected within ten days after it is made is deemed to occur when it becomes effective between the parties as a matter of law.[149] This element also does not pose serious concerns in the bid-in context largely because of cases holding that a foreclosure sale constitutes a transfer.[150]

4. *Made Within Certain Time Periods Provided in the Bankruptcy Code*[151]

Not all preferences are voidable. Section 547(b) contains certain time limits or reach-back periods, limiting the power of a trustee to attack prepetition transfers. The time period is a compromise of several policies—the policies of finality and protection of title, on the one hand, and the limitation of opt-out behavior on the part of creditors on the other. For most creditors, the preference period is ninety days from the filing of the petition.[152] The filing date is excluded from the count, but the last day is included, unless it is a Saturday,

145. *Id.* § 547(b)(2).
146. *Id.* § 547(e).
147. *Id.* § 547(e)(1)(A).
148. *Id.* § 547(e)(1)(B).
149. *Id.* § 547(e)(2)(A).
150. *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531 (1994); Ehring v. Western Community Moneycenter (*In re* Ehring), 900 F.2d 184, 187-88 (9th Cir. 1990).
151. 11 U.S.C. §§ 547(b)(4), (e)(2).
152. *Id.* § 547(b)(4)(A).

Sunday, or legal holiday.[153] Again, the time of the transfer as determined by § 547(e) will be determinative as to whether the transfer occurred on or within ninety days (or one year, if an insider) of the filing of the bankruptcy petition.[154]

For creditors who are insiders,[155] the preference period is expanded from ninety days to one year from the filing of the petition.[156] The assumption implicit in expanding the preference period for insiders is that they are in a position to know of the debtor's precarious financial condition before most others.[157] Again, this element does not pose significant concern in the bid-in context.

5. *Debtor Insolvency*[158]

Insolvency is generally defined under the Bankruptcy Code as the sum of the debtor's debts exceeding the fair value of the debtor's property: the balance sheet approach to insolvency.[159] Section 547(f) creates the rebuttable presumption that the debtor is insolvent for ninety days preceding the filing of the bankruptcy petition.[160] Determination of insolvency in the partnership context may be more complicated because it takes into account the sum of the excess of the value of the partners' separate property over the partners' separate debts as well as the partnership's property.[161] However, insolvency does not generally pose difficult issues in the bid-in context.

6. *Preferential Effect*[162]

The final element of an avoidable preference requires that the transfer have the effect of giving the transferee more than it otherwise would receive in a Chapter 7 liquidation case had the transfer not been made.[163] This preferential effect is the essence of an avoidable preference action.[164]

The § 547(b)(5) element of an avoidable preference is almost always met if an unsecured creditor receives a payment.[165] Conversely, if the debtor pays a fully secured creditor, and the security interest is not avoidable under one of the avoiding powers, the transfer by the debtor is not a preference.[166] A transfer

153. *Id.* app. Bankr. R. 9006(a).
154. *Id.* § 547(e).
155. *Id.* § 101(31); *see supra* note 134.
156. 11 U.S.C. § 547(b)(4)(B).
157. *Id.* § 101(31).
158. *Id.* §§ 547(b)(3), 101(32).
159. *Id.* § 101(32).
160. *Id.* § 547(f).
161. *Id.* § 101(32)(B).
162. *Id.* § 547(b)(5).
163. *Id.*
164. *See* Countryman, *supra* note 58, at 733-34.
165. *Id.* at 736.
166. *Id.* at 739-40.

to a fully secured creditor gives the creditor no more than it would have received under a Chapter 7 liquidation. Additionally, payment of a § 507(a) priority claim is not an avoidable preference if the estate houses sufficient assets to pay all higher and equal priority claimants;[167] however, § 547(b)(5) is generally met where the debtor has made payments to an undersecured creditor. The law presumes that, at least absent relinquishment of a portion of the collateral equal to the payment made by the debtor, any payment within the ninety day preference period is a reduction of an undersecured creditor's unsecured claim and therefore amounts to a preferential transfer for the benefit of the undersecured creditor.[168]

It is this element of the avoidable preference action that lies at the center of the cases that have addressed whether a creditor bid-in at a real property foreclosure sale could constitute an avoidable preference.[169] For example, assume Debtor owes $1,000 to Creditor secured by real property valued at $10,000. Upon default, Creditor forecloses on the property, bidding the full amount of the debt at the sale, with the result that $1,000 is the winning bid price. Thus, Creditor realizes an asset worth $10,000 from the foreclosure sale; whereas if the transfer had not been made, the creditor would have been entitled to only $1,000, the amount of its secured claim under a Chapter 7 liquidation. Consequently, Creditor appears to have received more than it would have in a Chapter 7 case and had the transfer not been made.

B. Conceptual Interface Between § 548 and § 547

A trustee's ability to employ § 547 of the Bankruptcy Code is in one sense more limited than the *Durrett* theory of attacking the foreclosure as a fraudulent transfer largely because of the enlarged time window provided in § 548. In the case of § 547, the transfer must have occurred within ninety days of the filing of the bankruptcy petition.[170] In contrast, § 548 permits a reach-back period of one year, and potentially far longer by resort to § 544 and state fraudulent transfer law.[171]

Section 547 is further limited by the requirement that the transfer be "on account of an antecedent debt."[172] This insulates any sale to third parties and restricts the avoidance power to situations in which the creditor successfully bids in the property at the foreclosure sale and becomes the owner. However,

167. *See* TREISTER, *supra* note 126, § 4.03(c)(1)(G), at 159.

168. *See* Drabkin v. A.I. Credit Corp., 800 F.2d 1153, 1157 (D.C. Cir. 1986); Countryman, *supra* note 58, at 744.

169. Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales as Preferential Transfers: Another Serious Threat to Secured Creditors?*, 24 TEX. TECH L. REV. 985, 1004-06 (1993); David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 274-79 (1995).

170. Bankruptcy Code, 11 U.S.C. § 547(b)(4)(A) (1994).

171. *Id.* § 548(a).

172. *Id.* § 547(b)(2).

this latter limitation is not significant in light of the fact that in the vast majority of real property foreclosures, the foreclosing lender is the high, and often only, bidder.[173]

Interestingly, § 547 can be interpreted as broader than § 548 in at least one way. Even under *Durrett*, a bid for property in the amount of seventy percent of the property's value or more has prevented a sale from being set aside as a constructive fraudulent transfer.[174] Thus, § 547 could be used to void even those sales where the bid price was in excess of seventy percent of the value of the property, so long as the creditor would receive more than it would in a Chapter 7 case had the transfer not been made.[175] Obviously, the incentive to void a sale greatly diminishes as the bid price approaches the fair market value of the property.

IV. THE ANOMALIES OF BANKRUPTCY LAW AS APPLIED TO REAL PROPERTY FORECLOSURES

This section presents various scenarios under which the debtor, either voluntarily or involuntarily, transfers assets to creditors and non-creditors. Both fraudulent transfer law and preference law are then applied to predict the outcome if such transfers were challenged. Though it would appear that the outcome would be the same regardless of whether the transfer was voluntary or involuntary[176] and regardless of whether the transfer was challenged in or out of the bankruptcy setting, existing case law shows this is not the case.[177]

Example 1: *Assume that Debtor voluntarily transfers $500 to a non-creditor third party and receives nothing from the non-creditor in return.*

Analysis: Regardless of whether this transfer is harmful to Debtor's creditors, it is not subject to avoidance as a preferential transfer for a variety of reasons, the most obvious being that there is no antecedent debt as required to void preferential transfers.[178] However, assuming that the transfer is harmful to the creditors because Debtor is insolvent, it should be easy to avoid this transfer as either an actual or a constructive fraudulent transfer.[179] As conventional wisdom goes, a debtor must be just before he is generous.

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173. Mattingly, *supra* note 6, at 95.

174. *See, e.g.*, Barrett v. Commonwealth Fed. Sav. & Loan Ass'n, 939 F.2d 20, 25 (3d Cir. 1991).

175. 11 U.S.C. § 547(b)(5).

176. *See id.* § 101(54).

177. *See generally* BFP v. Resolution Trust Corp., 511 U.S. 531, 543-44 n.7 (1994) (comparing voluntary and involuntary transfers under § 548 of the Bankruptcy Code).

178. *See* 11 U.S.C. § 547(b)(2).

179. *See id.* § 548(a).

Example 2: *Assume Debtor voluntarily transfers $500 to a creditor that was owed $100.*

Analysis: In this case, it would seem that the transfer can be avoided as either a preference or possibly a fraudulent transfer. With respect to the preference, the $100 debt satisfies the requirement of an antecedent debt, and it should be easy to establish that the creditor has received more than it otherwise would have in a Chapter 7 liquidation.[180] Even if the creditor held a secured claim with a lien in collateral valued at $500, the creditor would not be entitled to receive any more than the amount of its debt, and thus still appears to have been treated preferentially. Fraudulent transfer law should likewise be available to avoid this transaction and recover the transfer of assets for the benefit of all creditors. Even if the transfer was not made with actual intent to hinder, delay, or defraud creditors, it nonetheless would be difficult to see how the transfer of $500 to reduce a $100 debt could be construed as providing the debtor with reasonably equivalent value for the $500.[181]

Each of the above two scenarios assumed that the transfer consisted of $500 cash. But what if, instead of cash, the transfer was of real or personal property? Would the outcome be the same? Disregarding the problem of correct valuation of the assets, it would seem that the form of payment should not be relevant. However, it is.

The first two scenarios also assumed that the transfers were voluntary. There are situations in which the transfer of the debtor's assets occurs on an involuntary basis. The most common mechanisms by which this occurs involve collection actions against a debtor such as garnishments, judicial liens, and real and personal property foreclosures. In the following scenarios, the transfers occur involuntarily.

Example 3: *Assume that Debtor involuntarily transfers $500 to a non-creditor in exchange for $100.*

Analysis: This involuntary transfer would in all likelihood be the result of a forced sale. Instead of $500 cash, the asset being transferred would be the property being sold. The noncreditor would be the high bidder at the sale, and, in exchange for the property, would deliver the purchase price to the creditor conducting the sale. Nonetheless, for purposes of this scenario, assume that the asset being transferred is actually

180. *See id.* § 547(b)(5).
181. *See id.* § 548(a)(2).

$500 cash in exchange for the $100 bid. As in Example 1, above, it would be difficult to construe this as a preference to the noncreditor buyer because there is no antecedent debt.[182] Furthermore, this transfer would not be a preference for the creditor that forced the sale because that creditor will only retain proceeds up to the amount of the debt (unless the selling creditor had perfected its judgment lien within ninety days of bankruptcy and would not receive as much in a Chapter 7 liquidation). Could the transfer of $500 cash for $100 be avoided as a fraudulent transfer? It is difficult to fathom that it could not be.

Example 4: *Assume that instead of cash, the $500 asset being transferred to the noncreditor is personal property.*

Analysis: If it was *personal* property, almost every court would conclude that it did not constitute a fraudulent transfer because there was no transfer within the reach-back period.[183] The transfer did not occur when the sale was conducted; rather, it occurred when the lien was granted.[184]

Example 5: *What if the asset being transferred to the noncreditor is $500 of real property pursuant to a foreclosure sale?*

Analysis: Again, most courts would conclude that the transfer was not fraudulent absent some form of collusion or irregularity. However, this is not based on the absence of a transfer. Section 101(54) makes clear that the term "transfer" includes foreclosure of the debtor's equity of redemption.[185] The basis for holding that no fraudulent transfer occurred is the Supreme Court's holding in *BFP*.[186] For purposes of bankruptcy law, the proceeds received at a regularly conducted noncollusive foreclosure sale are deemed a reasonably equivalent value.[187] Contrast this with the outcome in Examples 1 and 2 above, where a fraudulent transfer would likely exist if Debtor voluntarily transfers $500 in property in satisfaction of the $100 debt.

Example 6: *Assume Debtor involuntarily transfers $500 in property, but this*

182. *See id.* § 547(b)(2).

183. *See* Williams, *supra* note 13, at 71-72, n.85.

184. However, the debtor may possess a cause of action in the event the sale of personal property was not commercially reasonable in all aspects. *See* U.C.C. §§ 9-504, 9-507 (1997).

185. 11 U.S.C. § 101(54).

186. BFP v. Resolution Trust Corp., 511 U.S. 531 (1994).

187. *Id.* at 545.

time the high bidder is the creditor who forced the sale, and outbids the noncreditor buyer described above by $10.

Analysis: If Debtor owes $110 or more, no money actually changes hands, and the creditor merely credit bids or bidsin the property by crediting the amount bid against the amount of the debt,[188] can this situation be construed either as a preference or a fraudulent transfer? With regard to a fraudulent transfer, the answer as supplied by *BFP* is an emphatic no. Could this transfer constitute a preference? At first the answer seems to be no because the same transfer for a lower price detailed in Example 4 is not a preference. But closer analysis reveals that this is not necessarily true. If the creditor bidsin the full amount owed ($110), then even where the creditor is fully secured or oversecured, the creditor has still received more than it would have in a Chapter 7 liquidation ($500 vs. $110)[189] on account of an antecedent debt.[190] This would seem to fit within the elements of an avoidable preference. If the creditor was undersecured, the preference would be clearer since this particular creditor would be receiving full payment on account of an antecedent debt, which is more than it would have received in a Chapter 7 liquidation.[191]

Following is a matrix that spells out the disparate treatment of transfers based on the nature of the transfer (voluntary or involuntary), the status of the transferee (creditor or noncreditor), the type of property transferred (personal or real), and the application of the specific avoidance power (preference or fraudulent transfer). A "yes" entry in a cell of the matrix means that the scenario is subject to attack, a "no" means that it is not.

188. *See* Mattingly, *supra* note 6, at 101.
189. *See* 11 U.S.C. § 547(b)(5).
190. *See id.* § 547(b)(2).
191. *See id.* § 547(b)(5).

TABLE 1
PREFERENCE ANALYSIS

	Personal	*Real*
Creditor/Voluntary Transfer	Yes	Yes
Creditor/Involuntary Transfer	No	? (2)
Noncreditor/Voluntary Transfer	No1	No (1)
Noncreditor/Involuntary Transfer	No1	No (1)

(1) No antecedent debt as required by § 547.
(2) This question is the focus of the Article.

TABLE 2
FRAUDULENT TRANSFER ANALYSIS

	Personal	*Real*
Creditor/Voluntary Transfer	Yes	Yes
Creditor/Involuntary Transfer	No (2)	No (1)
Noncreditor/Voluntary Transfer	Yes	Yes
Noncreditor/Involuntary Transfer	No (2)	No (1) & (*BFP*)

(1) *See* BFP v. Resolution Trust Corp., 511 U.S. 531 (1994). Even prior to *BFP*, § 3b of the UFTA would prevent a state law challenge on the basis of a fraudulent transfer in those states that adopted the Act.
(2) Generally no.

Are there policy reasons to justify this disparate treatment of the transfers, depending on whether the transfer was voluntary or involuntary, to a creditor or noncreditor, concerning real property or personal property? Part IV of this Article explores this question.

V. AUTHORITIES ADDRESSING REAL PROPERTY FORECLOSURES AS AVOIDABLE PREFERENCES

Prior to the limitation of the *Durrett*[192] rule by the Supreme Court in *BFP*,[193] a few cases did indeed make use of § 547 to set aside oppressive foreclosure sales as voidable preferences.[194] However, not all such attempts were successful, and some courts refused to apply § 547 to foreclosure sales, holding that foreclosures are not the type of transfer preference laws are intended to address.[195]

With the elimination by *BFP* of the constructive fraudulent transfer attack, it might be expected that trustees and debtors will increasingly use § 547 to attack real property foreclosures as preferential in order to recapture debtor equity for the benefit of the estate. However, this has not been the case. In fact, there are only two reported decisions after *BFP* where such an effort has been made, and neither was successful.[196] Trustees' and debtors' counsel have apparently concluded, from their reading of *BFP*, that any effort to attack a foreclosure on the basis of an avoidable preference theory would be futile.

Following is a careful discussion of the authorities on point. Section A discusses authorities that have favorably entertained avoidable preference actions. Section B discusses authorities that have rejected an avoidable preference action.

A. Authorities Concluding that Foreclosure Sales Are Avoidable Preferences

One of the first decisions to hold that a foreclosure sale could be avoided as a preferential transfer was *Federal National Mortgage Ass'n v. Wheeler (In re Wheeler)*.[197] In *Wheeler* the original borrowers died and left their interest in the property to several heirs.[198] Two of the heirs quitclaimed their interests in the property to the third heir, who had lived on the property since the time of its

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192. The *Durrett* rule refers to the dicta in the decision in which the court indicated that any bid amount less than 70% would likely be construed as a fraudulent transfer. This quickly came to be treated as a bright-line rule by many practitioners in the Fifth Circuit. *See, e.g.*, White v. Luton (*In re* White), 47 B.R. 98, 101 (Bankr. S.D. Tex. 1985).

193. BFP v. Resolution Trust Corp., 511 U.S. 531, 542-43 (1994).

194. *See* Winters v. First Union Nat'l Bank (*In re* Winters), 119 B.R. 283, 284 (Bankr. M.D. Fla. 1990); Park North Partners, Ltd. v. Park North Assocs. (*In re* Park North Partners, Ltd.), 85 B.R. 916, 918 (Bankr. N.D. Ga. 1988); Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 B.R. 818, 822 (Bankr. N.D. Ala. 1983).

195. *See, e.g.*, Cottrell v. United States (*In re* Cottrell), 213 B.R. 33, 43-44 (M.D. Ala. 1997).

196. *See* O'Neill v. Dell (*In re* O'Neill), 204 B.R. 881 (Bankr. E.D. Pa. 1997); Big Yank Corp. v. Bank One (*In re* Water Valley Finishing, Inc.), 170 B.R. 831 (Bankr. S.D.N.Y. 1994).

197. 34 B.R. 818 (Bankr. N.D. Ala. 1983).

198. *Id.* at 819.

purchase in 1971.[199] By 1982, the mortgage payments were in arrears, and foreclosure proceedings were instituted.[200] After properly accelerating the indebtedness, the lender foreclosed the property, and, being the high bidder at the sale, purchased the property for the amount of its debt, $15,044.79.[201]

Approximately three weeks after the foreclosure sale, the debtor filed a petition in bankruptcy and included the lender's claim in her Chapter 13 plan.[202] When the lender objected to inclusion in the plan and sought approval of the mortgage foreclosure, the debtor commenced an action to set aside the sale under both §§ 548 and 547 of the Bankruptcy Code.[203] The lender asserted that the value of the property was $21,000, meaning that the bid-in purchase price was almost seventy-two percent of the value.[204] However, the debtor asserted that the property was worth $30,000 and that it had been appraised by the county tax appraiser at $23,460.[205] Ultimately the court determined that the value of the property was $24,000 and determined that because the bid-in price was less than sixty-three percent of the court's valuation of the property, the sale would be set aside as a constructive fraudulent transfer consistent with the Fifth Circuit's holding in *Durrett*.[206]

The *Wheeler* court also found that the sale constituted an avoidable preferential transfer under § 547.[207] Acknowledging that the lender was fully secured, and therefore entitled to receive the full value of its claim, the court stated that the lender was entitled to receive no more than the amount of its claim.[208] By being both a creditor and purchaser at the sale, the lender was able to capture the additional value of the property above the indebtedness; thus, the foreclosure sale enabled the lender to receive more than it would have received in a Chapter 7 liquidation.[209] Consequently, because the other requirements of § 547 had been met, the court held that the foreclosure sale constituted a preferential transfer.[210]

The court's analysis and holding in *Wheeler* is consistent with the result reached in *Winters v. First Union National Bank (In re Winters)*,[211] the most recent decision to hold that a foreclosure can indeed constitute a preference under § 547. In *Winters* the lender was the high bidder at its foreclosure sale and purchased the property for a bid-in amount of $14,284.26.[212] The lender

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199. *Id.* at 819-20.
200. *Id.* at 820.
201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.* at 821-22.
207. *Id.* at 822.
208. *Id.*
209. *See* Bankruptcy Code, 11 U.S.C. § 547(b)(5) (1994).
210. *Wheeler*, 34 B.R. at 822.
211. 119 B.R. 283 (Bankr. M.D. Fla. 1990).
212. *Id.* at 284.

subsequently listed the property for sale at $60,000 and eventually sold it for $30,000, the amount of the first offer.[213] The debtor filed a Chapter 11 petition in bankruptcy within 90 days of the foreclosure challenging the foreclosure as both a fraudulent transfer and an avoidable preference.[214] The court found the result inequitable because the lender captured over $15,715 of equity at the expense of the unsecured creditors and held that the plaintiff was entitled to prevail under either theory of recovery.[215]

Another decision in which § 547 was used to avoid a foreclosure sale was *Park North Partners, Ltd. v. Park North Associates (In re Park North Partners, Ltd.)*.[216] The bankruptcy judge reached this result only after being directed by the district court.[217] In his opinion, Judge Kahn noted that he was voiding the bid-in reluctantly and urged the district court to reconsider its holding that a nonjudicial foreclosure sale held pursuant to state law could constitute a preference under § 547.[218] The bankruptcy judge strongly believed that such a foreclosure could never constitute a preference because it was not the type of transfer Congress intended to be recaptured through § 547.[219] The bulk of the bankruptcy judge's opinion focused on why, in his view, real property foreclosures should not be preferences. In Judge Kahn's opinion, a foreclosure sale could never be set aside as a preference because it did not meet the requirements imposed by § 547; namely, the transfer did not enable the creditor to receive more than it would under a Chapter 7 case, and it was not on account of an antecedent debt.[220] According to him, because fully secured creditors are not entitled to any distribution of property of the estate through the bankruptcy system, it is illogical to try to decide if the creditor would have received more, and this element of a preference simply cannot be applied to a foreclosure sale.[221] Furthermore, Judge Kahn maintained that there could be no transfer on account of an antecedent debt even in the event of a "surplus" above the amount of the indebtedness.[222] The "surplus" constituted a windfall to the creditor and must be analyzed as a potential fraudulent transfer and not as a transfer on account of an

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213. *Id.*
214. *Id.*
215. *Id.* at 285.
216. 85 B.R. 916 (Bankr. N.D. Ga. 1988).
217. *Id.* at 917.
218. *Id.* at 918 ("Although this Court will make such a determination, it does so reluctantly and most respectfully urges the *District Court*, in the event this Judgement is appealed, *to reconsider* its holding that a nonjudicial foreclosure sale held pursuant to state law can constitutes a preference under §547 of the Bankruptcy Code.").
219. *Id.*
220. *Id.*
221. *Id.* at 919; *see also* First Fed. Sav. & Loan Ass'n v. Standard Bldg. Assocs., Ltd., 87 B.R. 221, 224 (N.D. Ga. 1988) (agreeing with Judge Kahn's point of view stating "that the provision regarding the setting aside of preferences in § 547 of the bankruptcy code does not apply to nonjudicial foreclosures").
222. Park North Partners, Ltd. v. Park North Assocs. (*In re* Park North Partners, Ltd.), 85 B.R. 916, 918 (Bankr. N.D. Ga. 1988)..

antecedent debt.[223] Nonetheless, pursuant to the directive of the district court Judge Kahn held that the foreclosure of property with a stipulated value of $1,050,000, purchased by the lender for its bid-in amount of $857,209.83, constituted a preference under § 547.[224] The judge consequently awarded the debtor a money judgment for the difference between the two amounts.[225]

Similarly, in *Morris Plan Co. v. Fountain (In re Fountain)*[226] the court held that a prebankruptcy foreclosure sale can be set aside as a preference under § 547.[227] In *Fountain* the second lien holder had purchased property, subject to the first lien, valued at $37,500 for its bid-in amount of $6,000.[228] The court found that this sale allowed the secured lender to receive "considerable equity which otherwise [would] have existed for the debtor" and was, therefore, avoidable as a preference.[229]

Commentators have concluded that an unreasonable bid-in may constitute an avoidable preference because the secured party would receive more from the foreclosure sale than it would have received in bankruptcy, where the bankruptcy trustee could have captured the unrealized equity for the benefit of the estate: "The theory even works if, in the hypothetical liquidation, the secured party would have received 100¢ on the dollar—provided that, in real life, the secured party gets more than the face amount of her claim."[230]

The influential commentators Grant S. Nelson and Dale A. Whitman have one of the strongest positions on the point:

> [It is an] ironic conclusion that section 547 may be used to deal with the lesser of two wrongs—namely, the transfer that gives a creditor up to the full amount of her claim—but is unavailing to the extent the transfer gives her more than she is due. The more blameworthy creditor conduct must be dealt with, under this reasoning, only as a fraudulent conveyance. However unsatisfying such a conclusion may seem intuitively, it could nevertheless be defended if the language of section 547 either compelled such a result or was at least ambiguous.[231]

Nelson and Whitman conclude that the application of § 547(b) to unreasonable bid-ins is supported by the language of the provision and the policy embodied in the Bankruptcy Code that seeks the capture of equity for the benefit of the

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223. *Id.*
224. *Id.* at 919.
225. *Id.*
226. 32 B.R. 965 (Bankr. W.D. Mo. 1983).
227. *Id.* at 967-68.
228. *Id.* at 967 n.5.
229. *Id.* at 968 n.6.
230. *See, e.g.*, Carlson, *supra* note 169, at 276-77.
231. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 8.17.2, at 682 (3d ed. 1994).

estate.[232] Two additional commentators, Craig Averch and Michael Collins, have addressed the second point made by Nelson and Whitman, concluding that an unreasonable bid-in results in the loss of what may be a valuable asset to the estate.[233] For example, if a secured party, who is owed $10,000, successfully forecloses on real property worth $15,000 by bidding in its debt, $5,000 of debtor equity has been transferred by the debtor to the secured creditor at the expense of the bankruptcy estate.

Professor David Gray Carlson has also considered the issue, concluding that unreasonable bid-ins should fall under an avoidable preference attack:

> It may first appear startling that bid-ins might be voidable preferences. Surely the secured party as buyer is a transferee of a different capacity than the secured party as creditor. Yet, on second thought, a secured party who bids in at her own foreclosure sale is very much receiving debtor property in exchange for the extinguishment of antecedent debt. So conceived, a bid-in looks like a transfer on antecedent debt, and hence potentially a voidable preference.[234]

Carlson echoes the observations of others that application of the avoidable preference power to unreasonable bid-ins is consistent with the language of § 547(b), recaptures a valuable asset for the benefit of the estate, and dissuades unfair foreclosure sales:[235]

> In short, the voidable preference theory of bid-ins comports with both the language and the policy of § 547(b), and its imposition to trip up unfair foreclosure proceedings should be considered a good thing. If so, courts can side-step the Supreme Court's recent fiat in *BFP* and reestablish bankruptcy review of oppressive foreclosure sales.[236]

B. Authorities Concluding that Foreclosure Sales Are Not Avoidable Preferences

Not every decision that has addressed the issue of whether a foreclosure sale can constitute a preference concluded that an avoidable preference existed. For example, the Ninth Circuit rejected the assertion that a nonjudicial foreclosure sale could constitute a preference, basing its holding on the premise that a creditor could never receive more from a foreclosure sale than it would under

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232. *Id.*
233. Averch & Collins, *supra* note 169, at 1033-34.
234. Carlson, *supra* note 169, at 277.
235. *Id.* at 277-79.
236. *Id.* at 279 (footnote omitted).

a Chapter 7 case distribution.[237]

In *Ehring* the lender under a second deed of trust was the high bidder at its foreclosure sale and purchased the property for its credit bid of $199,746.41.[238] Less than a month later, the lender entered into a contract to sell the property for $390,000, which represented a $110,000 profit for the lender after payment of all the outstanding indebtedness under both the first and second liens.[239] Within ninety days of the foreclosure sale, the debtor filed for relief under § 547(b) of the Bankruptcy Code, seeking recovery of the $110,000 "profit" as an avoidable preference.[240]

The Ninth Circuit held that the foreclosure sale did indeed qualify as a transfer within ninety days of bankruptcy, thus removing any remnant of the Ninth Circuit's prior opinion in *Madrid*.[241] The court further acknowledged that the transfer was on account of an antecedent debt;[242] however, it concluded that the sale was not a preference because the transfer did not enable the creditor to receive *more* than it would otherwise receive under a Chapter 7 liquidation.[243]

> This analysis . . . fails to consider the reality of the transaction. If the creditor received "more" it is only because the creditor elected to purchase the property at the foreclosure sale rather than simply accepting the receipts of a sale to a third party. Had the third party outbid the creditor, there could be no preference because the price paid would not have been transferred for an antecedent debt. Since section 547 does not reach a third-party purchaser, it is difficult to see why the existence of a preference should turn on the status of the purchaser as a creditor. *If the sale was defective or the purchaser otherwise took unfair advantage of the debtor, the transfer may be voided under section 548, regardless of whether the purchaser was the creditor or a third party.* We see no reason to construe section 547 to permit avoidance of an otherwise properly conducted sale based solely on the creditor being the highest bidder.[244]

The court examined what it called the "reality of the transaction" and

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237. Ehring v. Western Community Moneycenter (*In re* Ehring), 900 F.2d 184, 189 (9th Cir. 1990).

238. *Id.* at 185-86.

239. *Id.* at 186.

240. *Id.*

241. *Id.* at 187-88. This holding was based largely on the amendment to the definition of "transfer" in the Bankruptcy Code in 1984. *See supra* notes 54-55 and accompanying text.

242. 900 F.2d at 188.

243. *Id.* at 189; *see also* Bankruptcy Code, 11 U.S.C. § 547(b)(5) (1994) (allowing the trustee to avoid such transfers).

244. 900 F.2d at 188-89 (emphasis added).

determined that the "profit" realized by the lender was not the result of the foreclosure sale, but the result of the lender's election to purchase the property at the foreclosure sale rather than just accept the receipts of a sale to a third party.[245] As a result of the foreclosure sale, what the lender received was simply the bid amount and no more.

The court was troubled by the fact that if a third-party buyer submitted the high bid at a foreclosure sale, there would be no question that the sale could not be construed as a preference because no "antecedent debt" would have existed.[246] The court observed that the issue of whether or not a sale constituted a preference should not turn on the status of the purchaser.[247]

Interestingly, the Ninth Circuit rested its holding, in part, on the availability of a fraudulent transfer action by which a trustee can recapture any value for the benefit of the estate.[248] Because a fraudulent transfer action was foreclosed in *BFP*, the Supreme Court thwarted the Ninth Circuit's concern, expressed in *Ehring*, that at least one avoidance power remain to recapture the value lost through an unfair foreclosure sale. In light of *BFP*, it is no longer certain how the Ninth Circuit would rule.[249]

Additionally, in *First Federal Savings & Loan Ass'n v. Standard Building Associates, Ltd.*,[250] the court rejected an attempt by the trustee to attack a foreclosure sale under § 547(b). The court found that a foreclosure sale does not conceptually fit within the definition of a preference under § 547(b).[251]

> The preference provision applies to those creditors who by virtue of a pre-petition transfer receive more than they would "under the distributive provisions of the bankruptcy code." Fully secured mortgage holders are not entitled to anything under the "*distributive provisions*" of the bankruptcy code, precisely because they have liens covering specific assets.[252]

The court misconstrued what is meant by the term "distributive provisions" of the Bankruptcy Code. The court embraced a stingy and artificial definition of the term, observing that only § 726 contains the "distributive provisions" of the Bankruptcy Code.[253] The court missed § 725, which entitles a secured party to its collateral or collateral value in a bankruptcy case.[254] Section 725 fairly falls

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245. *Id.* at 188.
246. *Id.* at 188-89.
247. *Id.*
248. *Id.* at 189.
249. *See* Carlson, *supra* note 169, at 278 n.272.
250. 87 B.R. 221 (N.D. Ga. 1988).
251. *Id.* at 224.
252. *Id.* at 224 (quoting Park North Partners, Ltd. v. Park North Assocs. (*In re* Park North Partners, Ltd.), 85 B.R. 916 (Bankr. N.D. Ga. 1988)) (alteration in original).
253. Bankruptcy Code, 11 U.S.C. § 726 (1994).
254. *Id.* § 725.

within the meaning of "distributive provisions" in § 547(b)(5). Furthermore, as noted by Professor Carlson, the court cannot mean what it said in *First Federal*: "If oversecured creditors receive *nothing* in a hypothetical liquidation test, then *anything* they receive in real life violates the § 547(b)(5) test—precisely the opposite of what [the court] . . . implies."[255]

C. *The Avoidance of Unreasonable Bid-Ins as Preferences After* BFP

In 1994, the Supreme Court handed down its decision in *BFP v. Resolution Trust Corp.*[256] The Court held in *BFP* that the price received at a regularly conducted, noncollusive foreclosure sale conclusively establishes "reasonably equivalent value" of the mortgaged property for purposes of § 548 of the Bankruptcy Code.[257] *BFP* eliminated the ability the trustee had previously enjoyed in certain circuits to challenge real property foreclosures as constructively fraudulent transfers based solely on the bid price received at the foreclosure sale.

The Court in *BFP* did not specifically address the issue of whether a regularly conducted foreclosure sale could reasonably continue to be challenged as a preference. The Court expressly limited its holding to fraudulent transfer attacks of mortgage foreclosures of real estate.[258] It appears, at least superficially, that a legitimate attack still could be launched against a foreclosure sale as a preference. In theory, a lender that bids eighty percent of the fair market value of the property could have that sale challenged as a preference, but the very same sale could not be challenged as a constructive fraudulent transfer, even if the lender had only bid forty percent of the property's fair market value.

However, the dearth of attempts to set aside foreclosure sales as preferences after *BFP* seems to indicate that practitioners do not view § 547 as a viable avoidance tool in the wake of *BFP*. Indeed, one lower court has expressly stated that the holding of *BFP* "is equally applicable to both kinds of avoiding powers."[259]

Why the reluctance? The answer is self-evident if the rationale for the holding in *BFP* is the protection of title. Both § 548, as discussed in *BFP*, and § 547 have the potential of causing uncertainty in title to foreclosed real property. This uncertainty theoretically leads to lower bid prices which hurt the foreclosing creditor as well as the debtor and its estate. Thus, the policy of protecting title to foreclosed real property in *BFP* applies to unreasonable creditor bid-in situations under § 547 and would prevent the avoidance under § 547 as well if that is the sole policy underpinning of *BFP*.

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255. Carlson, *supra* note 169, at 278-79.
256. 511 U.S. 531 (1994).
257. *Id.* at 545.
258. *Id.* at 537 n.3.
259. Cottrell v. United States (*In re* Cottrell), 213 B.R. 378, 383 (Bankr. M.D. Ala. 1996).

Allowing the avoidance of a foreclosure sale under the preference statute may not only produce the anomalous result of voiding transfers because of price that would not be voided under fraudulent transfer law, but also of causing the uncomfortable possibility of allowing sales to third party purchasers to stand, regardless of price, but then voiding the very same sale if the creditor raises the bid and becomes the high bidder. This is because the preference law could not be applied to the third party due to the lack of an antecedent debt. Fraudulent transfer law does not make this distinction. Under *Durrett* an unacceptable transfer at less than seventy percent of the fair market value was capable of being voided regardless of the purchaser's status.[260]

Thus, it would be unlikely that the possibility of avoiding foreclosure sales as preferences survived the Court's decision in *BFP.* The dearth of reported decisions in which such a challenge has even been attempted since *BFP* is strong evidence that counsel to debtors and trustees have interpreted *BFP* as a bar to an avoidable preference action. The following section explains the fallacy of conventional wisdom.

D. *The Reestablishment of Bankruptcy Review of Oppressive Foreclosure Sales*

The wording of both §§ 548 and 547 indicate that if the statutes were fairly applied to unreasonable bid-ins, then either theory of avoidance should be appropriate to set aside prepetition foreclosure sales of real property. First, "reasonably equivalent value" is purposefully vague and by its terms could require the precise inquiry articulated by the Seventh Circuit in *Bundles*.[261] The language in § 548(a)(2)(A) does not lend itself to the strained construction employed by the Supreme Court in *BFP.* To be sure, there is a rich history of fraudulent transfer law that supports such a narrow view of value,[262] but with a Court bent on a literal reading of statutes,[263] the language of § 548(a)(2) and the rule in *BFP* cannot be easily reconciled. Second, the elements of an avoidable preference in § 547(b) are met in its application to unreasonable creditor bid-ins where debtor equity in the real property existed. Specifically, a creditor receives more than it would have received in a Chapter 7 liquidation had the transfer not been made. Sound policy arguments could be made against applying § 547 to bid-ins, but it is difficult to reconcile a creditor receiving $500 in property in satisfaction of a $100 debt with § 547(b)(5). Furthermore, the stated policies of the Bankruptcy Code also seem to be furthered by the use of § 547 to rescind

260. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 202-03 (5th Cir. 1980).

261. Bundles v. Baker (*In re* Bundles), 856 F.2d 815 (7th Cir. 1988).

262. For an examination of the history of fraudulent transfer law, see Williams, *supra* note 13.

263. *See, e.g.*, United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241-43 (1989) (stating that resolving a dispute over the meaning of a relevant section begins "with the language of the statute itself").

unreasonable bid-ins at real property foreclosure sales. Typically, the policies of the Bankruptcy Code are stated to be the preservation of the estate, the ratable distribution of assets among all the unsecured creditors, and the desire to avoid providing an incentive to creditors to make a race to the courthouse in an effort to seize more than their ratable share just prior to the debtor's filing of a petition.[264] The avoidable preference power permits a trustee to recapture a debtor's equity in the foreclosed property for the benefit of the estate.[265] Thus, through the application of § 547(b), a valuable asset is preserved for the benefit of the estate and the purposes of the Bankruptcy Code furthered.

Typically, in the study of bankruptcy law, if both the language of the statute and the policies embodied in the Bankruptcy Code support a position, that position wins the debate. This does not appear to be the case with the application of § 547(b) to bid-ins. Trustees are not bringing these actions and courts do not appear to be receptive. The reason given for this reluctance is the Supreme Court's opinion in *BFP*, notwithstanding the fact that the Court specifically limited its holding to fraudulent transfer actions.[266] Thus, to appreciate fully the reluctance of bankruptcy practitioners to challenge unreasonable bid-ins post-*BFP*, one needs a more complete understanding of what was really at issue in that case.

Why would the Supreme Court in *BFP* interpret the phrase "reasonably equivalent value" in a manner that would appear to contradict both the wording and the underlying policies of the Bankruptcy Code? What competing policies are there that, as the four dissenting judges correctly described, would lead to "engrafting a foreclosure-sale exception onto 11 U.S.C. § 548(a)(2)(A), in derogation of the straightforward language used by Congress"?[267]

The majority opinion itself sets forth some indication of the underlying concerns. The Court used a considerable amount of the opinion to describe the foreclosure process and its impact on the price that can be expected for the real property at the sale. According to the Court, a forced sale cannot be anticipated to bring the same as a more leisurely sale, and thus the fair market value of a property based on a typical arm's-length transaction is an inappropriate benchmark by which to assess "reasonably equivalent value."[268]

Essentially, the Court assumed that by adopting the foreclosure method and policies that their specific laws mandate, states have determined what a reasonable price for property sold at a forced sale should be—it is any price in the range of bids that will not be set aside under state law as so grossly unfair or unconscionable as to shock the conscience of the court. The Court in *BFP* was unwilling to encroach upon the right of the states to make this determination without a clearer textual meaning of "reasonably equivalent value."

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264. *In re* Beyond Words Corp., 193 B.R. 540, 543-44 (N.D. Cal. 1996).
265. Bankruptcy Code, 11 U.S.C. § 547(b) (1994).
266. BFP v. Resolution Trust Corp., 511 U.S. 531, 537 n.3 (1994).
267. *Id.* at 549 (Souter, J., dissenting).
268. *Id.* at 539-40.

The Court was especially reluctant to allow bankruptcy law to intrude upon state foreclosure law because "'the general welfare of society is involved in the security of the titles to real estate' and the power to ensure that security 'inheres in the very nature of state government.'"[269] The Court's concern that "[t]he title of every piece of realty purchased at foreclosure would be under a federally created cloud"[270] is obviously a major policy reason behind the Court's decision in *BFP*. The majority makes an additional reference to this aspect of *BFP* when it addresses, in a footnote, a criticism leveled by the dissent: "The dissent . . . ignores the fact that it is not state authority over debtor-creditor law in general that is at stake in this case, but the essential sovereign interest in the security and stability of title to land."[271] Alas, it is the concern of good title to and not the value of real property that convinced the Court to immunize foreclosure sales from challenge under fraudulent transfer law. Notwithstanding compelling textual and policy arguments to the contrary, those same rationales may essentially bar an avoidance action under § 547 to challenge unreasonable creditor bid-ins.

However, there is another equally plausible reading of *BFP* that may support avoidance of unreasonable creditor bin-ins. In *BFP*, aside from protection of title, the Court focused on process. The Court was careful to limit its holding to situations where applicable state foreclosure process was strictly followed; therefore, one may read *BFP* as establishing the proposition that if the process is fair, it necessarily follows that the value derived as the fruit of the process is fair. Process is king. The Court will not entertain attacks on the result of the process if the process is fair. Additionally, what constitutes a fair process, according to the Court, is a matter of state and federal law.

When this rationale is applied to unreasonable creditor bid-ins, it appears that a focus on process may condemn such foreclosure sales. In deciding whether a preferential effect exists under § 547(b)(5), the court compares what the creditor received through the transfer with what the creditor would have received in a hypothetical Chapter 7 liquidation if the transfer had not been made. This hypothetical liquidation case is itself a fair process by which a fair value is determined. If the creditor receives more than fair value, that is, more than under the hypothetical Chapter 7 liquidation, then the transfer should be subject to avoidance. Thus, *BFP* may promote, not hinder, certain attacks on real property foreclosures.

VI. CONCLUSION

Real property foreclosures under the Bankruptcy Code pose a viperous nest of complex conceptual problems. Under *BFP* the Supreme Court insulated regularly conducted, noncollusive real property foreclosure sales from attack

269. *Id.* at 544 (quoting American Land Co. v. Zeiss, 219 U.S. 47, 60 (1911)).
270. *Id.*
271. *Id.* at 544-45 n.8 (emphasis omitted).

under § 548 as a constructively fraudulent transfer. The Court accomplished this result by holding that the bid price received at foreclosure sales constitutes reasonably equivalent value as a matter of law, if the sale is a regularly conducted, non-collusive foreclosure sale. However, this decision did not address a trustee's attack on a real property foreclosure sale under § 547 as an avoidable preference. Although authorities disagree on the issue of whether a real property foreclosure sale constitutes an avoidable preference where the creditor is the winning bidder and substantial debtor equity is lost by the estate, *BFP* may suggest that any new attacks should be rejected as inconsistent with the protection of title notions so strong a part of real property law. However, this suggestion is inconsistent with the language of § 547(b) and with the policies embodied in the Bankruptcy Code. Rather, the more compelling argument would show that unreasonable creditor bid-ins should be subject to challenge under § 547.