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## AVOIDABILITY OF FORECLOSURE SALES UNDER SECTION 548(a)(2) OF THE BANKRUPTCY CODE: REVISITING THE TRANSFER ISSUE AND STANDARDIZING REASONABLE EQUIVALENCY

Vic Sung Lam

*Abstract:* Federal courts consider the 1984 amendments to the Bankruptcy Code to have conclusively defined "transfer" to include foreclosure sales under section 548(a)(2). This Comment questions this widely accepted interpretation. Moreover, federal courts have strongly disagreed on the meaning of "reasonably equivalent value" under section 548(a)(2) of the Bankruptcy Code for the purpose of avoiding a foreclosure sale as a constructive fraudulent transfer. This Comment examines the three dominant but divergent approaches to determining reasonable equivalency. It concludes that both the *Durrett* 70-percent rule and the *Madrid* state-procedural approach are inappropriate standards because they fail to comport with the statutory language and purpose of section 548(a)(2). This Comment also asserts that a multi-factor analysis analogous to the UCC commercial reasonableness standard can best achieve the purpose of section 548(a)(2) and balance the comity concerns between federal and state laws. Finally, it suggests that courts engaging in such an analysis should not focus exclusively on public sales, but should also inquire into pre-foreclosure sales efforts commonly accepted as an integral part of a commercially reasonable disposition.

A bankruptcy trustee may avoid a foreclosure<sup>1</sup> sale conducted prior to a debtor's bankruptcy petition as a constructive fraudulent transfer under section 548(a)(2) of the Bankruptcy Code.<sup>2</sup> To successfully avoid the sale, the trustee must establish that the foreclosure was a transfer of the debtor's property for less than a reasonably equivalent value.<sup>3</sup> Congress has provided a definition of "transfer" widely interpreted to encompass foreclosure sales. This Comment, however, questions the popular view by arguing that although a foreclosure may be a transfer under the current definition of transfer, the debtor's equity has not been transferred where a statutory right to redeem from the foreclosure sale exists and remains property of the debtor's estate. Unlike the term "transfer," Congress has not defined "reasonably equivalent value," and the meaning of the phrase remains unclear. This uncertainty has led courts to apply divergent standards to deter-

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1. Foreclosure in this Comment refers to a foreclosure of any kind, including mortgage foreclosures, deed of trust foreclosures, foreclosures of security interests in personalty, forfeiture of real estate contracts, and execution sales. For a list of cases applying § 548 of the Bankruptcy Code to the above types of foreclosures, see THOMAS D. CRANDALL ET AL., *THE LAW OF DEBTORS AND CREDITORS*, ¶ 16.05, at 16-71 n.6 (rev. ed. 1991).

2. 11 U.S.C.A. § 548(a)(2)(A), (B)(i) (West Supp. 1993).

3. *Id.* § 548(a)(2)(A).

mine the avoidability of foreclosure sales. Within an analytic framework encompassing the statutory language and purpose of section 548(a)(2), this Comment critically evaluates the divergent approaches to determining reasonable equivalency. It concludes that giving section 548(a)(2) its intended effect requires courts to adopt a multi-factor commercial reasonableness analysis. It also argues that courts applying the standard should not focus solely on public sales, but should broaden their inquiry to include commonly-accepted sales efforts as an integral part of their commercial reasonableness analysis.

## I. THE FRAUDULENT TRANSFER PROVISION AND ITS PURPOSE

### A. Section 548(a) of the Bankruptcy Code

The fraudulent transfer provision of the Bankruptcy Code, section 548(a), consists of two subsections. Section 548(a)(1) authorizes avoidance by the trustee in bankruptcy of a transfer of the debtor's property where actual fraudulent intent is proven.<sup>4</sup> Section 548(a)(2) provides for avoidance without regard to any actual intent to defraud.<sup>5</sup> Although it is possible for a debtor to conspire with a secured creditor in a foreclosure proceeding to intentionally defraud other creditors, most foreclosures do not involve actual intent to defraud. In most cases, foreclosing creditors are merely enforcing their security rights against a defaulting debtor. As a result, bankruptcy trustees primarily rely on section 548(a)(2) to invalidate pre-petition foreclosure sales as constructively fraudulent transfers.<sup>6</sup>

Section 548(a)(2)(A) and (B)(i) grant a trustee in bankruptcy the power to avoid a transfer of a debtor's interest in property<sup>7</sup> if (1) the transfer occurred within one year of the debtor's bankruptcy petition;<sup>8</sup> (2) the debtor received less than a reasonably equivalent value in

4. *Id.* § 548(a)(1).

5. *Id.* § 548(a)(2).

6. Other statutory bases a bankruptcy trustee may use to avoid foreclosure sales are outside the scope of this Comment. Two such statutory bases, however, are relevant. The preference provision of the Bankruptcy Code, 11 U.S.C.A. § 547(b) (West 1979), permits a trustee to avoid pre-petition transfers that have the effect of preferring one creditor over others by giving the favored creditor more than its respective share of the debtor's assets under the bankruptcy law. Another provision of the Code grants a trustee the rights of a hypothetical lien creditor, 11 U.S.C.A. § 544(a)(1) (West Supp. 1993), of a bona fide purchaser of real property, *id.* § 544(a)(3), and of an actual creditor with an allowable unsecured claim, 11 U.S.C.A. § 544(b) (West 1979), to avoid transfers voidable under applicable nonbankruptcy law or state law. See CRANDALL ET AL., *supra* note 1, ¶¶ 16.02, .03.

7. 11 U.S.C.A. § 548(a) (West Supp. 1993).

8. *Id.*

exchange for the transfer;<sup>9</sup> and (3) the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer.<sup>10</sup>

Judicial interpretations of this section have given rise to controversies over when a “transfer” occurs with respect to foreclosure sales and over the meaning of “reasonably equivalent value.” Despite the general agreement now on the transfer issue, the meaning of “reasonably equivalent value” still remains the focus of sharp disagreement among the federal circuits.

*B. The Equity-Protecting Purpose of Section 548(a)(2)*

The purpose of section 548 is to preserve bankrupt debtors’ estates for fair distribution to all creditors.<sup>11</sup> In the context of foreclosure sales, the purpose of section 548(a)(2) becomes to preserve the debtors’ equity in foreclosed properties.<sup>12</sup> While discussions of the transfer issue seldom refer to this statutory purpose, discussions of reasonable equivalency often do. Despite the consensus on and the frequent reference to the purpose of section 548(a)(2), courts strongly disagree on what the statutory language of “reasonably equivalent value” ought to mean to serve the statutory purpose and have reached divergent conclusions regarding the appropriate standard for determining reasonable equivalency. It becomes imperative then to be mindful of the commonly agreed statutory purpose when considering the issues and the differing views.

II. REVISITING THE TRANSFER ISSUE UNDER SECTION 548(a)(2)

The transfer issue is important since courts need not determine the issue of reasonably equivalent value if a foreclosure sale does not constitute a transfer. As originally enacted in 1978, the Bankruptcy Code

9. *Id.* § 548(a)(2)(A).

10. *Id.* § 548(a)(2)(B)(i).

11. See *Grissom v. Johnson (In re Grissom)*, 955 F.2d 1440, 1446–47 (11th Cir. 1992) (stating that the purpose of § 548 is to prevent depletion of bankruptcy estates); *Barrett v. Commonwealth Fed. Sav. & Loan Ass’n*, 939 F.2d 20, 23–24 (3d Cir. 1991); *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 824 (7th Cir. 1988) (stating that the purpose is to “preserve the assets of the [bankruptcy] estate”); *Henry-Luqueer Properties, Inc. v. Mayo (In re Henry-Luqueer Properties, Inc.)*, 145 B.R. 771, 775 (E.D.N.Y. 1992) (stating that the purpose is to “foster an equitable distribution of the debtor’s property”); *Ruebeck v. Attleboro Sav. Bank (In re Ruebeck)*, 55 B.R. 163, 168 (Bankr. D. Mass. 1985) (“[T]he pervading intent . . . behind the Bankruptcy Code . . . is equitable distribution.”).

12. This purpose entails reasonably maximizing foreclosure sale prices so that debtors’ estates do not suffer unreasonable depletion through loss of debtors’ equity in foreclosure sales. See *BFP v. Imperial Sav. & Loan Ass’n (In re BFP)*, 974 F.2d 1144, 1148 (9th Cir. 1992) (describing the objective of § 548(a)(2) as “price-maximizing”).

did not explicitly define "transfer" to include foreclosures. As a result, some courts held that a foreclosure sale did not constitute a transfer because the only transfer occurred at the time the security interest such as a mortgage or a deed of trust was perfected under state law.<sup>13</sup> Under this one-transfer approach, if the date of perfection of a security interest fell outside the one-year period, the foreclosure sale would be beyond the reach of section 548(a)(2), thus eliminating the need to determine if the transfer was for a reasonably equivalent value.<sup>14</sup> However, federal courts now deem the Bankruptcy Amendments and Federal Judgeship Act of 1984 (the 1984 Amendments)<sup>15</sup> to have overruled the one-transfer approach<sup>16</sup> and to have resolved the "transfer controversy."<sup>17</sup> According to this widely accepted two-transfer view, a transfer occurs both at the time of perfection and at the time of foreclosure sale.

In spite of overruling the one-transfer view, the 1984 Amendments may not have resolved the transfer issue. One may still plausibly

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13. See *Madrid v. Lawyers Title Ins. Corp.* (In re *Madrid*), 725 F.2d 1197, 1199 (9th Cir. 1984) [hereinafter *Madrid II*]; see also *Alsop v. State* (In re *Alsop*), 22 B.R. 1017, 1018 (D. Alaska 1982).

14. Section 548(a) has a one-year statute of limitation. See 11 U.S.C.A. § 548(a) (West Supp. 1993).

15. BAFJA, commonly known as the 1984 Amendments, amended the definition of transfer in § 101 to encompass the "foreclosure of the debtor's equity of redemption," and also amended § 548(a) to explicitly include both voluntary and involuntary transfers. 11 U.S.C.A. §§ 101(54) (West 1993), 548(a) (West Supp. 1993); *Verna v. Dorman* (In re *Verna*), 58 B.R. 246, 250 (Bankr. C.D. Cal. 1986).

16. *Ehring v. Western Community Moneycenter* (In re *Ehring*), 900 F.2d 184, 187 (9th Cir. 1990) (conceding that the 1984 Amendments overruled its ruling on the transfer issue in *Madrid II*); *General Indus., Inc. v. Shea* (In re *General Indus., Inc.*), 79 B.R. 124, 129-30 (Bankr. D. Mass. 1987); *Verna*, 58 B.R. at 251; *Ruebeck v. Attleboro Sav. Bank* (In re *Ruebeck*), 55 B.R. 163, 167 (Bankr. D. Mass. 1985). The scripted colloquy inserted into the Congressional Record after the enactment of the 1984 Amendments, in which Senator Robert Dole tells Senator Dennis DeConcini that the 1984 Amendments have no bearing on "the *Durrett* issue," 130 CONG. REC. S13771-72 (daily ed. Oct. 5, 1984), is not appropriate authority in judicial decision making. See *Garcia v. United States*, 469 U.S. 70, 76 (1984) (stating that the authoritative source for finding legislative intent lies in the Committee Reports rather than the "snippets" of individual members); see also *Ruebeck*, 55 B.R. at 167 n.5 (stating that post-enactment statements are not appropriate authority).

17. See *Ehring*, 900 F.2d at 187; *General Indus.*, 79 B.R. at 129-30; *Ruebeck*, 55 B.R. at 167. The conspicuous lack of discussion of the transfer issue in recent cases strongly indicates a trend disfavoring the one-transfer view. See *Grissom v. Johnson* (In re *Grissom*), 955 F.2d 1440, 1443 (11th Cir. 1992) (assuming transfer without discussion although perfection almost certainly occurred some 18 years prior to the bankruptcy petition); *BFP v. Imperial Sav. & Loan Ass'n* (In re *BFP*), 974 F.2d 1144, 1145-46 (9th Cir. 1992). See generally *Barrett v. Commonwealth Fed. Sav. & Loan Ass'n*, 939 F.2d 20 (3d Cir. 1991); *Henry-Luqueer Properties, Inc. v. Mayo* (In re *Henry-Luqueer Properties, Inc.*), 145 B.R. 771 (E.D.N.Y. 1992).

argue that a transfer resulting in the loss of a debtor's equity interest<sup>18</sup> does not actually occur at the foreclosure sale but occurs at the time the applicable state statutory redemption period has run.<sup>19</sup> This argument is limited, however, in that the statutory right to redeem is not available in all states. Even in those states with a statutory right to redeem,<sup>20</sup> the right is not available to all debtors or for all types of foreclosures.<sup>21</sup> Nevertheless, if a statutory right to redeem is available to a debtor, the right may become property of the debtor's estate under section 541 of the Bankruptcy Code.<sup>22</sup> Once property of the estate, the trustee may exercise the right to redeem or sell it to willing buyers under section 363(b)(1) of the Code,<sup>23</sup> thereby precluding the loss of the debtor's equity interest. Thus, the debtor's equity in the foreclosed property is not transferred at the foreclosure sale but remains property of the estate in the form of a statutory right to redeem for the duration of the statutory redemption period.<sup>24</sup> Under this three-transfer view, the relevant transfer for purposes of section 548(a)(2) is the forfeiture of the debtor's equity upon the expiration or termination of the statutory redemption period. The transfer at the foreclosure sale does not forfeit the debtor's equity and becomes inconsequential in view of the equity-protecting purpose of section 548(a)(2). This three-transfer view is consistent with the statutory definition of transfer. Although the phrase "foreclosure of the debtor's equity of redemption" in the definition of transfer<sup>25</sup> arguably refers to termination of equitable redemption rather than statutory redemp-

18. The equity interest here means the extra value of the property in excess of the foreclosure sale price.

19. The statutory right to redeem foreclosed property allows the mortgagor or other redeeming party to regain possession and ownership if the redeeming party pays the foreclosure sale purchaser the foreclosure sale price and all related costs within the statutorily prescribed period. See CRANDALL ET AL., *supra* note 1, ¶ 8.08[3][g], at 8-45.

20. For a list of jurisdictions that allow the statutory right of redemption, see *id.* ¶ 8.08[3][g], at 8-46 n.108.

21. *Id.* ¶ 8.08[3][g], at 8-46. "[T]he availability of the statutory right to redeem varies significantly from state to state depending on such factors as the amount of the debt, the type of real estate, and whether a deficiency judgment has been obtained." *Id.*

22. *Id.* ¶ 13.04[1], at 13-19 n.28.

23. 11 U.S.C.A. § 363(b)(1) (West 1993). In fact, the trustee may have a duty to dispose of the right to redeem in a way compatible with the best interest of the parties in interest. See *id.* § 704(1) (West Supp. 1993).

24. The redemption period ranges from three months to one year. See, e.g., CAL. CIV. PROC. CODE § 729.030 (West Supp. 1993); MICH. COMP. LAWS ANN. § 600.3240(3)-(5) (West 1987); N.J. STAT. ANN. § 2A:50-4 (West 1987); WASH. REV. CODE ANN. § 6.23.020 (West Supp. 1993). Note that the running of a redemption period may be tolled by § 108, or arguably by the automatic stay of § 362 of the Bankruptcy Code. See CRANDALL ET AL., *supra* note 1, ¶ 13.04[1], at 13-19.

25. See 11 U.S.C.A. § 101(54) (West 1993).

tion,<sup>26</sup> Congress is unlikely to have intended the phrase to limit the meaning of transfer, especially in light of the entire definition of transfer.<sup>27</sup> The broad and all-inclusive definition of transfer should include the actual forfeiture of the debtor's equity interest at the time the statutory redemption period expires.

The argument for the three-transfer view is persuasive, but courts apparently have not ruled on its merits yet. If accepted, the three-transfer view can have a significant impact on actions brought under section 548(a)(2). Under the three-transfer view, the relevant transfer for purposes of section 548(a)(2) does not occur for as long as three months to over a year after the foreclosure sale, depending on the length and tolling of the statutory redemption period. Thus, a three-transfer rule may have the effect of preventing a trustee from bringing an action under section 548(a)(2) for many months after the foreclosure sale. Courts should take this delaying effect into consideration in determining the merits of the three-transfer view.

### III. CURRENT JUDICIAL INTERPRETATIONS OF REASONABLY EQUIVALENT VALUE

Unlike the term transfer, Congress has not defined "reasonably equivalent value" in the Code,<sup>28</sup> leaving the responsibility of defining the term to the courts.<sup>29</sup> Three distinct approaches to interpreting "reasonably equivalent value" have developed. The first approach, the *Durrett* 70-percent rule, focuses on the foreclosure sale price measured against a benchmark percentage of the fair market value established by appraisals, or the appraised value, of a foreclosed property. The second approach, the *Madrid* state-procedural rule, focuses on compliance with state foreclosure procedures. The third approach, the *Bundles* multi-factor analysis, examines all relevant factors surrounding the sale in view of some equitable or commercially reasonable standard.

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26. Equitable redemption refers to redemption prior to a foreclosure sale while statutory redemption refers to redemption after the sale. CRANDALL ET AL., *supra* note 1, § 8.08[3][g], at 8-44.

27. See 11 U.S.C.A. § 101(54) (West 1993).

28. *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 819 (7th Cir. 1988). A proposal to the 1984 Amendments granting an irrebuttable presumption of reasonably equivalent value to any mortgagee or third-party purchaser who purchases mortgaged property at a regularly conducted, non-collusive foreclosure sale for a price equal to the full amount of the mortgage debt, was not enacted. *Verna v. Dorman (In re Verna)*, 58 B.R. 246, 250 (Bankr. C.D. Cal. 1986). The final version of BAFJA did not define "reasonably equivalent value," nor did it provide any guidance for the courts to follow in interpreting the phrase.

29. *Barrett v. Commonwealth Fed. Sav. & Loan Ass'n*, 939 F.2d 20, 23 (3d Cir. 1991).

A. *The Durrett 70-Percent Rule: A Numerical-Ratio Litmus Test for Reasonable Equivalency*

In bringing foreclosure sales under the ambit of section 548(a)(2) of the Bankruptcy Code, the Fifth Circuit's decision in *Durrett v. Washington National Insurance Co.*<sup>30</sup> has been attributed by some with establishing a 70-percent litmus test for determining reasonably equivalent value. In *Durrett*, a debtor executed a promissory note secured by a deed of trust.<sup>31</sup> The debtor defaulted on the note after servicing the debt for over seven years.<sup>32</sup> Pursuant to the power of sale clause contained in the deed of trust, the trustee sold the property at a foreclosure sale for 57.7 percent (\$115,400) of the admitted fair market value (\$200,000).<sup>33</sup> Nine days after the sale, the debtor filed a petition in bankruptcy and sought to invalidate the sale as a fraudulent conveyance under section 67(d) of the Bankruptcy Act.<sup>34</sup> The United States District Court for the Northern District of Texas denied relief.<sup>35</sup> On appeal, the Fifth Circuit vacated the district court decision and held that the foreclosure sale was not a fair exchange for equivalent value and constituted a fraudulent transfer.<sup>36</sup> The Fifth Circuit also noted that it had not been able to locate any judicial decision that approved a transfer of real property for less than 70 percent of the market value.<sup>37</sup> As a result of this dictum, *Durrett* has been said to represent the proposition that a foreclosure sale for less than 70 percent of the fair market value is not a sale for reasonably equivalent value under section 548(a)(2).<sup>38</sup> According to this approach attributed to *Durrett*, the sale price realized at a foreclosure sale measured against the appraised fair market value of the property is the sole determining factor. This approach, more accurately described as the

30. 621 F.2d 201 (5th Cir. 1980).

31. *Id.* at 202.

32. *Id.*

33. *Id.* at 202-03

34. *Id.* at 202 n.1. Section 67(d) is the predecessor of § 548(a)(2) of the Bankruptcy Code.

35. *Durrett v. Washington Nat'l Ins. Co.*, 460 F. Supp. 52, 54 (N.D. Tex. 1978), *vacated*, 621 F.2d 201 (5th Cir. 1980).

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

37. *Id.*

38. *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*, 98 B.R. 983, 986 (Bankr. S.D. Cal. 1989). The 70-percent benchmark does not appear to be a hard and fast rule in practice. *See, e.g., infra* note 39. *But see Barrett v. Commonwealth Fed. Sav. & Loan Ass'n (In re Barrett)*, 104 B.R. 688, 692 (Bankr. E.D. Pa. 1989) (avoiding a foreclosure sale for 69.5 percent of the market value), *vacated and remanded*, 111 B.R. 78 (E.D. Pa. 1990); *Federal Nat'l Mortgage Ass'n v. Wheeler (In re Wheeler)*, 34 B.R. 818, 821 (Bankr. N.D. Ala. 1983) (applying the 70-percent rule mechanically); *Berge v. Sweet (In re Berge)*, 33 B.R. 642, 649-50 (Bankr. W.D. Wis. 1983).



numerical-ratio approach, has developed a following at the lower court level.<sup>39</sup>

*B. The Madrid State-Procedural Approach: Substituting Compliance with State Foreclosure Procedures for Reasonable Equivalency*

The second approach, first outlined by the Ninth Circuit Bankruptcy Appellate Panel in *Lawyer's Title Insurance Corp. v. Madrid (Madrid I)*,<sup>40</sup> does not consider the foreclosure price at all, but instead focuses on whether a foreclosure sale complies with the applicable state foreclosure procedures. Under this approach, a court will conclusively presume that a non-collusive, regularly conducted foreclosure sale yields a reasonably equivalent value.

*Madrid I* involved a non-judicial, pre-petition foreclosure sale similar to the one in *Durrett*.<sup>41</sup> The bankruptcy court found that the sale was conducted properly in accordance with the state law, but that the sale price was 64 percent to 67 percent of the fair market value at the time of sale.<sup>42</sup> Following the *Durrett* 70-percent rule, the court invalidated the foreclosure sale.<sup>43</sup> On appeal, the Bankruptcy Appellate Panel for the Ninth Circuit declined to follow the *Durrett* rule, reasoning that "a regularly conducted sale, open to all bidders and all creditors, is itself a safeguard against the evils of private transfers to relatives and favorites."<sup>44</sup> The Appellate Panel stated that "[t]he law of foreclosure should be harmonized with the law of fraudulent conveyances," and that harmonization could be best achieved by equating the reasonably equivalent value requirement of section 548(a)(2) with the sale price realized at a non-collusive and regularly conducted fore-

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39. See, e.g., *Brasby v. Joseph C. Perry, Inc. (In re Brasby)*, 109 B.R. 113, 125 (Bankr. E.D. Pa. 1990); *Orsa Assoc., Inc. v. MBA Fin., Inc. (In re Orsa Assoc.)*, 99 B.R. 609, 615-18 (Bankr. E.D. Pa. 1989); *In re Corbett*, 80 B.R. 32, 37 (Bankr. E.D. Pa. 1987); *Smith v. American Consumer Fin. Corp. (In re Smith)*, 21 B.R. 345 (Bankr. M.D. Fla. 1982); *Perdido Bay Country Club Estates v. Equitable Trust Co. (In re Perdido Bay Country Club Estates)*, 23 B.R. 36 (Bankr. S.D. Fla. 1982); *Jones v. Home Life Ins. Co. (In re Jones)*, 20 B.R. 988, 993 (Bankr. E.D. Pa. 1982); *Coleman v. Home Sav. Ass'n (In re Coleman)*, 21 B.R. 832 (Bankr. S.D. Texas 1982).

40. 21 B.R. 424 (Bankr. 9th Cir. 1982) [hereinafter *Madrid I*], *aff'd on other grounds, Madrid II*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984).

41. See *id.* at 425.

42. *Madrid v. Del Mar Commerce Co.*, 10 B.R. 795, 800 (Bankr. D. Nev. 1981), *rev'd, Madrid I*, 21 B.R. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds, Madrid II*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984).

43. *Id.* at 800-01.

44. *Madrid I*, 21 B.R. at 426-27.

closure sale.<sup>45</sup> Based on this reasoning, the Appellate Panel reversed the bankruptcy court's decision and upheld the foreclosure sale.<sup>46</sup>

The Sixth Circuit Court of Appeals has since expressed its approval of *Madrid I's* reasoning in dicta.<sup>47</sup> The Ninth Circuit Court of Appeals, however, gave *Madrid I* its latest boost and explicitly adopted the state-procedural approach in *BFP v. Imperial Savings & Loan Ass'n (In re BFP)*.<sup>48</sup> The Ninth Circuit's holding in *BFP* irrebutably presumes a foreclosure sale to be a transfer for a reasonably equivalent value if the sale was non-collusive and regularly conducted in accordance with state foreclosure procedures.<sup>49</sup> This approach equates state procedural requirements with reasonably equivalent value for purposes of section 548. Under this approach, absent collusion, intentional fraud, or violation of state foreclosure procedures, a foreclosure sale will withstand a challenge under section 548(a)(2) even if the price realized falls substantially below the fair market value of the property foreclosed.

C. *The Bundles Multi-factor Analysis: Considering the Totality of Circumstances in Determining Reasonable Equivalency*

Dissatisfaction with both the *Durrett* 70-percent rule and the *Madrid* state-procedural approach became evident when the Eighth Circuit refused to adopt either standard and instead required a case-by-case evidentiary determination of reasonably equivalent value.<sup>50</sup> The Seventh Circuit provided the most well-recognized formulation of this case-by-case approach<sup>51</sup> in *Bundles v. Baker (In re Bundles)*.<sup>52</sup> In *Bundles*, the Seventh Circuit, after examining the two approaches in *Madrid I* and *Durrett*, concluded that both lines of authority were unsatisfactory,<sup>53</sup> and held that a court should consider the totality of the circumstances on a case-by-case basis.<sup>54</sup> Under this approach, a

45. *Id.* at 427. This approach functionally precludes consideration of the issue of adequacy of the consideration (reasonable equivalency under § 548(a)(2)). *Id.* at 428 (Volinn, J., dissenting).

46. *Id.* at 427. The Ninth Circuit affirmed the Appellate Panel's decision but on the ground that the foreclosure was not a transfer. *Madrid II*, 725 F.2d at 1199.

47. See *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1139 (6th Cir. 1985).

48. 974 F.2d 1144, 1148 (9th Cir. 1992).

49. *Id.* at 1149.

50. *First Fed. Sav. & Loan Ass'n of Bismark v. Hulm (In re Hulm)*, 738 F.2d 323, 327 (8th Cir.), cert. denied, 469 U.S. 990 (1984). The *Hulm* court rejected the state-procedural approach and conspicuously ignored *Durrett*.

51. See *BFP*, 974 F.2d at 1148 n.5 (explicitly acknowledging *Bundles* formulation as the most well recognized).

52. 856 F.2d 815 (7th Cir. 1988).

53. *Id.* at 819-21.

54. *Id.* at 824.

court may grant a presumption, rebuttable by the trustee, that the price realized at a regularly conducted foreclosure sale represents a reasonably equivalent value, and the court must examine all relevant factors including the sale price, whether the appraised fair market value was fair, whether the bidding at the sale was competitive, and whether the property was advertised widely.<sup>55</sup> This multi-factor approach with its improved variants<sup>56</sup> has been widely accepted among the circuits,<sup>57</sup> and appeared to be the recent trend until the Ninth Circuit revitalized the *Madrid I* approach in *BFP*.

To date, all federal circuits except the Second, Tenth and D.C. Circuits have spoken on the issue of reasonably equivalent value under section 548(a)(2). Most circuits have adopted the *Bundles* multi-factor analysis either explicitly<sup>58</sup> or implicitly.<sup>59</sup> The Sixth and Ninth Circuits have adopted the *Madrid* state-procedural approach.<sup>60</sup> The Fifth Circuit has not addressed the issue of reasonable equivalency directly since *Durrett*, but seemed to imply in *Federal Deposit Insurance Corp. v. Blanton*<sup>61</sup> a less mechanical approach than the *Durrett* 70-percent rule.<sup>62</sup>

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55. *Id.* Although the *Bundles* court did not articulate the standard for considering the relevant factors of a foreclosure sale, it implicitly adopted the commercial reasonableness standard by citing cases that explicitly adopted the standard. *See id.*

56. Judge Queenan, in *General Indus., Inc. v. Shea* (*In re General Indus., Inc.*), 79 B.R. 124, 132-33 (Bankr. D. Mass. 1987), suggested a controlling standard of "commercial reasonableness" for considering the relevant factors, drawing analogy to the UCC. Judge Malugen, in *Lindsay v. Beneficial Reinsurance Co.* (*In re Lindsay*), 98 B.R. 983, 991 (Bankr. S.D. Cal. 1989), formulated a three-pronged procedure for the multi-factor analysis based on the commercial reasonableness standard: a court should (1) determine whether the foreclosure sale was non-collusive and properly conducted in accordance with state law; (2) examine all "circumstances surrounding the sale to determine whether commercially reasonable steps were taken to achieve the best price;" and (3) review the price realized at the sale if and only if the court finds that the foreclosing creditor failed to take commercially reasonable steps to achieve the best forced sale price.

57. *See, e.g.*, *Grissom v. Johnson*, 955 F.2d 1440, 1445-47 (11th Cir. 1992); *Barrett v. Commonwealth Fed. Sav. & Loan Ass'n*, 939 F.2d 20, 23-25 (3d Cir. 1991); *Cooper v. Ashley Communications, Inc.* (*In re Morris Communications*), 914 F.2d 458, 467 (4th Cir. 1990); *Bundles*, 856 F.2d at 823-24; *First Fed. Sav. & Loan Ass'n of Bismark v. Hulm* (*In re Hulm*), 738 F.2d 323, 327 (8th Cir. 1984).

58. *See Grissom*, 955 F.2d at 1445 (11th Cir.); *Barrett*, 939 F.2d at 23-25 (3d Cir.); *Cooper*, 914 F.2d at 466 (4th Cir.); *Bundles*, 856 F.2d at 824-25 (7th Cir.).

59. *See Hulm*, 738 F.2d at 327 (8th Cir.); *Consove v. Cohen* (*In re Roco Corp.*), 701 F.2d 978, 981-82 (1st Cir. 1983).

60. *See BFP v. Imperial Sav. & Loan Ass'n* (*In re BFP*), 974 F.2d 1144, 1148-49 (9th Cir. 1992); *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1138-40 (6th Cir. 1985).

61. 918 F.2d 524 (5th Cir. 1990).

62. *See id.* at 531 n.7.

#### IV. ANALYSIS OF THE CURRENT APPROACHES TO DETERMINING REASONABLE EQUIVALENCY

Assuming that a foreclosure sale is a transfer,<sup>63</sup> courts must look into the issue of reasonable equivalency. The current three-way split among the circuits epitomizes their differing views on the relative importance of the federal interest in preserving debtors' equity on the one hand, and the traditional state interest in determining property rights on the other. A satisfactory resolution of the disagreement must adequately address the valid concerns courts have shown in reaching their divergent decisions.

The first step in resolving the disagreement is to establish an analytic framework for evaluating the respective merits of the three approaches. In the context of interpreting "reasonably equivalent value" under section 548(a)(2), three criteria are important: (1) an acceptable standard must comport with the statutory purpose of section 548;<sup>64</sup> (2) it must also be consistent with the statutory language of the section;<sup>65</sup> and (3) it must not unduly interfere with the traditional state areas of regulation.<sup>66</sup> These criteria capture the valid concerns expressed by the various courts and embody the substantive underpinnings for the different approaches.

##### *A. Durrett Should Be Recognized for First Acknowledging a Federal Right of Redemption Under Section 548(a)(2) Rather Than Establishing a Rigid and Arbitrary 70-Percent Rule Inconsistent with the Statutory Language and Purpose of Section 548*

The purpose of section 548 is to protect debtors' equity for fair distribution to all creditors.<sup>67</sup> Whether a rigid 70-percent rule can adequately serve this equity-protecting purpose remains doubtful. Courts

63. For a discussion of the transfer issue, see *supra* notes 13–27 and accompanying text.

64. See *supra* notes 11–12 and accompanying text (indicating the widespread consensus on the statutory purpose of § 548).

65. See *Norfolk & W. Ry. v. American Train Dispatchers Ass'n*, 111 S. Ct. 1156, 1163 (1991) (indicating that statutory interpretation begins with statutory language); *Bundles v. Baker* (*In re Bundles*), 856 F.2d 815, 822–23 (7th Cir. 1988) (stating that courts' duty is to simply interpret the language of the statute); *Lindsay v. Beneficial Reinsurance Co.* (*In re Lindsay*), 98 B.R. 983, 989 (Bankr. S.D. Cal. 1989) (stating that any analysis of § 548(a) must begin with the clear language of the statute).

66. *BFP v. Imperial Sav. & Loan Ass'n* (*In re BFP*), 974 F.2d 1144, 1149 (9th Cir. 1992); *cf. Madrid I*, 21 B.R. 424, 427 (Bankr. 9th Cir. 1982) (arguing that the state law of foreclosure should be harmonized with the federal law of fraudulent conveyances), *aff'd on other grounds, Madrid II*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984).

67. See *supra* notes 11–12 and accompanying text.

applying the *Durrett* 70-percent rule rely on appraisals submitted by the parties to each case.<sup>68</sup> This appraisal-based valuation is problematic for at least two reasons. First, methods of appraisal are not an exact science and rely on many assumptions. Appraisals of residential properties are commonly based on comparable sales, but some types of property such as many commercial properties simply lack comparable sales. These appraisals are often based on questionable assumptions and can vary widely depending on the individual appraisers. Second, even appraisals based on the so-called comparable sales fail to take into consideration the forced nature, the liquidity requirement, and other price-reducing characteristics of foreclosure sales.<sup>69</sup> The extent to which these price-suppressing characteristics affect the value of the foreclosed property depends on the time, place, economic conditions, and particular circumstances involved. Absent any evidence that the price-reducing characteristics consistently account for about 30 percent of the appraised market value, the 70-percent benchmark is arbitrary. The tenuous appraisals coupled with the arbitrary 70-percent benchmark render the *Durrett* 70-percent rule a shot-in-the-dark approach to determining reasonable equivalency and thus to accomplishing the equity-protecting purpose of the statute. In practice, the rule subjects both creditors and debtors to appraisal risk and creates inequity. On the one hand, a court may avoid a well-run foreclosure sale which achieved the true market value of the collateral given the market conditions, but the sale price happened to fall short of the 70-percent benchmark. On the other hand, the rule may fail to protect much of the debtor's equity in cases where the sale price fell far short of the true realizable market value, but happened to be slightly above the 70-percent benchmark. Thus, blindly applying this numerical formula to complex factual situations without any regard for the accompanying circumstances inevitably creates inequity and cannot effectively serve the purpose of section 548.

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68. Each party presumably pursues its own best interests in submitting appraisals. Usually, courts choose some average of the often different appraisals as the fair market value. Some courts following the *Durrett* 70-percent rule believe this method of valuation is fair and not particularly difficult. See, e.g., *Brasby v. Joseph C. Perry, Inc. (In re Brasby)*, 109 B.R. 113, 124-25 (Bankr. E.D. Pa. 1990).

69. Foreclosure sales involve liquidation of collateral in a relatively short period of time. They generally require all-cash payment from third-party purchasers, and also lack proper title at the time of payment. See Scott B. Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933, 978-79 (1985). These characteristics inevitably suppress sale prices to a level below those so-called comparable, fully negotiated transactions. See *Ruebeck v. Attleboro Sav. Bank (In re Ruebeck)*, 55 B.R. 163, 170 (Bankr. D. Mass. 1985) (indicating that a foreclosure sale price falls short of the fair market value even under the best of conditions).

Not only is a rigid 70-percent rule unable to effectively achieve the statutory purpose of protecting debtors' equity, it also fails to comport with the statutory language of section 548(a)(2). Congress has chosen the words "reasonably equivalent value" to express its intended standard rather than fixing a numerical formula.<sup>70</sup> Such statutory language indicates that courts need to examine more factors than just the sale price measured against an arbitrary numerical benchmark.<sup>71</sup> Thus, a rigid 70-percent rule oversimplifies the requirements of the statutory language.

More importantly, the Fifth Circuit probably did not intend its "purest form of dicta"<sup>72</sup> in *Durrett* to become a rigid 70-percent rule.<sup>73</sup> In fact, the Fifth Circuit recently indicated its unwillingness to adopt any rigid percentage rule in *Federal Deposit Insurance Corp. v. Blanton*.<sup>74</sup> Thus, the so-called *Durrett* 70-percent rule is probably a mere creation of some lower courts and commentators and certainly lacks substantive merits as a legal rule. Rather than establishing a rigid 70-percent rule, *Durrett* should be recognized as breaking new ground by first acknowledging a federal right of redemption in non-collusive foreclosure sales<sup>75</sup> because the constructive fraudulent transfer provision indeed provides a de facto one-year redemption period within which debtors may recover their foreclosed property if they did not receive a reasonably equivalent value for their property.<sup>76</sup>

### *B. The Madrid State-Procedural Approach Does Not Comport with the Statutory Language of Section 548(a)(2) and Strips Section 548(a)(2) of Its Intended Effects*

While a rigid 70-percent rule represents an implausible attempt to serve the purpose of section 548, the *Madrid* state-procedural approach actually undermines the very purpose of the provision. The approach replaces the federal standard of reasonable equivalency with

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70. See 11 U.S.C.A. § 548(a)(2)(A) (West Supp. 1993). Had Congress intended merely a numerical definition for "reasonably equivalent value," it could have simply provided a percentage in the statute.

71. See *Grissom v. Johnson*, 955 F.2d 1440, 1445 (11th Cir. 1992) ("There is no simple mathematical test which adequately substitutes for [the] required analysis of all important facts. . . . Congress did not intend to make a fixed percentage dispositive of reasonable equivalence.").

72. *Id.* at 1444.

73. To date, the Fifth Circuit has not acknowledged a rigid 70-percent rule many have attributed to its decision in *Durrett*.

74. See 918 F.2d 524, 531 n.7 (5th Cir. 1990).

75. See 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, 265-66 (1985).

76. See 11 U.S.C.A. § 548(a)(2) (West Supp. 1993).

the state procedural standards for proper foreclosure sales,<sup>77</sup> effectively limiting all federal inquiry to examining compliance with state foreclosure procedures and precluding any examination of the value of the property foreclosed upon.<sup>78</sup> Such a substitution makes sense only if the federal and state standards substantively coincide. However, the state procedures generally do not comport with the price-maximizing objective of the federal statute.<sup>79</sup> In fact, most current state foreclosure procedures are inadequate for maximizing prices and are "in drastic need of upgrading."<sup>80</sup> Until state procedures can achieve the same substantive goal as the federal standard, equating the two for the purpose of section 548(a)(2) is not appropriate.

The *Madrid* state-procedural approach also renders section 548(a)(2) redundant. Under this approach, trustees can avoid foreclosure sales for collusion or failure to comply with state procedures, but they can already do so under other provisions of the Bankruptcy Code. Specifically, sections 548(a)(1) and 558 permit avoidance for collusion.<sup>81</sup> Sections 544(b) and 558 permit avoidance allowable under applicable state law for failure to comply with state foreclosure procedures.<sup>82</sup> Thus, the state-procedural approach renders section 548(a)(2) duplicative of existing bankruptcy provisions and amounts to interpreting section 548(a)(2) out of existence, depriving bank-

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77. See *BFP v. Imperial Sav. & Loan Ass'n (In re BFP)*, 974 F.2d 1144, 1149 (9th Cir. 1992) (irrebuttably presuming reasonable equivalency for non-collusive foreclosure sales conducted in compliance with state law).

78. See *Ruebeck v. Attleboro Sav. Bank (In re Ruebeck)*, 55 B.R. 163, 167 (Bankr. D. Mass. 1985) (pointing out that the *Madrid* approach proscribes factual inquiry into reasonable equivalency).

79. See *General Indus., Inc. v. Shea (In re General Indus., Inc.)*, 79 B.R. 124, 131-32 (Bankr. D. Mass. 1987) (stating that state procedures are not designed to maximize foreclosure sale prices).

80. Ehrlich, *supra* note 69, at 961-62. State foreclosure procedures are based on the archaic assumption that publicly held auctions can realize the market price for a foreclosed property. This might have been true in times when towns were small and news of foreclosure sale could be easily disseminated to interested parties. However, modern society has changed substantially, and selling one's property on the courthouse doorsteps is no longer an effective way to realize the true market value of property. See *id.* The most recent empirical study confirms the inadequacy of state foreclosure procedures to achieve satisfactory prices and further indicates that such inadequacy hurts both the mortgagor and the mortgagee. See Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 884 (1985).

81. Section 548(a)(1) applies to a collusion involving the debtor as a colluding party, see 11 U.S.C.A. § 548(a)(1) (West Supp. 1993), while § 558 applies to a collusion by others against the debtor's interest, see *id.* § 558 (formerly § 541(e) prior to the 1984 Amendments).

82. Under § 544(b), the trustee asserts the rights of an actual creditor with an allowable unsecured claim to avoid a sale. See 11 U.S.C.A. § 544(b) (West 1979). Under § 558, the trustee asserts the defenses of the debtor to avoid a sale. See 11 U.S.C.A. § 558 (West Supp. 1993).

ruptcy trustees of an independent federal cause of action under that section.

In addition to undermining the statutory purpose, the *Madrid* state-procedural approach fails to comport with the statutory language of section 548(a)(2). Section 548(a)(2) does not make any distinction between sales that comply with state law and those that do not.<sup>83</sup> Congress clearly did not legislate an irrebuttable presumption of reasonable equivalency for sales that merely complied with state law.<sup>84</sup> To judicially create such a presumption is inappropriate.<sup>85</sup> The role of the judiciary is to interpret the language of the statute<sup>86</sup> and “give effect to congressional will, however ambiguous its manifestation.”<sup>87</sup> Congress’ conscious use of a federal standard is not ambiguous and indicates its unwillingness to rely on state procedures to protect the federal interest in equitable distribution of debtors’ assets.<sup>88</sup> Thus, interpreting section 548(a)(2) to dispense with an independent federal assessment of reasonable equivalency<sup>89</sup> ignores congressional will, effectively shields inadequately conducted foreclosures from judicial scrutiny under section 548(a)(2), and thereby severely undermines the ability of trustees to recover lost equity.<sup>90</sup>

Despite the apparent problems with the *Madrid* state-procedural approach, the Ninth Circuit in *BFP v. Imperial Savings & Loan Ass’n (In re BFP)*,<sup>91</sup> the most recent support for this approach, argued that market stability and comity concerns for traditional state areas of regulation compelled the adoption of the approach.<sup>92</sup> While the concerns are legitimate, the court’s reasoning is flawed. In attacking the *Bundles* multi-factor analysis as upsetting market stability, the Ninth Cir-

83. See *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 821 (7th Cir. 1988).

84. *Id.* A proposed amendment to § 548 adopting such an irrebuttable standard was deleted from the 1984 Amendments. See *supra* note 28. This indicates that Congress was not willing to adopt such a standard.

85. See *Landon v. Plasencia*, 459 U.S. 21, 34–35 (1982) (stating that the role of the judiciary does not extend to imposing its will over congressional choice of policy).

86. *Bundles*, 856 F.2d at 823.

87. *Id.* at 822.

88. *Id.* at 824.

89. *Id.* at 821.

90. Since the great majority of foreclosure sales are non-collusive and regularly conducted according to minimal state requirements, the approach effectively creates a wholesale exemption for these often poorly conducted foreclosure sales. See *Barrett v. Commonwealth Fed. Sav. & Loan Ass’n*, 939 F.2d 20, 24 n.6 (3d Cir. 1991); *Bundles*, 856 F.2d at 823; *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*, 98 B.R. 983, 990 (Bankr. S.D. Cal. 1989).

91. 974 F.2d 1144 (9th Cir. 1992).

92. See *id.* at 1148–49. Unlike *BFP*, *Madrid I* offered much scantier arguments for the approach, and merely implied the comity concerns. *Madrid I*, 21 B.R. 424, 427 (Bankr. 9th Cir. 1982).



cuit relied on Professor Scott B. Ehrlich's criticisms directed at the *Durrett* approach in practice, not at the *Bundles* approach.<sup>93</sup> Examination of Professor Ehrlich's article reveals that he concurs with the widely held view that the current inadequate state foreclosure procedures render the *Madrid* state-procedural approach inappropriate.<sup>94</sup> In fact, he even suggests that courts continue putting pressure on the states until they "revamp" their foreclosure procedures.<sup>95</sup>

The Ninth Circuit also raised the comity issue of giving due regard to traditional state areas of regulation.<sup>96</sup> The court, however, misapplied the comity principle in its pre-emption analysis to justify the *Madrid* state-procedural approach. The recent Supreme Court decision, *Cipollone v. Liggett Group, Inc.*,<sup>97</sup> cited by the Ninth Circuit in support of its position,<sup>98</sup> expressly recognized congressional purpose as the "'touchstone' of pre-emption analysis."<sup>99</sup> The congressional purpose for section 548(a)(2) clearly encompasses creating an independent federal cause of action.<sup>100</sup> The *Madrid* state-procedural approach, however, strips section 548(a)(2) of its independent cause of action by equating reasonable equivalency with state procedural requirements and by precluding independent federal determination of reasonable equivalency.<sup>101</sup> According to the Supreme Court, such a conflict with congressional purpose constitutes sufficient grounds for pre-empting state procedures.<sup>102</sup> To the extent pre-empted, the state foreclosure procedures should be "without effect" for purposes of section 548(a)(2).

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93. See *BFP*, 974 F.2d at 1148-49 (criticizing the *Bundles* approach as an untenable and ad hoc approach that produces intolerable uncertainty and undermines price-maximizing objectives, citing Professor Ehrlich's article). But see Ehrlich, *supra* note 69, at 963-64. Professor Ehrlich pointed out that virtually every case that has followed *Durrett* has in practice engaged in case-by-case factual analysis rather than applying a rigid 70-percent rule. See *id.* at 963 n.89. According to Professor Ehrlich, the *Durrett* line rather than the *Bundles* line of case-by-case analyses is actually untenable and ad hoc. See *id.* at 963-65.

94. See Ehrlich, *supra* note 69, at 966 (stating that *Madrid I* is valid only if state procedures are adequate); *id.* at 975 (concluding that state procedures are woefully inadequate).

95. See *id.* at 967. The most recent empirical study indicates that state foreclosure procedures have also failed to achieve their own intended results of competitive bidding and fair prices. See Wechsler, *supra* note 80, at 852, 884.

96. See *BFP*, 974 F.2d at 1149.

97. 112 S. Ct. 2608 (1992).

98. See *BFP*, 974 F.2d at 1149.

99. *Cipollone*, 112 S. Ct. at 2617 (citing *Malone v. White Motor Corp.*, 435 U.S. 497 (1978)).

100. See *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 823 (7th Cir. 1988); see also *General Indus., Inc. v. Shea (In re General Indus., Inc.)*, 79 B.R. 124, 131 (Bankr. D. Mass. 1987) (arguing courts must take the statute at face value as intending to cover all foreclosures).

101. See *supra* notes 77-90 and accompanying text.

102. See *Cipollone*, 112 S. Ct. at 2617 (declaring that any state law that conflicts with federal law is "without effect") (quoting *Maryland v. Louisiana*, 451 U.S. 725 (1981)).

The pre-emption issue becomes increasingly important in view of the states' willingness to compromise the purpose of section 548(a)(2) by adopting the *Madrid I* formulation of reasonable equivalency in the Uniform Fraudulent Transfer Act (UFTA).<sup>103</sup> As the majority of states have adopted UFTA at the expense of the purpose of section 548(a)(2),<sup>104</sup> federal courts must not fail to adequately protect the federal interests under section 548(a)(2) by misjudging the relative importance of the pre-empting federal statute and due regard for state regulations.<sup>105</sup>

C. *The Bundles Multi-Factor Analysis Gives Section 548(a)(2) Its Intended Effects and Balances Comity Concerns*

The *Bundles* multi-factor analysis, which takes into consideration all relevant facts of a foreclosure sale in determining reasonable equivalency, represents the most sensible approach to the issue of reasonable equivalency. First, this approach permits federal courts to independently examine foreclosure sales to ensure achieving the equity-protecting purpose of section 548(a)(2).<sup>106</sup> Second, the approach has sufficient flexibility to allow courts to accord due regard for state and local interests in individual cases.<sup>107</sup> Third, the statutory language of "reasonably equivalent value" implies judicial inquiry into reasonableness of foreclosure sales in light of both the statutory purpose<sup>108</sup> and particular circumstances.<sup>109</sup> Courts cannot adequately determine reasonableness of foreclosures without making a factual inquiry into all the relevant factors of a case. In short, the *Bundles* multi-factor analysis comports with the purpose and language of section 548(a)(2) and permits courts to balance comity concerns. More-

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103. See Unif. Fraudulent Transfer Act § 3(b) 7A U.L.A. 650 (1985). The National Conference of Commissioners on Uniform State Laws, after heated debate, adopted the *Madrid I* formulation to counteract the "Durrett problem," the perceived encroachment by § 548(a)(2) upon state regulation of foreclosures. For a detailed discussion of the UFTA, see Peter A. Alces & Luther M. Dorr, Jr., *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. ILL. L. REV. 527 (1985).

104. To date, more than half of the states have adopted UFTA. For a list of jurisdictions that have adopted UFTA, see CRANDALL ET AL., *supra* note 1, ¶ 6.07[2][a], at 6-160 n.128.

105. See *International Longshoremen's Ass'n v. Davis*, 476 U.S. 380, 389 (1986).

106. See *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 824 (7th Cir. 1988).

107. See *Grissom v. Johnson*, 955 F.2d 1440, 1449 (11th Cir. 1992) (arguing that the multi-factor analysis is the only way to provide adequate deference to state foreclosure procedures and rights of secured creditors, without trammeling upon the statutory purpose of § 548).

108. *Henry-Luqueer Properties, Inc. v. Mayo (In re Henry-Luqueer Properties, Inc.)*, 145 B.R. 771, 775 (E.D.N.Y. 1992) (pointing out that the purpose is to foster an equitable distribution of the debtor's property).

109. *General Indus., Inc. v. Shea (In re General Indus., Inc.)*, 79 B.R. 124, 132 (Bankr. D. Mass. 1987).

over, despite the emphasis on sale prices, even *Durrett* and its progeny have in fact implicitly engaged in case-by-case analysis of all the relevant facts.<sup>110</sup> This phenomenon further suggests the appropriateness of the *Bundles* multi-factor analysis.

The multi-factor approach as formulated in *Bundles*, however, merely lists some factors to be considered in determining reasonable equivalency and fails to explicitly provide a definite controlling standard for considering those factors.<sup>111</sup> Nevertheless, case law clearly indicates that courts have adopted a commercial reasonableness standard, drawing an analogy to the Uniform Commercial Code (UCC).<sup>112</sup> The basis for adopting the UCC standard by analogy is sound. First, the UCC is the most uniform and enlightened modern state law on the subject of commercial reasonableness.<sup>113</sup> It naturally becomes the best candidate to harmonize state law and a federal reasonableness standard.<sup>114</sup> Second, the commercial reasonableness standard, unlike state real estate foreclosure procedures, comports with the equity-protecting purpose of section 548(a)(2) because a commercially reasonable foreclosure sale should achieve a price reasonably equivalent to the full realizable market value and thereby preserves any market-determined equity interest the debtor may have in the foreclosed property. Moreover, the Supreme Court recently, when faced with an insufficiently defined term in a similar bankruptcy provision involving property rights in the assets of a bankrupt's estate, looked to the UCC for guidance in determining when a transfer was made by a check pay-

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110. See *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 204 (5th Cir. 1980). The court wrote, "[o]ur review of the entire evidence leaves us with a definite and firm conviction that the price . . . was not a 'fair equivalent' for the property," strongly indicating that the court's decision rested on all the facts rather than the price alone. See *id.* *Durrett's* progeny often make their decisions in a similar fashion. See Ehrlich, *supra* note 69, at 963 n.89. Note that *Durrett's* case-by-case factual analysis lacks a definite controlling standard.

111. See *Bundles v. Baker (In re Bundles)*, 856 F.2d 815, 824 (7th Cir. 1988).

112. See *General Indus.*, 79 B.R. at 131-33; see also *Grissom v. Johnson*, 955 F.2d 1440, 1446 (11th Cir. 1992) (requiring foreclosing parties to take "all commercially reasonable steps" to recover debtors' equity); *Bundles*, 856 F.2d at 824 (citing cases which have explicitly argued for the standard); *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*, 98 B.R. 983, 990-91 (Bankr. S.D. Cal. 1989).

113. *General Indus.*, 79 B.R. at 131, 132-33.

114. See *id.* at 133. But see *Madrid I*, 21 B.R. 424, 427 (Bankr. 9th Cir. 1982) (advocating harmonization between state foreclosure procedures and the federal fraudulent conveyance law). Note that the UCC foreclosure requirements are used for personalty and fixtures rather than realty, but the distinction between personalty and realty is irrelevant for purpose of § 548(a)(2) because Congress did not make the distinction in the fraudulent transfer provisions. The term "transfer," as defined in the statute, includes both kinds of property. See 11 U.S.C.A. § 101(54) (West 1993).

ment.<sup>115</sup> Therefore, absent a better standard, the UCC commercial reasonableness standard should be the controlling standard for considering all the relevant factors under section 548(a)(2).

### V. BROADENING JUDICIAL INQUIRY INTO THE COMMERCIAL REASONABLENESS OF FORECLOSURE SALES

Courts currently applying the commercial reasonableness standard have not taken full advantage of the relevant UCC provisions to achieve the price-maximizing objective of section 548(a)(2). To date, courts have limited their inquiry to public sales and have neglected private channels as an important means of property disposition.<sup>116</sup> The UCC requires “every aspect of the disposition,” including the “method” of disposition, to be commercially reasonable.<sup>117</sup> Choosing a public sale in spite of higher private offers may be commercially unreasonable, regardless of how well-run the public sale.<sup>118</sup> Thus, courts should look beyond public sales and examine the methods of disposition as an additional factor for determining the commercial reasonableness of foreclosure sales.

The UCC also specifies as a commercially reasonable paradigm sales conducted “in the usual manner in any recognized market” for the type of collateral involved.<sup>119</sup> Public sales are often not the usual manner of selling property. For example, one would normally not choose to sell one’s home at a public sale since it will be extremely difficult for public sales to achieve the highest realizable market values.<sup>120</sup> In cases involving partnership interests, the usual manner of selling through commercial channels will almost certainly result in higher prices for the collateral.<sup>121</sup> Thus, federal courts should inquire into sales efforts customary for the type of property involved as an integral part of the inquiry into the promotion of public foreclosure

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115. See *Barnhill v. Johnson*, 112 S. Ct. 1386, 1389 (1992) (using the UCC to determine what constitutes a transfer under § 547(b), the preference provision).

116. See, e.g., *Grissom*, 955 F.2d at 1448; *Barrett v. Commonwealth Fed. Sav. & Loan Ass’n*, 939 F.2d 20, 26 (3d Cir. 1991); *Bundles*, 856 F.2d at 824; *Lindsay*, 98 B.R. at 992.

117. U.C.C. § 9-504(3).

118. See *United States v. Willis*, 593 F.2d 247, 250, 259 (6th Cir. 1979) (holding commercially unreasonable a public sale for approximately \$41,000 when the secured party had two pre-auction private offers of \$200,000 and \$210,000).

119. UCC § 9-507(2).

120. See *General Indus., Inc. v. Shea (In re General Indus., Inc.)*, 79 B.R. 124, 130 (Bankr. D. Mass. 1987).

121. See *Thomas v. Price*, 975 F.2d 231, 238 (5th Cir. 1992) (indicating that a private sale of partnership interest through commercial channels was almost certain to result in higher realization on the collateral).

sales. Prospective buyers found through such efforts should be invited to attend the foreclosure sales. This broadened inquiry can increase competitive bidding and as a result better serve the price-maximizing objective of section 548(a)(2).

As a practical matter, foreclosed properties are inherently not as marketable as other properties due to the uncertainty in title and the risks usually accompanying distressed properties; thus foreclosure sales may never be able to achieve similar market prices.<sup>122</sup> This fact is an additional reason for considering the usual commercial practices where market forces operate. The goal should not be to attain the full appraised market value; it should be to attain a reasonably full realizable value, given the market conditions and the inherent downward pressure of foreclosures. Since the market provides the best means of determining value, the best way to determine the reasonably full realizable value is to let the property be tested fully by market forces. The broadened inquiry allows such testing and provides in practice a better means of ascertaining the true value of the foreclosed property.

## VI. CONCLUSION

Despite the widespread view that the 1984 Amendments have conclusively resolved the transfer issue, the equity-protecting effect of state statutory redemption casts doubts on the validity of this view in jurisdictions allowing post-foreclosure statutory right of redemption. In these jurisdictions, one may plausibly argue that three transfers are at issue, and the third transfer upon expiration of the statutory redemption period, rather than the second one at the foreclosure sale, is the relevant transfer for purposes of section 548(a)(2). The three-transfer view, if adopted, can significantly impact actions brought under section 548(a)(2) by preventing a trustee from bringing such an action for up to a year or more. The transfer issue aside, of the three divergent approaches to determining reasonable equivalency under section 548(a)(2), the multi-factor analysis following the commercial reasonableness approach of the UCC provides the most balanced method for achieving the purpose of section 548(a)(2). However, courts already applying the commercial reasonableness standard are urged to broaden their inquiry to include customary sales efforts through the usual channels as an integral part of their commercial reasonableness analysis. This broadened inquiry can better serve the

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122. See *General Indus.*, 79 B.R. at 132.

## Avoidability of Foreclosure Sales

equity-protecting purpose of section 548(a)(2) by taking advantage of market forces to help determine more accurately the true realizable values of foreclosed properties.