A SEARCH FOR REASON IN "REASONABLY EQUIVALENT VALUE" AFTER *BFP V. RESOLUTION TRUST CORP.*

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INTRODUCTION

Under state fraudulent transfer law, a creditor can undo or avoid a transfer of property from his debtor to a third party if the debtor intended the transfer to "hinder, delay or defraud" his creditors.[1] Alternatively, a creditor can avoid a transfer without proving the debtor's fraudulent intent by showing the transfer was a constructive fraud. Although state law varies among jurisdictions, the test for constructive fraud generally requires the creditor to show that at the time of the transfer, the debtor was insolvent or nearly insolvent, and that the transfer was for less than "fair consideration" or for less than "reasonably equivalent value" in exchange.[2]

The Bankruptcy Code provides federal law bases by which a trustee in bankruptcy can avoid certain pre petition transfers of the debtor's property as fraudulent. Once the debtor files for relief, the bankruptcy trustee can avoid any transfer under section 544(b) that a creditor could have avoided under state law.[3] The Bankruptcy Code also contains a distinctly federal ground for avoidance that is not derivative of creditors' state law rights. A trustee may avoid a transfer of the debtor's property that occurred within one year before commencement of the bankruptcy case on proof that the debtor actually intended to defraud its creditors, (actual fraud)[4] or that the transfer occurred within a year prior to the filing, while

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[1] *See, e.g.*, UNIF. FRAUDULENT CONVEYANCE ACT § 9, 7A Pt. II U.L.A. 198 (1999) [hereinafter UFCA] ("Where a conveyance or obligation is fraudulent as to a creditor, such creditor . . . [may] have the conveyance set aside . . . [or may] disregard the conveyance and attach or levy . . . ."); UNIF. FRAUDULENT TRANSFER ACT § 7, 7A Pt. II U.L.A. 339 (1999) [hereinafter UFTA] (stating creditor may obtain "avoidance of the transfer or obligation . . . [or] an attachment or other provision remedy against the asset transferred or other property of the transferee . . . ."); S.C. CODE ANN. § 27–23–20 (Law. Co-op. 1991) ("Every conveyance . . . made for the intent and of purpose to defraud and deceive . . . [is deemed] to be utterly void, frustrate and of no effect . . . .").

[2] *See, e.g.*, UFCA § 4, 7A Pt. II U.L.A. 198 ("Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if conveyance is made or obligation is incurred without a fair consideration."); UFTA § 5, 7A Pt. II U.L.A. 339 (stating transfer by debtor is fraudulent as to creditors if debtor made transfer "without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.").

[3] *See* 11 U.S.C. § 544(b)(1) (2000) ("[T]rustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim . . . .").

[4] *See* 11 U.S.C. § 548(a)(1)(A) (2000) (noting trustee can avoid transfers made one year before bankruptcy if debtor, either voluntarily or involuntarily, made transfer "with actual intent to hinder, delay, or defraud

the debtor was insolvent or nearly so, and for which the debtor received "less than a reasonably equivalent value in exchange" (constructive fraud).[5]

Both the state and federal grounds for constructive fraud avoidance turn in part on proof that the transfer price was less than the reasonable value of the property. Despite this similarity, the state and federal grounds are not coextensive. The distinction between them highlights an important but subtle disagreement about the scope of constructive fraud as grounds for transfer avoidance under state law and in bankruptcy. The disagreement has two dimensions. First, courts and commentators do not completely understand or agree on the relevance of collusion between the transferor and transferee in constructive fraud avoidance actions. Second, the function of the bankruptcy transferee's federal constructive fraud avoiding power relative to creditors' rights under state law is obscure. The confluence of the two dimensions appears starkly when a trustee in bankruptcy challenges as a constructive fraud a foreclosure sale or other forced transfer regulated by state law. Both state and federal articulations of constructive fraud grounds for avoidance appear to render avoidable any wealth depleting transfer that occurs while the debtor is insolvent and on the slide to bankruptcy without express regard to the cause of the wealth depletion. But, under state law, evidence of a positive difference between fair market value and a regulated, forced transfer price does not justify avoidance absent evidence of collusion or other irregularity.[6] The potential

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any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred . . . .").

[5] *See* 11 U.S.C. § 548(a)(1)(B) (providing trustee may avoid transfer made within one year of filing if debtor "voluntarily or involuntarily . . . received less than a reasonably equivalent value in exchange for such transfer . . . ." and was insolvent, became insolvent thereby, was undercapitalized, or intended at time of transfer to incur debts beyond his ability to pay). When a transfer is unavoidable under state law, the trustee can avoid it, if at all, only under section 548. This assumes that the transfer is not subject to avoidance under another of the trustee's avoiding powers, *e.g.*, the power to avoid preferential transfers under 11 U.S.C. § 547. *See generally id*. § 547 (setting forth preference power of trustee in bankruptcy). The trustee's section 548 avoiding power can be useful, although not essential, to a trustee in cases where the transfer is also avoidable under state law, for example where use of section 548 eliminates litigation about which state law applies to the challenged transfer.

[6] For example, the UFTA, adopted by thirty-eight jurisdictions, protects certain regulated transfers from constructive fraud avoidance by treating the transfer price set by such regulation as the "reasonably equivalent value" of the property transferred. Where UFTA does not provide the governing law, states generally require a party seeking to avoid a regulated transfer to show an irregularity in the proceeding, collusion, or a "grossly inadequate" transfer price. *See, e.g.*, German Vill. Prods., Inc. v. Miller, 290 N.E.2d 855, 858 (1972) ("Generally, a judicial sale can be set aside after conformation only upon a showing of gross inadequacy of price."). The size of the wealth depletion alone does not justify avoidance absent circumstances that "shock the conscience" of the court. *See, e.g.*, Nussbaumer v. Superior Ct., 489 P.2d 843, 846 (Ariz. 1971) ("Where a grossly inadequate price is bid, such as shocks one's conscience, an equity court may set aside the sale . . . ."); *cf.* Coles v. Trecothick, 32 Eng. Rep. 592, 597 (1804) (stating unless transfer price inadequacy is "such as shocks the conscience, and amounts in itself to conclusive and decisive evidence of fraud in the transaction, it is not in itself a sufficient ground for refusing a specific performance."). *See generally* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.3 (1997) ("A foreclosure sale price obtained pursuant to a foreclosure proceeding that is otherwise regularly conducted in compliance with applicable law does not render the foreclosure defective unless the price is grossly inadequate."); 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 288–90 (4th ed. 2001) (discussing effect of foreclosure on title).

conflict between state and federal constructive fraud grounds becomes apparent. If a non collusive regulated transfer for less than fair market value is not avoidable under state law, should the bankruptcy trustee be able to avoid a nonetheless because the transfer price is "less than reasonably equivalent value" under federal law?

In 1994, the Supreme Court considered the trustee's power to avoid a non collusive mortgage foreclosure sale as a constructive fraud. In *BFP v. Resolution Trust Corp.*,[7] the Court held, in a five to four opinion, that the price a transferee paid at a non collusive, regularly conducted judicial foreclosure sale was the reasonably equivalent value of the property. But, the Court's opinion left open the possibility that under other circumstances, a non collusive, regulated transfer might yield less than a reasonably equivalent value under section 548(a)(1)(B), and thus be vulnerable to avoidance by the debtor's bankruptcy trustee.

Ten years after *BFP*, its effect on otherwise unavoidable regulated transfers divides bankruptcy courts. Part II of the article explains the history of the trustee's power to avoid regulated transfers as constructive frauds leading up to the Court's decision in *BFP*. Part III considers how courts have applied *BFP* to regulated transfers under section 548, and by analogy to post petition transfers under section 549 and preferences under section 547. Most courts have interpreted *BFP* broadly to protect from the trustee's avoiding powers all non collusive, regulated transfers. But, some courts have declined to apply *BFP* to statutory forfeitures that do not involve at least a pretext of competitive bidding on grounds that the transfer price bears no relation to the "value" of the property and thus under section 548, cannot be its "reasonably equivalent value." Part IV argues that Congress has created an impossible dilemma for bankruptcy courts. A decade after *BFP*, courts and litigants still search in vain for the criteria by which to assess the reasonableness under federal bankruptcy law of a below fair market transfer price that state law deems reasonable. Until Congress clarifies its intention, bankruptcy courts faced with constructive fraud avoidance actions should first determine whether the state has regulated the price setting process for the transfer in question. If so, the court should treat the transfer price as the "reasonably equivalent value" of the property absent evidence supporting an inference that collusion or other deviation from the regulated procedure depressed the transfer price.

I. THE EVOLUTION OF THE TRUSTEE'S POWER TO AVOID REGULATED TRANSFERS

A. The Fall of Fraud and the Rise of "Reasonably Equivalent Value"

Dating at least to the fraudulent conveyance provision in the English Statute of Elizabeth in the sixteenth century, a creditor's option to avoid a transfer of property

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[7] 511 U.S. 531, 545 (1994) (holding price paid at foreclosure is adequate so long as "all the requirements of the State's foreclosure law have been complied with . . . .").

was a specie of the law of fraud. Avoidance rested on circumstantial evidence that the debtor's purpose for the transfer was to take assets for himself and his cohorts by hiding them from creditors.[8] Because the remedy of transfer avoidance is meted out against the transferee, however, the complicity of the transferee in the scheme was at least equally important to the debtor's fraudulent purpose.[9] At the beginning of the twentieth century, however, fraudulent transfer law appeared to change its focus from the parties' motives in undertaking the transfer, to the effect of the transfer on creditors, specifically its negative impact on the transferor's unsecured creditors.[10]

In 1918, the drafters of the Uniform Fraudulent Conveyance Act[11] added to the original Statute of Elizabeth articulation of actual fraud grounds for avoidance a second ground that does not depend on proof of the debtor's fraudulent purpose.[12]

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[8] *See* Act Against Fraudulent Deeds, Gifts, Etc., 1571, 13 Eliz., c. 5 (Eng.) (providing any conveyance made for intent or purpose to hinder, delay or defraud is void); *see also* sources cited *supra* note 1.

[9] *See* 13 Eliz., c. 5 (protecting purchasers when exchange was "upon good consideration and bona fide lawfully conveyed . . . ."); UFCA § 3, 7A Pt. II U.L.A. 198 (defining "fair consideration" to include requirements of "fair equivalent" and transferee's "good faith."); *see also* Thomas E. Hogan, Inc. v. Berman, 37 N.E.2d 742, 744 (Mass. 1941) (noting fraudulent conveyance law, both before and after UFCA has protected innocent purchasers).

[10] *E.g.*, CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 423–24 (1997) (describing the "objectification" of fraudulent transfer law by the promulgation of the UFCA in 1918 as a "watershed in the evolution of fraudulent transfer law" and the constructive fraud grounds as "a form of strict liability designed to redress creditor injury."); Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531, 534–35, 562, 576–77 (1987) (stating that the laws governing both fraudulent and preferential transfers has been changed to de-emphasize the mental states of the parties to the transaction in favor of the transfer's effect).

[11] The UFCA was promulgated by the Commissioners on Uniform State Laws in 1918. UFCA, 7A Pt. II U.L.A. 198, historical notes. The stated goal was to facilitate interstate business by providing a uniform statutory scheme that would resolve the "confusions and uncertainties of the existing law." UFCA, 7A Pt. II U.L.A. 198, prefatory note. The UFCA retained the "actual fraud" ground for avoidance in section 7. UFCA § 7, 7A Pt. II U.L.A. 198 (stating conveyances made with actual intent as distinguished from intent presumed in law to defraud either present or future creditors is avoidable by both present and future creditors without proof of the debtor's insolvency).

[12] The appearance of a constructive fraud grounds in the beginning of the twentieth century may have been in response to creditors' frustration with non-responsive, defaulting debtors beginning at the end of the nineteenth century. A commentator noted that the economic panic of 1893 "proved disastrous to those retailers who had stocked up with goods at pre panic prices, especially in the agricultural communities, and the temptation was great to unload for even a small percentage of the original cost of the merchandise." Thomas Clifford Billig, *Bulk Sales Laws: A Study in Economic Adjustment*, 77 U. PA. L. REV. 72, 76 n.18, 77 (1928). Creditors argued that the fact that the transfer occurred for a below fair market price alone supported an inference of the debtor's fraudulent intent and that the transferee's bad faith. *See, e.g.*, Coder v. McPherson (*In re* Coder), 152 F. 951, 953–54 (8th Cir. 1907); *In re* Pease, 129 F. 446, 448 (E.D. Mich. 1902); Hennequin v. Naylor, 24 N.Y. 139, 141 (1861). Without evidence that the transferee was in cahoots with the debtor, however, creditors found no relief under fraudulent conveyance law because it protected a bona fide purchaser from the effect of avoidance. *E.g.*, Carter v. Richardson, 60 S.W. 397, 399 (Ct. App. Ky. 1901). Creditors organized into trade groups and lobbied successfully for legislation known as bulk sales laws (now largely repealed) which provided creditors a right to avoid a transfer to one who acquired merchandise or stock in trade in bulk by showing noncompliance with statutory requisites, and without regard to whether the transferee participated or otherwise was on notice of a fraud on creditors. *See* Billig, *supra*, at 79–81; U.C.C. Art. 6, prefatory note (1999) (stating law of fraudulent conveyances "provided no remedy against persons who bought in good faith, without reason to know of the seller's intention to pocket the proceeds and disappear, and for adequate value.").

The UFCA section 4 rendered avoidable conveyances made by a person "who is or will be thereby rendered insolvent without regard to his actual intent" if the conveyance was made "without a fair consideration."[13] This new ground for avoidance expressly dropped the *debtor's* subjective mental state as an element of proof, [14] but it required assessment of the "good faith" of the *transferee* as well as an evaluation of the fairness of the price given for the property relative to its value.[15]

The drafters intended the innovation to clarify and unify state law governing fraudulent transfers.[16] Far from accomplishing their goal of clarity, the drafters created a different and even more abstract task for courts—assessing the good faith of a transferee and relatedly, the fairness of the consideration an insolvent received for transferred property.[17]

An articulation of constructive fraud as federal grounds for transfer avoidance first appeared in the 1938 Chandler Act, when Congress adopted the UFCA

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[13] UFCA § 4, 7A Pt. II U.L.A. 198. UFCA §§ 5, 6 provide that certain conveyances for less than fair consideration are fraudulent if made by a transferor who meets tests of financial distress other than insolvency. Under section 5, if the person making or the conveyance is "engaged or about to engage in a business or transaction" leaving him with "unreasonably small capital" post-conveyance, the conveyance is fraudulent as to present creditors and those who and obligations made by those who believe they will incur greater debts than they are able to pay as to both present and future creditors. UFCA §§ 5, 6, 7A Pt. II U.L.A. 198.

[14] The only exception to the irrelevance of the debtor's intent as to constructive fraud appears in UFCA section 6 which deems certain conveyances for "less than fair consideration" to be fraudulent when the debtor "intends or believes that he will incur debts beyond his ability to pay." UFCA § 6, 7A Pt. II U.L.A. 198.

[15] U.F.C.A. § 3, 7A Pt. II U.L.A. 198.

> Fair consideration is given for property, or obligation
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> (a) [w]hen in exchange for such property . . . as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or
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> (b) [w]hen such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

Id.

[16] UFCA, 7A Pt. II U.L.A. 198, prefatory note. *See generally* 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, 260–61 (1985) (describing discord among state courts as to the circumstances under which requisite fraudulent intent might be presumed).

[17] The two components identified in the definition of "fair consideration:" fair equivalence and the transferee's good faith, are not independent. The transferee's good faith tends to correlate with the equivalence of the transfer price relative to the value of the value of the property. The fact that the transferee acquires the property for a sliver of its fair market value supports an inference that the transferee colluded with the transferor to obtain that result in fraud of creditors. Conversely, evidence of collusion or opportunity to collude between the parties to the transfer tends to call into question the "fairness" of below market transfer price. *See* 1 GARARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 295 (rev. ed. 1940) (noting nonequivalence in values exchanged is evidence of the transferee's bad faith because "a buyer knows what he is getting."). Glenn suggested that assessments of "fair equivalence" and transferee "good faith" should inform each other. "The truth lies in between." *Id*. at § 296. A second complicating factor is the malleable nature of the benchmark of "value" against which the transfer price is to be measured. *See* McGill v. Commercial Credit Co., 243 F. 637, 647 (D. Md. 1917) (casting "fair market value" in terms of the price paid by a "willing buyer" to a "willing seller" renders valuation an effort "to find out not what a real buyer and a real seller, under the conditions actually surrounding them, do, but what a purely imaginary buyer will pay a make-believe seller, under circumstances which do not exist . . . .").

language.[18] Forty years later, Congress adopted a different articulation of constructive fraud in Bankruptcy Code section 548.[19] The Code replaced "fair consideration" with "reasonably equivalent value."[20]

The term "reasonably equivalent value" only appears in section 548, and the Code does not define it.[21] Nor does the reason for the adoption of the term appear in the legislative history.[22] Congress may have meant the new term to eliminate the significance of the transferee's good or bad faith in an action to avoid a transfer under section 548.[23] But, the legislative history contradicts the assertion that Congress meant to expand radically the trustee's avoiding powers to include transfers to a noncolluding, arms length transferee. The committee reports noted that section 548 "derive[s] in large part from section 67d of the Bankruptcy Act . . . ." and that "[i]ts history dates from the statute of 13 Eliz. c. 5 (1570)."[24] Moreover,

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[18] The Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544 (1898) *amended by* Chandler Act of June 22, 1938, ch. 575, § 67d(1)(e), (2)(a), 52 Stat. 840 (1938). "We have condensed the provisions of the Uniform Fraudulent Conveyance Act, retaining its substance and as far as possible, its language." Nat'l Bankruptcy Conf., Analysis of H.R. 12889, 74th Cong., 2d Sess. 214 (1936) (House Judiciary Comm. Print). *See generally* James Angell McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 U. CHI. L. REV. 369 (1937). Notably, Congress substituted the term "transfer" for "conveyance" which appeared in the UFCA. *Compare* UFCA § 4, 7A part II U.L.A. 198 (1999), *with* Chandler Act, 52 Stat. ch. 575 § 67(d)(2) (codified at 11 U.S.C. § 107(d)(2) (1976)) (repealed 1978). The Chandler Act defined "transfer" expressly to include involuntary parting with an interest in property. 11 U.S.C. § 1(30) (1976) (repealed 1978). Prior to amendment by the Chandler Act, the Bankruptcy Act incorporated nearly verbatim the fraudulent transfer provision of the Statute of Elizabeth. Bankruptcy Act of July 1, 1898, ch. 541, § 67, 30 Stat. 564.

[19] *See* 11 U.S.C. § 548(a)(1)(B) (2000). Codification of the Religious Liberty and Charitable Donations Protection Act of 1998, Pub. L. No. 105-183, 112 Stat. 517, required renumbering of section 548. The constructive fraud grounds which had been codified as section 548(a)(2) was renumbered as (a)(1)(B).

[20] *Id*. ("received less than reasonably equivalent value in exchange for such transfer or obligation").

[21] *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 537 (1994) (describing the term as an entirely novel phrase). Section 548(d)(2)(A) defines "value" 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[.]" 11 U.S.C. § 548(d)(2)(A). The UFCA does not define "value." UFTA defines "value" the same way as section 548(d)(2)(A) but makes it clear that a promise of support can constitute value if it is given in the ordinary course of the transferee's business. UFTA § 3, 7A part II U.L.A. 339 (1999).

[22] The Committee Reports are silent on the reason for the change in language. *See* Lisa Pendley, Comment, In re BFP*: Mortgage Foreclosures and the Bankruptcy Code's "Reasonably Equivalent Value,"* 8 DEPAUL BUS. L.J. 227, 233 (1996) (noting history of section 548).

[23] The new phrase would adopt the view of a few courts who read "fair consideration" to require assessment of the intrinsic reasonableness of the *size* of the disparity between the transfer price and the "value" of the property without regard to whether the transfer price was or might have been manipulated by a bad faith transferee. *E.g.*, Darby v. Atkinson (*In re* Ferris), 415 F. Supp. 33, 39–40 (W.D. Okla 1976) (noting court rectified what it perceived as "unfair" loss for debtor/tenants by ignoring good faith of lessor); Zellerbach Paper Co. v. Valley Nat'l Bank, 477 P.2d 550, 555 (Ct. App. Ariz. 1970) (assessing "fair consideration" solely by reference to whether price paid was "reasonable and fair proportion"); Schlect v. Schlect, 209 N.W. 883, 885 (Minn. 1926) (stating "fair consideration" is given if price paid "fairly represents" value transferred).

[24] S. REP. NO. 95-989 at 89–90 (1978) *reprinted in* 1978 U.S.C.C.A.N. 5787, 5875; H.R. REP. NO. 95-595 at 375 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6331. In 1973, the Commission on the Bankruptcy Laws of the United States submitted a bill which substituted "reasonably equivalent value" for "fair consideration." H.R. DOC. NO. 93-137, pt. II, at 175 (1973) (proposing the Bankruptcy Act of 1973). The accompanying report does not explain the change: "[t]here is no need to define fair consideration since taken

if Congress had meant "reasonably equivalent value" to exclude any assessment of the possible effect of collusion on the transfer price, it could have chosen the term "fair market value" instead of "reasonably equivalent value" as the point of comparison with the transfer price. That Congress chose the term "reasonably equivalent value" indicates that it intended the phrase to have a meaning distinct from "fair market value."[25] Notwithstanding the conflicting evidence, some commentators seized upon the language change as evidence of Congress' intent to depart from centuries of fraudulent transfer law in which the transferee's good faith and the absence of collusion provided a safe harbor from avoidance of a transfer from an insolvent for less than fair market value.[26]

Since 1978, Congress has failed to clarify its intention. In the 1984 amendments to the Bankruptcy Code, Congress expanded the definition of "transfer" to include "foreclosure of the debtor's equity of redemption."[27] It also added the words "voluntarily or involuntarily" to modify the term "transfer" as it appears in section 548(a).[28] By these amendments, Congress probably intended to resolve the dispute among courts as to whether involuntary transfers (*i.e.* not "conveyances") were included within the trustee's section 548 avoiding power.[29] Both changes clarify what constitutes a "transfer." Neither elucidates the meaning

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care of in the invalidating rules [sic]." *Id*. at 177 n.2. The Commission Report noted vaguely that the Bankruptcy Act's fraudulent transfer provision, section 67d, was "confusing as to its requirement of good faith." *Id.*

[25] *See* Russello v. United States, 464 U.S. 16, 23 (1983) (quoting United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally or purposely in the disparate inclusion or exclusion.")).

[26] *See* LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 548.05[1][b] (15th ed. rev. 1997) ("In a significant change from the "fair consideration" standard "reasonably equivalent value" does not contain a good faith component."); Steven Alden et al., *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the* Durrett *Problem*, 38 BUS. LAW. 1605, 1606 n.2 (1983) (describing the constructive fraud grounds for avoidance as requiring a "[s]crutiny of the objective result" of the transfer); Paul J. Colletti, *A Title Insurer Looks at the Avoidance Provisions of the Bankruptcy Reform Act of 1978*, 15 REAL PROP. PROB. & TR. J. 588, 595 (1980) ("[U]nder the 'constructive fraudulent conveyance' provisions, the transferee's good or bad faith should be immaterial."); Scott B. Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933, 956 (1985) ("such an inquiry is completely inconsistent with the elimination of the 'good faith' requirement by section 548(a)(2).").

[27] 11 U.S.C. § 101(54) (2000) (defining "transfer").

[28] *Id*. § 548(a)(1).

[29] The change extinguished arguments to the contrary. *E.g*., Madrid v. Lawyers Title Ins. Corp. (*In re* Madrid), 725 F.2d 1197, 1199 (9th Cir. 1984) (holding "transfer" occurred when the mortgage was perfected and not on the foreclosure sale); Abrahmson v. Lakewood Bank & Trust Co., 647 F.2d 547, 549–50 (5th Cir. 1981) (Clark, J. dissenting) (finding foreclosure sale was not considered a "transfer"); William v. Travelers Ins. Co. (*In re* William), 39 B.R. 678, 680 (Bankr. D. Minn. 1984) (explaining "transfer" to occur time of perfection of the mortgage); Strauser v. Veterans Admin. (*In re* Strauser), 40 B.R. 868, 870–71 (Bankr. N.D. Ohio 1984) (defining time of "transfer" as time when mortgage is perfected). *See generally* Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 CARDOZO L. REV. 581, 589–90 (1987).

of "reasonably equivalent value."[30]

Another important development occurred in 1984. The Uniform Fraudulent Transfer Act (UFTA) was promulgated. It expressly expanded state fraudulent transfer law to cover involuntary transfers, not just voluntary conveyances.[31] It also adopted the Bankruptcy Code term "reasonably equivalent value" in the definition of constructively fraudulent transfer, making the uniform state law consistent in this respect with section 548.

The drafters of the UFTA did something with "reasonably equivalent value" that Congress did not. The UFTA clarified how a court is to account for a regulated transfer that yields a below fair market transfer price. It contains a safe harbor that expressly defines as "reasonably equivalent value" the price paid by a transferee at a non collusive, regularly conducted foreclosure sale.[32] In the 1984 amendments to the Bankruptcy Code, Congress enacted UFTA's expanded definition of "transfer."[33] It considered but did *not* adopt a safe harbor from constructive fraud avoidance for foreclosure sales and other regulated transfers.[34] Congress offered no explanation for its rejection of the safe harbor for regulated transfers.[35]

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[30] *See, e.g.*, BFP v. Resolution Trust Corp., 511 U.S. 531, 536 (1994) (rejecting petitioner's argument to this effect).

[31] The UFTA picked up the amended definition of "transfer" from 11 U.SC. § 101(54) (2000), replacing the term "conveyance" which had appeared in the UFCA. By so doing the drafters clearly included involuntary dispositions of property within the scope of UFTA. UFTA § 1(12), 7 U.L.A. 276 (1999) (defining "transfer" to include both voluntary and involuntary transfers); *see also* 11 U.S.C. § 101(54) (2000) (including voluntary and involuntary transfers within the definition of "transfer" in the Code).

[32] UFTA § 3(b), 7 U.L.A. 295 ("A person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, non collusive foreclosure sale or execution of a power of sale under a mortgage, deed or trust, or security agreement."). Notably, section 3(b) applies only to "foreclosure *sales*" *Id*. (emphasis added). Another section protects from avoidance a transfer that "results from: (1) termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law; or (2) enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code." UFTA § 8(e), 7 U.L.A. 352 (stating transfer not voidable under section 4(a)(2) or section 5 if the transaction results from either a termination of a lease or enforcement of an Article 9 security interest). These sections are probably responsive to the request of the American Bar Association Section of Real Property, Probate and Trust Law to the drafting committee to include a provision which would abrogate the *Durrett* approach under state law and thus prevent trustees from taking advantage of creditor-friendly state fraudulent transfer law under 11 U.S.C. § 544(b). *See* Henning, *supra* note 16, at 258 n.9 (citing *Summary of Action of the House of Delegates*, 1983 A.B.A. PROC. 1, 31 (resolution endorsing amendment to state fraudulent conveyance law and to section 548)); *see also* RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 8.3 (1997), reporter's note (noting that the drafters intended UFTA section 3b to quell "a fear that bankruptcy judges and state courts would interpret state fraudulent conveyance law as incorporating *Durrett* principles"). For a discussion of *Durrett*, see *infra* text accompanying notes 36–46.

[33] 11 U.S.C. § 101(54) (2000).

[34] *See* S. REP. NO. 98-445, at 106 (1983).

> A secured party or third party purchaser who obtains title to an interest of the debtor in property pursuant to a good faith pre-petition foreclosure, power of sale, or other proceeding or provision of nonbankruptcy law permitting or providing for the realization of security upon default of the borrower under a mortgage, deed of trust, or other security agreement takes for reasonably equivalent value within the meaning of this section.

Id.; *see also* Zinman, *supra* note 29 at 592–94 (discussing legislative history of this bill).

[35] In 1998, Congress passed the Religious Liberty and Charitable Donations Protection Act, Pub. L. No. 105-183, 112 Stat. 517, which, among other things, amended section 548 by protecting certain transfers to

B. The Regulated Transfer in Bankruptcy

Congress' failure in 1984 to address whether non collusive regulated transfers were subject to constructive fraud avoidance under section 548 (a)(1)(B) exacerbated the uncertainty over the meaning of "reasonably equivalent value" that had begun a few years earlier. The idea that a bankruptcy court could invalidate a regulated transfer that state law deemed unavoidable based solely on the court's feeling that the transfer price was unreasonably low took center stage in 1980 in the Fifth Circuit case, *Durrett v. Washington National Insurance Co.*[36]

In *Durrett*, the debtor defaulted and his creditor foreclosed his equity in the real property collateral under a power of sale in a deed of trust.[37] The purchaser was an unrelated third party who bid the amount of the debt, approximately fifty-seven percent of the hypothetical fair market value of the property.[38] The debtor filed for bankruptcy relief nine days after the foreclosure sale and the debtor in possession sought to avoid the sale on constructive fraud grounds.[39]

The district court dismissed the action, holding that the foreclosure sale was a "transfer"' within the meaning of Bankruptcy Act section 67(d),[40] and that the foreclosure sale price was "fair consideration" for the transferred property.[41] The Fifth Circuit reversed, holding that the transfer price was not the "fair equivalent" of the value of the property and thus it was not "fair consideration" notwithstanding the transferee's good faith.[42] It noted that it could not locate any court decision approving a transfer "for less than seventy percent of the market value of the property."[43] This 70% of fair market value test for the reasonableness of a transfer price, although dicta, caught on and came to be known as the "*Durrett* rule."[44] The

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charitable organizations from avoidance as constructively fraudulent transfers. 11 U.S.C. § 548(a)(2) (2000). The amendment similarly does not illuminate the meaning of "reasonably equivalent value" except that it indicates Congress' intention to protect certain donative transfers to religious groups or charities from fraudulent transfer avoidance even if the transfer was for "less than reasonably equivalent value" in exchange.

[36] 621 F.2d 201, 203–04 (5th Cir. 1980) (holding price paid for property was not a "fair equivalent" for the property and directing rescission of the transfer); *see, e.g.*, David Simpson, *Real Property Foreclosures: The Fallacy of* Durrett, 19 REAL PROP. PROB. & TR. J. 73, 73 (1984) (identifying *Durrett* as a radical departure from prior law).

[37] Under a term of the deed of trust, a default in payment triggered the creditor's right to a nonjudicial public sale. *Durrett*, 621 F.2d at 202.

[38] *Id*. at 201–03. The parties stipulated that the transferee acted in good faith. *Id*. at 203.

[39] *Id*. at 202.

[40] *Id*.

[41] Durrett v. Wash. Nat'l Ins. Co., 460 F. Supp. 52, 54 (N.D. Tex. 1978), *rev'd*, 621 F.2d 201 (5th Cir. 1980).

[42] *Durrett*, 621 F.2d at 203.

[43] *Id*.

[44] *See* James Bruce Davis & Steven A. Standiford, *Foreclosure Sale as Fraudulent Transfer Under the Bankruptcy Code: A Reasonable Approach to Reasonably Equivalent Value*, 13 REAL ESTATE L.J. 203, 225–26 (1984) (noting *Durrett* court had no valid precedent for the 70% rule); *see, e.g.*, BFP v. Imperial Sav. & Loan Ass'n (*In re* BFP), 974 F.2d 1144, 1148 n.4 (9th Cir. 1992) ("The 'Durrett rule' holds so long as the debtor received at least 70% of fair market value, the sale cannot be avoided under § 548(a)(2)(A)."); Walker v. Littleton (*In re* Littleton), 888 F.2d 90, 92 n.5 (11th Cir. 1989) (noting courts have applied court's

Fifth Circuit later affirmed its view in *Durrett* in a case decided under the Bankruptcy Code in *Abramson v. Lakewood Bank and Trust Co.*[45]

Two years later, the Ninth Circuit Bankruptcy Appellate Panel in *In re Madrid*,[46] held that the price achieved for the property at a non collusive foreclosure sale is its reasonably equivalent value under section 548(a)(1)(B)(i).[47] The debtor defaulted under both the first and second deeds of trust on his house, and the trustee sold the property to a third party for the amount of the second lien, subject to the first.[48] After the debtor filed for relief, the bankruptcy court, relying on *Durrett*, held that the foreclosure sale was unavoidable under Nevada law, but was avoidable under section 548 as a transfer for less than reasonably equivalent value.[49]

The Ninth Circuit Bankruptcy Appellate Panel noted that inadequacy of the foreclosure sale price did not justify undoing the sale under California law.[50] The court reaffirmed the centrality of an inference of collusion in constructive fraud avoidance actions. While the cases the Fifth Circuit relied on in *Durrett* were voluntary, unregulated transfers where the inadequacy of the transfer price supported an inference of collusion, the exercise of power of sale in this case was non collusive and regularly conducted according to state law. The distinction definitively negated any inference of collusion or fraud.[51] The dissent articulated the competing view that constructive fraud avoidance under section 548 had expanded

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reasoning in *Durrett* to section 548 cases); Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547, 548 (5th Cir. 1981) (relying upon *Durrett* to determine whether non judicial foreclosure sale constituted "transfer" within meaning of Act); Gilman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 444–48 (Bankr. D. Utah 1982) (noting that dicta in *Durrett* has been interpreted to require 70% of fair market value to constitute reasonably equivalent value, discussing cases that did not follow *Durrett*, and concluding reasonable equivalence depends on the facts of each case).

[45] 647 F.2d 547 (5th Cir. 1981). The dissent asserted that the *Durrett* approach would destabilize the market for real property and create a downward spiral of foreclosure sale prices. *Id*. at 550 (Clark, J. dissenting). In *Fed. Deposit Ins. Co. v. Blanton*, 918 F.2d 524 (5th Cir. 1990), the Fifth Circuit clarified that the 70% rule was only dicta in *Durrett*. *FDIC*, 918 F.2d at 531–32 n.7. In *In re* Coleman, 21 B.R. 832 (Bankr. S.D. Tex. 1982), the court concluded it was bound by *Durrett* but if free to do so would have followed Judge Clark's dissent in *Abramson*. *In re Coleman*, 21 B.R. at 834.

[46] Lawyers Title Ins. Corp. v. Madrid (*In re* Madrid), 21 B.R. 424 (B.A.P. 9th Cir.), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir. 1982). The case was hot news in real property circles. The American Land Title Association, the Mortgage Brokers Institute, the American Council of Life Insurance, the American College of Real Estate Lawyers, the California Bankers Association, and the California Bank Clearing House Association filed amicus briefs. *See* Alden et al., *supra* note 26 at 1607 n.8.

[47] *In re Madrid*, 21 B.R. at 426.

[48] *Id*. at 425.

[49] *Id*. at 426–27.

[50] *Id*. at 427 (noting state law generally requires a party challenging a foreclosure sale to show "some element of fraud, unfairness, or oppression accounting for the inadequacy in price."); *see supra* note 6; *see also* Gottlieb v. McArdle, 580 F. Supp. 1523, 1525–26 (stating inadequate sale price is insufficient to set aside foreclosure sale under Michigan law) (E.D. Mich. 1984); Strauser v. Veterans Admin. (*In re* Strauser), 40 B.R. 868, 870 (Bankr. N.D. Ohio 1984) (holding consideration received at non collusive foreclosure sale should be presumed to be "reasonably equivalent value"); William v. Travelers Ins. Co. (*In re* William), 39 B.R. 678, 680–81 (D. Minn. 1984) (agreeing with bankruptcy court that inadequacy of price alone is insufficient to challenge valid foreclosure sale).

[51] *In re Madrid*, 21 B.R. at 426–27 ("[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.").

beyond its fraud-based origins to provide unsecured creditors an option in bankruptcy to reverse wealth depleting transfers by an insolvent solely because the transfer injured unsecured creditors "unreasonably." It reasoned that the purpose of section 548 is to "bring[] into focus the claims of the debtor's other creditors that they have been deprived of recourse to an asset by an improvident sale."[52] It noted that the majority had effectively eliminated any assessment of the reasonableness of a regularly conducted foreclosure sale price where the statutory language recognized no such limitation on the bankruptcy court's discretion.[53] The dissent preferred a "strong presumption of adequacy" rather than a conclusive presumption. It offered no insight into what factors might support a finding of "unreasonableness" other than noting that the bankruptcy judge who had held in favor of the debtor "gave the matter a good deal of thought."[54]

The Ninth Circuit Court of Appeals affirmed the B.A.P. but on different grounds.[55] It held that the foreclosure sale was not a "transfer" subject to section 548. Rather under section 548(d)(1), the relevant transfer to the creditor occurred when it perfected its security interest in the collateral, typically at the time of the loan closing.[56] Other courts had earlier taken this route around the problem.[57]

Three years later, the Sixth Circuit considered the meaning of "reasonably equivalent value" in *In re Winshall Settlor's Trust*.[58] The case reached the court on appeal from a dismissal of the debtor's chapter 11 petition. The property was a parking garage in Detroit, Michigan with an alleged fair market value between $1.0 and 1.8 million which sold at a pre-petition foreclosure sale for $400,000.[59] The petitioner filed for chapter 11 protection but the bankruptcy court dismissed because the trust had no assets or business at the time of filing and thus did not qualify for relief as a business trust.[60] To save its chapter 11 case, the debtor in possession

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[52] *Id*. at 428.

[53] *Id*.

[54] *Id*. (arguing that better rule for these cases would be to give foreclosure sale a presumption of adequacy with burden of proof on plaintiff to show that consideration paid was inadequate).

[55] *In re Madrid*, 725 F.2d 1197 (9th Cir. 1984).

[56] *Id*. at 1201–02.

[57] *See, e.g.*, Abrahmson v. Lakewood Bank & Trust Co., 647 F.2d 547, 549 (5th Cir. 1981) ("The actual transfer of title was made . . . via the deed of trust, executed . . . to secure an indebtedness then owing . . . ."); William v. Travelers Ins. Co. (*In re* William), 39 B.R. 678, 680 (D. Minn. 1984); Strauser v. Veterans Admin. (*In re* Strauser), 40 B.R. 868, 870–71 (Bankr. N.D. Ohio 1984) ("[T]he consideration received at a non collusive and regularly conducted foreclosure sale should be conclusively presumed to constitute "reasonable equivalent value" under § 548(a)(2)(A) . . . .").

[58] 758 F.2d 1136 (6th Cir. 1985).

[59] *Id*. at 1138.

[60] *Id*. at 1137.

> The Bankruptcy Court dismissed the petition on the grounds that the debtor had failed to prove that it was a business trust and hence was not entitled to be a debtor under 11 U.S.C. § 109(d), and for the further reason that there was no res or business being conducted at the time of filing.

Id.

brought an action to avoid the foreclosure sale.[61] The Sixth Circuit affirmed the bankruptcy court's view that bankruptcy law should not alter the state law of fraudulent conveyances with regard to this foreclosure sale. After considering the *Durrett* and *Madrid* decisions, it held that Congress did not intend to cloak bankruptcy courts with the power to "override [the rights] of good faith purchasers at state foreclosure sales or the policy judgments of states in balancing the interests of parties thereto" in order to achieve an "equitable distribution" of a debtor's assets.[62]

When an appropriate case reached the Seventh Circuit, it reached yet another conclusion about Congress' intent regarding the scope of the trustee's constructive fraud avoiding power. In *Bundles v. Baker*,[63] the court held that whether a foreclosure sale price was "reasonably equivalent value" depended on "all the facts and circumstances" of the sale, with a rebuttable presumption that the price was the "reasonably equivalent value" of the property.[64] The Seventh Circuit noted that section 548 did not provide for an exception from constructive fraud avoidance for non collusive regulated transfers.[65] So, the court rejected a per se rule protecting such transfers from avoidance because such treatment would impermissibly create an exception to the trustee's power not enumerated in the statute.[66] The court must make an assessment in each case of whether the transfer price was the reasonably equivalent value of the property, regardless state law's assessment of the fairness of the transfer.[67]

Among the facts the Seventh Circuit held should be considered was the fairness of the state law foreclosure procedure under which the sale occurred.[68] If the

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[61] *Id*. at 1137–38. The debtor in possession boldly argued that its unsecured creditors would be better off in a chapter 11 case than in state court because its creditors had no right to avoid the foreclosure sale under state law. *Id*. at 1138 & n.2.

[62] *Id*. at 1139 n.4.

[63] 856 F.2d 815 (7th Cir. 1988). A chapter 13 debtor moved to set aside the foreclosure of the equity in his house and to recover the house from a third party who purchased it at a sheriff's foreclosure sale conducted according to Indiana law. The winning bid submitted by a third party was about $5,000, and the parties stipulated the property's fair market value at $15,500. *Id.* at 817.

[64] *Id*. at 824–25. *See generally* Bundles v. Baker (*In re* Bundles), 61 B.R. 929, 936 (Bankr. S.D. Ind. 1986), *aff'd*, 78 B.R. 203 (S.D. Ind. 1987), *rev'd* 856 F.2d 815 (7th Cir. 1988) (holding foreclosure was not "for less than reasonably equivalent value." Further stating "any avoiding effect accorded a low purchase price by [section 548(a)(1)(B)] is misplaced and overbroad with respect to regularly conducted, non collusive foreclosure sales."); Bundles v. Baker, 78 B.R. 203, 208 (S.D. Ind. 1987) (affirming holding "the reasonable equivalence standard should be . . . irrebuttably satisfied where property is sold at a regularly conducted, non collusive foreclosure sale to a third party purchaser, and where the deed to the property is executed and recorded before the debtor filed his bankruptcy petition.").

[65] *Bundles*, 856 F.2d at 821.

[66] *Id*.

[67] *Id*.

[68] *Id*. ("[S]tate specific foreclosure procedures might alter the analysis if they were not designed to return to the debtor-mortgagor his equity in the property."). Specifically, the court should evaluate state foreclosure procedures to determine whether "there was a fair appraisal of the property, whether the property was advertised widely, and whether competitive bidding was encouraged."). *See id*. at 825 (courts should "accord respect to the state foreclosure sale proceedings."); *see also* Grissom v. Johnson (*In re* Grissom), 955 F.2d 1440, 1445–46 (11th Cir. 1992) (court should analyze circumstances surrounding foreclosure sale).

foreclosure occurred under procedures the bankruptcy court determined were not designed to maximize the foreclosure sale price, it could find that the price was not a reasonably equivalent value for the property.[69]

Under what came to be known as the *Bundles* rule, the size of the value disparity was one of several factors relevant to determining reasonably equivalent value.[70] The presence of disparity between a regulated transfer price and hypothetical fair market value alone could not render the price unreasonable.[71] But, if the *cause* of the disparity was state law procedures that *unfairly* tolerated undervaluation of the debtor's equity, the price achieved could be less than a reasonably equivalent value and the transfer avoidable under section 548.[72]

Against this backdrop, the facts of *BFP v. Resolution Trust Corp.*[73] put the question squarely. A partnership called BFP owned a house subject to a note secured by a deed of trust.[74] After BFP defaulted on the note, the holder conducted a non collusive, judicially supervised foreclosure sale in compliance with California law.[75] A third party purchased the property at the sale for cash.[76] Three months later, BFP filed for relief under chapter 11 of the Bankruptcy Code.[77] As debtor in possession, it sought to avoid the foreclosure sale on grounds that it constituted a constructively fraudulent transfer under section 548.[78]

The Ninth Circuit Court of Appeals noted that the issue before it was "both one of statutory interpretation and the growing tension between preemption and the requirements of a vigorous federal system."[79] The appeal of the *Durrett* and *Bundles* approaches was that they "rest[ed] on a plain-language interpretation of section 548"[80] whereas, the third *Madrid* approach "effectively creates a judicial exception to the trustee's avoiding powers under [section] 548."[81] The court expressed concern that such an irrebuttable presumption would "undermine[] the ability of the trustee .

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[69] *Bundles*, 856 F.2d at 824.

[70] *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 537 (1994) (referring to *Durrett* and *Bundles* approaches); Jeffery Sharp, *Returning Confidence to Prepetition Foreclosure Sales Under the Bankruptcy Code: Scrutinizing the Federal Policy and a Vague Statute*, 32 AM. BUS. L.J. 185, 204 (1994) (referring to *Bundles* rule).

[71] *Bundles*, 856 F.2d at 824.

[72] *Id.*; *see also* Barrett v. Commonwealth Fed. Sav. & Loan Ass'n, 939 F.2d 20, 24 (3d Cir. 1990) (considering meaning of "reasonably equivalent value" and adopting variation of *Bundles* approach wherein regulated transfer price was *not* reasonably equivalent value, unless transferee could prove otherwise). *Id*.

[73] 511 U.S. 531 (1994).

[74] *Id*.

[75] *BFP*, 511 U.S. at 534. The bankruptcy court had found that the foreclosure sale conformed to Califomia law and "was neither collusive nor fraudulent." *Id*.

[76] *Id*.

[77] *Id*.

[78] *Id*. The debtor in possession argued that the sale price was less than the reasonably equivalent value of the property based on a comparison with the property's appraised fair market value. The purchaser paid $433,000 for the property whereas the debtor in possession asserted it was worth more than $725,000 at the time of the foreclosure sale. *Id*.

[79] BFP v. Imperial Sav. & Loan Ass'n (*In re* BFP), 974 F.2d 1144, 1149 (9th Cir. 1992).

[80] *Id*. at 1148.

[81] *Id*. (citing Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 823 (7th Cir. 1988)).

. . to recover lost equity, which is the purpose of the [section] 548 avoiding power."[82] On the other hand, the appeal of the third approach was that it protected stability of mortgage markets and comity for state law governing foreclosure sales.[83] The court held that states' interest in the stability of mortgages, and the court's obligation to temper its interpretation of federal law "with due regard for traditional state areas of regulation" should prevail in the balance between "bankruptcy policy and comity concerns."[84]

As things stood in 1994, the best that could be said about the meaning of "reasonably equivalent value" as applied to regulated transfer prices was that in some circuits the transfer price was conclusively equal to the reasonably equivalent value of the property, in others it might not be. Courts in jurisdictions that required an evaluation of the circumstances of the regulated transfer to ascertain the reasonableness of the transfer price had no clear guidance as to how to distinguish a large but reasonable below fair market transfer price from one that was less than reasonably equivalent value.[85]

This state of affairs is understandable given the statutory language. The language in section 548(a)(1)(B) fails courts in two ways. First, section 548(d)(2)(A) defines value, but not in a way that clarifies which market conditions are relevant in fixing the hypothetical value of property.[86] The ambiguity regarding the market conditions to be assumed in ascertaining the "true" value of transferred property also appears in state fraudulent transfer law.[87] But on that question, at least

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[82] *In re* BFP, 974 F.2d at 1148. The court cited no authority for the proposition that the purpose of the trustee's avoiding power is to enable the trustee to recover lost equity.

[83] *Id.; see, e.g.*, Ehrlich, *supra* note 26, at 963 ("[A]n ad hoc approach produces intolerable uncertainty regarding the finality of any purchase at a foreclosure sale even if the price paid at the sale is close to, but not equal to the retail market value.").

[84] *In re* BFP, 974 F.2d at 1149.

[85] *See, e.g.*, Richard v. Tempest (*In re* Richard), 26 B.R. 560, 562 (Bankr. D.R.I. 1983) ("[T]he 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."); Jones v. Home Life Ins. Co. (*In re* Jones), 20 B.R. 988, 994 (Bankr. E.D. Pa. 1982) (offering no explanation for assertion that winning bid at non collusive sheriff's sale of one third to one half of market value of property is not reasonably equivalent value); Gilman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 447 (Bankr. D. Utah 1982) ("The determination of reasonable equivalence should not be determined by state law" but rather "in light of the function of § 548 in fostering an equitable distribution of the debtor's property.").

[86] "Value means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C. § 548(d)(2)(A); *see In re Richardson*, 23 B.R. at 443 n.12 (noting section 548 does not fix "market value" as "the determinant of the worth of property" but that "the price which the property would actually bring if presently offered for sale by the owner, with a reasonable time for negotiation, should be a helpful starting point in determining value for purposes of section 548(a)(2)."). Note that section 547 on preferential transfers similarly does not define how property should be "valued" for purposes of determining the hypothetical distribution to the creditor/transferee in a chapter 7 case required by the improvement in position test in section 547(b)(5). See discussion *infra* at text accompanying notes 156–72.

[87] UFTA defines "value" as that which is given in exchange for the debtor's disposition of property. UFTA § 3(a), 7A Pt. II U.L.A. 339 (1999). It excludes from "value" an executory promise to furnish support to the debtor, but excepts from the exclusion, commercial promises to support the debtor, such as those made by a retirement home. *Id*.

the model state law is clearer. UFTA section 3(b), which has no counterpart in section 548, provides that a transferee of property pursuant to certain regulated transfers gives reasonably equivalent value for the property.[88]

The second failing of the statutory language is that it does not identify the parameters of reasonableness by which the difference between transfer price and value is to be assessed.[89] The extent to which a below fair market transfer price supported an inference of collusion used to be the touchstone of avoidability. The phrase "reasonably equivalent value" appeared to some observers to leave collusion by the side of the road. Unburdened by that weight, the trustee's power to avoid wealth depleting transfers by an insolvent debtor within one year of bankruptcy became totally unbounded.

C. BFP v Resolution Trust Corp.

When *BFP* reached the Supreme Court in 1994, it affirmed the Ninth Circuit with five justices in the majority and four dissenting.[90] Justice Scalia for the majority began with an assessment of the meaning of the constructive fraud provision in section 548.[91] The Court rejected the approach adopted by the *Durrett* and *Bundles* courts that plugged hypothetically derived fair market value of the property into the required comparison with the transfer price.[92] Rather, it held that absent collusion or procedural irregularity, the foreclosure sale procedure creates the relevant market conditions under which the value of the property is to be determined. The fact that state law regulated a particular transfer of property "like any other fact bearing upon the property's use or alienability, necessarily affects its worth."[93] Taking these regulated procedures into account, the price achieved at a real property foreclosure sale is exactly equal to the reasonably equivalent value of the property.[94]

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[88] *Id*. § 3(b).

[89] The criticism of the *Madrid* approach, that it creates an exception for regulated transfers from the "reasonableness" test in section 548(a)(1)(B) (voiced in Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 823 (7th Cir. 1988)) can be valid only if the boundaries of "reasonableness" exclude consideration of collusion or lack thereof on the question. If, however, the boundaries of "reasonableness" take the presence of collusion into account, a rule that recognizes a non collusive regulated transfer price as per se "reasonable" is an application of, and not necessarily an exception to, the "reasonableness" test.

[90] BFP v. Trust Resolution Corp., 511 U.S. 531, 544 (1994). Chief Justice Rhenquist and Justices O'Connor, Kennedy and Thomas joined Justice Scalia in the majority opinion. Justice Souter authored the dissent and was joined by Justices Blackmun, Stevens and Ginsburg.

[91] *Id*. at 535–36.

[92] *Id*. at 536–37 ("[S]uch reference is in our opinion not consistent with the text of the Bankruptcy Code."). Justice Scalia observed: "[T]he 'plain meaning' of 'reasonably equivalent value' continues to leave unanswered the one question central to this case, wherein the ambiguity lies: What is a foreclosed property worth? Obviously, until that is determined, we cannot know whether the value received in exchange for foreclosed property is 'reasonably equivalent.'" *Id*. at 547.

[93] *Id*. at 548.

[94] Foreclosure sale procedure is "unlike most other legal restrictions" because it "has the effect of completely redefining the market in which the property is offered for sale; normal free market rules of exchange are replaced by the far more restrictive rules governing forced sales." *Id*. at 548. The dissent

The Court noted states' interest in regulating property transfers.[95] 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."[96] It considered the "profound effect" on the security of property interests that would obtain if the trustee could avoid an otherwise unavoidable regulated transfer under section 548. "The title to every piece of realty purchased at foreclosure would be under a federally created cloud."[97]

Justice Souter for the dissent took a much broader view of a bankruptcy court's power to evaluate the reasonableness of a regulated transfer price. In the view of the dissenting justices, the trustee's constructive fraud avoidance power serves a bankruptcy specific, distributional purpose. Bankruptcy courts may define the boundary of that power to further that distributional goal. "[A] central premise of the bankruptcy avoidance powers is that what state law plainly allows as acceptable or "fair" as between a debtor and a particular creditor, may be set aside because of its impact on other creditors or on the debtor's chances for a fresh start."[98] The dissent interpreted the term "reasonably equivalent value" to justify avoidance if the transfer price was unreasonably less than the hypothetical fair market value of the property.[99] The gravamen of the assessment of reasonableness will be whether the challenged transfer "significantly and needlessly diminished the bankruptcy estate, *i.e.*, that it extinguished a substantial equity interest of the debtor and that the foreclosing mortgagee failed to take measures which (consistently with state law, if not required by it) would have augmented the price realized."[100]

In *BFP*, the Court did not resolve the interpretive problem that divided the courts before *BFP* and continues to befuddle them. First, in a footnote, the Court emphasized that its opinion covered "only mortgage foreclosures of real estate" and noted that "considerations bearing upon other foreclosures and forced sales . . . may be different."[101] Second, and more subtly, the Court justified its holding at least in part on the historical role of foreclosure as a creditor remedy,[102] the "ancient

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distinguished state regulation of creditors' rights of foreclosure from those regulating an owner's use of property such as zoning. "[T]he zoning ordinance would reduce the value of the property 'to the world,'" whereas "foreclosure rules affect not the price any purchaser 'would pay,' (internal citation omitted) but rather the means by which the mortgagee is permitted to extract its entitlement from the entire 'value' of the property." *Id*. at 557 n.10. The majority responded by noting that the dissent's distinction is without a difference. Both types of regulation affect the value of property. *Id*. at 540 n.4.

[95] The Court characterized states' interest in regulating property transfer as an "essential state interest." *Id.* at 544.

[96] *Id*. at 544 (quoting Am. Land Co. v. Zeiss, 219 U.S. 47, 60 (1911)).

[97] *Id*. at 544. The Court noted that title insurers had inserted into title policies exceptions from coverage for property purchased at a foreclosure sale in reaction to *Durrett* and its progeny. *Id*.

[98] *Id*. at 564 (Souter, J., dissenting).

[99] *Id*. at 560.

[100] *Id*.

[101] *Id*. at 537 n.3.

[102] *Id*. at 541–42 (discussing how English courts of chancery created equitable remedy of foreclosure to protect lenders in response to continued expansion of remedy of redemption for debtors).

harmony" between state foreclosure and fraudulent conveyance law,[103] and the "important state interest in regulating real property transfers,"[104] to which federal law must defer absent a "clear and manifest direction to the contrary."[105] By noting that certain regulated transfers are not subject to a bankruptcy court's assessment for the reasonableness of the transfer price while conceding in a footnote that others may be, the Court invited bankruptcy courts to evaluate the reasonableness of non collusive regulated transfers whenever the trustee can distinguish them from the transfer at issue in *BFP*.

II. THE TROUBLED LEGACY OF *BFP*

A. Regulated Transfers in the Shadow of a Footnote

Some courts have distinguished *BFP* based on a difference in the type of regulated transfer**.** In some states, parties customarily convey interests in real property by way of a land sale contract rather than by deed of trust or sale subject to a mortgage in favor of the seller.[106] As part of the terms of the contract, the vendor retains title to the property until the vendee has paid all the installments. If the vendee defaults, the vendor is entitled to terminate the contract and foreclose the vendee's equitable interest in the property. Although state courts vary in their approaches to enforcing land sale contract forfeiture clauses, such clauses, typically require that the defaulting vendee forfeit his interest in the property and any payments he has made prior to default.[107]

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[103] *Id*. at 542–43 (noting "peaceful coexistence" of fraudulent transfer law and foreclosure law that has existed over 400 years. Although Congress has power to disrupt "ancient harmony," the Court has deferred to pre existing practice unless text clearly calls for it.).

[104] *Id*. at 544 (stating "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"). The majority noted that the state interest at issue was "the essential sovereign interest in the security and stability of title to land." *Id*. at 545 n.8. It further noted that if the Court adopted BFP's reading of "reasonably equivalent value" "[t]he title of every piece of realty purchased at foreclosure would be under a federally created cloud." *Id*. at 544.

[105] *Id*. at 544–45.

[106] *See generally* NELSON & WHITMAN *supra* note 6, at § 3.26 (noting "installment land contract is the most commonly used substitute for the mortgage or deed of trust.").

[107] *Id*. at §§ 3.26–3.29 (stating forfeiture clauses typically provide that when vendee fails to perform his side of land sale contract, vendors' options include declaring contract terminated, repossession of land without legal process, and retention of prior payments as liquidated damages). In jurisdictions where the enforcement of land sale contract forfeiture clauses is not addressed by statute, some courts have refused to enforce them as written on grounds that they are unreasonable or inequitable. These courts have ameliorated the harshness of the vendee's loss by a variety of techniques including recognition of a vendee's right akin to an equity of redemption, e.g., cases cited *id*. § 3.29 at 78 n.1, § 3.29 at 80 n.8, or by affording the vendee restitution to the extent the value of the property exceeds the vendor's damages, *id*. § 3.29 at 85 n.34. Some courts afford a right of restitution only when the vendee's loss on forfeiture would be "unconscionable." *E.g*., Sawyer v. Marco Island Dev. Corp., 301 So. 2d 820 (Fla. Dist. Ct. App. 1974) (holding vendor entitled to keep payments and quiet title when none of purchasers had paid more than 25% of purchase price); Jacobson v. Swan, 278 P.2d 294 (Utah 1954) (holding notice to quit premises was unconscionable as there was no alternative, and lessor's proper damages was prescribed rental amount, not treble damages). Some courts

The trustee's power to avoid forfeiture of the purchaser's interest in property under such a land sale contract was at issue in *In re Grady*.[108] After the defaulting purchasers filed for chapter 13 relief, the trustee sought to avoid the contractual forfeiture of the debtors' equity as a constructively fraudulent transfer under section 548(a)(1)(B). The trustee argued that the forfeiture was invalid under Iowa law, and in any event it was avoidable under section 548(a)(1)(B).[109]

The debtors operated the property as a café in a small town in Iowa. The contract purchase price was $70,000. At the time of their default, the remaining debt was $12,000. During the year prior to the forfeiture, the debtors tried to sell the property, twice receiving offers but never closing.[110] The debtors finally found a potential buyer willing to pay $40,000 subject to some conditions.[111] Probably to save the deal for the debtors and to facilitate their proposed 100 percent chapter 13 plan, the court held that the trustee could avoid the forfeiture to the vendor under section 548. The key element was that the forfeiture yielded "less than reasonably equivalent value" for the debtors.[112]

The vendor argued that the debt extinguished by the forfeiture was the "reasonably equivalent value" of the property under section 548.[113] The bankruptcy court noted that courts that have applied *BFP* to non foreclosure regulated transfers "tend to focus on whether the debtor has similar legal protections in the event of [the forced sale] to those a mortgagor would have under state law in the event of mortgage foreclosure."[114] The transfer price in a forfeiture is debt forgiveness which "has no relationship to market forces . . . . and bear[s] no relationship to reasonably equivalent value."[115] The court reasoned that *BFP* applies only when the regulated transfer at issue implements a competitive bid process to set the transfer price. Under the same reasoning, in *In Grandote Country Club Co.*[116] the court held that because Colorado law required that its tax lien foreclosure sales "take place publicly

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simply recharacterize the contract as a mortgage, affording the vendee with an equitable right of redemption. *E.g.*, Kubany v. Woods, 622 So. 2d 22 (Fla. Dist. Ct. App. 1993) (describing agreement for deed as mortgage under Florida Law, which is subject to foreclosure rules); Parise v. Citizens Nat'l Bank, 438 So. 2d 1020 (Fla. Dist. Ct. App. 1983) (stating contract for deed is treated as mortgage, and seller must prove default and acceleration to foreclose); Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979) (treating land sale contract and purchase money mortgage similarly, thus giving mortgagor right to redeem property). *But see* Exch. Corp. v Kuntz, 202 N.W.2d 393 (Wis. 1972) ("Wisconsin is among the minority of states which allows strict foreclosure of the land contract rather than a foreclosure and sale such as is the procedure for the foreclosure of a mortgage, which is considered in this state to be a lien and not a conveyance.").

[108] Dunbar v. Johnson (*In re* Grady), 202 B.R. 120, 121 (Bankr. N.D. Iowa 1996).

[109] *Id*. at 121–22.

[110] *Id*.

[111] *Id*.

[112] *Id*. at 124. The transfer price was equal to the amount of the debt. *Id*.

[113] *Id*.

[114] *Id*. at 124. The court expressly disagreed with the result in another land contract forfeiture case, Vermillion v. Scarbrough (*In re* Vermillion), 176 B.R. 563 (Bankr. D. Or. 1994) (applying *BFP* to render debt in land sale contract forfeiture "reasonably equivalent value" of property).

[115] *Id*. at 125.

[116] 252 F.3d 1146 (10th Cir. 2001).

under a competitive bidding procedure," *BFP* would apply.[117] And, the Tenth Circuit Bankruptcy Appellate Panel in *Sherman v. Rose*[118] considered a transfer under an unusual Wyoming tax lien foreclosure statute that authorizes a tax lienor to sell collateral for the amount of the tax debt to a person selected by lottery. The court held that given this non competitive price-setting procedure, a transfer price of $450 was *not* a reasonably equivalent value in exchange for real property, which appraised at between $10,000 and $50,000.[119]

In contrast, a Connecticut court rejected this distinction in *In re Talbot*[120] where the transfer at issue was yet another kind of regulated transfer—a strict foreclosure under Connecticut law.[121] First, the court held that Connecticut's interest in the security of titles of property transferred under its strict foreclosure procedure was no less compelling than its interest in the security of titles transferred by way of foreclosure sale.[122] It further held that the key attributes of a "sale"—competitive bidding—were not essential to the Court's holding in *BFP*. Rather, "[the Court held] the states and not the market, were entitled to define the "value" of property in the mortgage foreclosure context."[123] The court rejected any distinction of *BFP* based on differences in the state's procedures for setting the transfer price in strict and judicial foreclosure proceedings.[124]

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[117] *Id*. at 1152.

[118] Sherman v. Rose (*In re* Sherman), 223 B.R. 555 (B.A.P. 10th Cir. 1998).

[119] *Id*. at 559 (stating on its face and as matter of equity, tax sale price could in no way be considered reasonably equivalent value). Courts have applied *BFP* to protect the IRS from constructive fraud avoidance. *E.g*., Turner v. United States (*In re* Turner), 225 B.R. 595, 598–99 (Bankr. D.S.C. 1997) (citing other cases applying *BFP* to IRS tax sales); Hollar v. Myers (*In re* Hollar), 184 B.R. 243, 252 (Bankr. M.D.N.C. 1995) (applying *BFP*'s rationale to IRS tax sales).

[120] Talbot v. Fed. Home Loan Mortgage Corp., (*In re* Talbot), 254 B.R. 63 (Bankr. D. Conn. 2000); *see also* Chase Manhattan Mortgage Corp. v. St. Pierre (*In re* St. Pierre), 295 B.R. 692, 698 (Bankr. D. Conn. 2003) (following *Talbot* holding).

[121] Connecticut is a "title" state whereby the mortgagor conveys legal title to the mortgaged property and holds equitable title. The mortgagor obtains legal title by exercising his "equity of redemption," which requires satisfaction of the terms of the mortgage. The mortgagee may foreclose the mortgagor's equity of redemption by a motion for judgment served on the mortgagor and accompanied by an appraisal stating the value of the property. The mortgagor's equity is foreclosed either by public sale or strict foreclosure, with the latter being the default procedure unless the court orders foreclosure by sale. The court has discretion to order a foreclosure by sale on motion of either party or on its own discretion if there is "substantial equity" in the property. If the court orders strict foreclosure, it sets a redemption period for the mortgagor. The court may take into account the amount of the mortgagor's equity in the property in setting the redemption period. Failure to timely redeem extinguishes the mortgagor's interest in the property and title vests in the mortgagee. Once the mortgagee files a certificate of foreclosure asserting its absolute title, the mortgagor holds an interest as tenant at sufferance and the court may issue an execution of ejectment. For a discussion of Connecticut's strict foreclosure law, see Fed. Nat'l Mortgage Ass'n v. Fitzgerald (*In re* Fitzgerald), 237 B.R. 252, 261–62 (Bankr. D. Conn. 1999).

[122] *In re Talbot*, 254 B.R. at 69.

[123] *Id*. at 69, *see also* Vermillion v. Scarbrough (*In re* Vermillion), 176 B.R. 563, 569–70 (Bankr. D. Or. 1994) (applying *BFP* to Oregon land sale contract forfeiture proceeding which was regularly conducted pursuant to state law). *But see* Wentworth v. Town of Acton (*In re* Wentworth), 221 B.R. 316, 319–20 (Bankr. D. Conn. 1998) (stating that *BFP* did not apply to nonjudicial tax forfeiture of property under Maine law, where property's fair market value was thirteen times greater than outstanding debt).

[124] *In re Talbot*, 254 B.R. at 69–70. Additionally, the *Talbot* court held, "[e]ven if the court were to consider the *Grady* approach," Connecticut's strict foreclosure procedures would provide adequate

Two months later another bankruptcy judge in the same district took a different view of the effect of *BFP* on Connecticut strict foreclosures. In *In re Fitzerald (Fitzgerald II)*,[125] the court noted that the Connecticut legislature does not accord a conclusive presumption of "reasonably equivalent value" to strict foreclosures under state fraudulent transfer law (unlike foreclosures by sale which generally are accorded that presumption)."[126] This court favored the evidentiary approach to reasonably equivalent value, and found support for that approach in *BFP*. "The Court decided *BFP* based upon the evidentiary value of the foreclosure sale process itself, concluding that the evidence of value produced by the foreclosure sale process (*i.e.*, the successful bid) is "the only *legitimate evidence* of the property's value at the time [the property] . . . is sold."[127] The bankruptcy court considered whether strict foreclosure procedure under Connecticut law produced "legitimate evidence' of the subject property's value at the time of the transfer of absolute title."[128] The court held that the transfer price achieved by a foreclosure *sale* is more significant as evidence of value than the transfer "price" (extinguishment of indebtedness) affected by a strict foreclosure.[129]

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safeguards (in fact better safeguards than the Iowa procedures at issue in *Grady*). *Id*. at 70–71; *see, e.g.*, Hemstreet v. Brostmeyer (*In re* Hemstreet), 258 B.R. 134, 138–39 (Bankr. W.D. Pa. 2001) (summarizing Pennsylvania tax lien foreclosure procedures); Washington v. Kellum (*In re* Washington), 232 B.R. 340, 344 (Bankr. E.D. Va. 1999) (stating Virginia tax foreclosure sale procedures provide "more than adequate protection" for delinquent taxpayers in form of protections such as notice, opportunity to cure, and strict adherence to statutory requirements, thus ensuring proceeds from tax sales satisfy "reasonably equivalent value" standard); *In re* Samaniego, 224 B.R. 154, 158–60 (Bankr. E.D. Wash. 1998) (Washington tax lien foreclosure); Russell-Polk v. Bradley (*In re* Russell-Polk), 200 B.R. 218 (Bankr. E.D. Mo. 1996) (Missouri tax lien foreclosure); Lord v. Neumann (*In re* Lord), 179 B.R. 429, 434–35 (Bankr. E.D. Pa. 1995) (Pennsylvania tax lien foreclosure); Golden v. Mercer County Tax Claim Bureau (*In re* Golden), 190 B.R. 52, 56–57 (Bankr. W.D. Pa. 1995) (same). *But see* McGrath v. Simon (*In re* McGrath), 170 B.R. 78, 81–83 (Bankr. D.N.J. 1994) (treating as legally irrelevant the differences between New Jersey procedures for mortgage and tax lien foreclosures).

[125] Chorches v. Fleet Mortgage Corp. (*In re* Fitzgerald), 255 B.R. 807 (Bankr. D. Conn. 2000). *See generally* DENIS R. CARON, CONNECTICUT FORECLOSURES: AN ATTORNEY'S MANUAL OF PRACTICE AND PROCEDURE ¶ 5.02D at 143 (3d ed. 1997) (stating application of *BFP* principles to Connecticut's "unique form of strict foreclosure" is uncertain).

[126] *In re Fitzgerald*, 255 B.R. at 810–11 ("[I]t is consistent with *BFP* for this court to acknowledge state sovereignty by consulting applicable state law (including state fraudulent transfer law.")); *see id*. at 812 (indicating plain language of the Connecticut version of UFTA § 3, (§ 52- 552d CONN. GEN. STAT. ANN.) protects only "sales."); *id*. at 813 (referring to "regularly conducted, non collusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement."); *id*. (recognizing Connecticut Legislature considered but did not adopt a non-uniform version of UFTA section 3 which would have included transfers by strict foreclosure in the safe harbor.); *id*. at 814 (indicating court "reserve[d] the issue of the standard of value to be applied in determining 'reasonably equivalent value' in the strict foreclosure context.").

[127] *Id*. at 811 (referring to *BFP*, 511 U.S. at 548–49).

[128] *Id*.

[129] *See id*. at 811. The court noted that the foreclosure court did make an explicit finding with regard to the 'fair market value' of the property. *Id*. at n.12. It held without explanation: "[I]f *BFP* applies, then fair-market value is not the proper valuation standard here for the property." *Id*. For "present purposes" the court disregarded the foreclosure court's finding regarding the fair market value of the property. *Id*.

B. Post-Petition Regulated Transfers Under Section 549

The effect of *BFP* on a bankruptcy court's assessment of the reasonableness of a regulated transfer price comes up in another context. Bankruptcy Code section 549(a) specifically authorizes a trustee to avoid all post petition transfers.[130] But, the trustee's power is subject to an exception. Subsection 549(c) protects post petition transfers of real property to good faith purchasers who: (1) have no knowledge of the bankruptcy case; (2) perfect their title under applicable law before notice of the bankruptcy is filed with the appropriate recorder's office; and (3) who gave "present fair equivalent value."[131] Thus, like section 548 (a)(1)(B), the exception to the trustee's power to avoid a post petition transfer of real property in section 549(c) turns in part on an assessment of the "fair" equivalence of the transfer price to the value of the property.

As a threshold matter, courts disagree about whether section 549(c) applies at all to post petition regulated transfers such as foreclosure sales when those transfers violate the automatic stay. One theory is that a transfer in violation of the stay (like a foreclosure sale initiated by a creditor) is void *ab initio*, not a transfer at all, so the trustee need not affirmatively avoid it nor worry about the application of subsection 549(c).[132] Other courts read section 549 as applying to all post petition transfers including involuntary, creditor initiated foreclosure transfers in violation of the stay. Under this view, section 549(c) provides protection from avoidance to a good faith purchaser of property at a post petition foreclosure transfer for "present fair equivalent value."[133]

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[130] *See* 11 U.S.C. § 549(a) (2000); *see, e.g.*, Raymark Indus., Inc. v. Lai, 973 F.2d 1125, 1131 (3d Cir. 1992) (indicating actions taken in violation of the stay are without effect).

[131] *See* 11 U.S.C. § 549(c) (indicating if transferee was in good faith but gave less than "fair equivalent value," trustee may avoid the transfer, but such transferee is entitled to lien on the property "to the extent of any present value given."); *see also* Schwartz v. United States (*In re* Schwartz), 954 F.2d 569, 573 (9th Cir. 1992) (stating transactions in violation of stay but protected from avoidance under section 549(c) are valid unless affirmatively challenged by trustee).

[132] *E.g.*, 40235 Wash. St. Corp. v. Lusardi, 329 F.3d 1076, 1081–82 (9th Cir. 2003) (noting some prior decisions imply, contrary to present holding, that section 549(c) creates an exception to automatic stay provision); Value T Sales, Inc. v. Mitchell (*In re* Mitchell), 279 B.R. 839, 844 (B.A.P. 9th Cir. 2002) ("We find no convincing authority for interpreting § 549(c) as an additional exception to the automatic stay."); *In re* Ford, 296 B.R. 537, 548–49 (Bankr. N.D. Ga. 2003) (noting conclusion that section 549(c) does not apply to foreclosure sales in violation of automatic stay is imperative for efficient administration of bankruptcy cases); Glendenning v. Third Fed. Sav. Bank (*In re* Glendenning), 243 B.R. 629, 633 (Bankr. E.D. Pa. 2000) (adopting minority view that section 549(c) is not an exception to section 362(a)); New Orleans Airport Motel Assocs. v. Lee (*In re* Servico, Inc.), 144 B.R. 933, 936 (Bankr. S.D. Fla. 1992) (section 549(a) does not apply to transfers in violation of automatic stay); Garcia v. Phoenix Bond & Indem. Co. (*In re* Garcia), 109 B.R. 335, 338–39 (N.D. Ill. 1989) (discussing difference between actions specifically prohibited by automatic stay and actions not otherwise authorized by Bankruptcy Code); Smith v. London (*In re* Smith), 224 B.R. 44 (Bankr. E.D. Mich. 1988) (holding post petition mortgage foreclosure sale violated automatic stay and was void).

[133] *See, e.g.*, *In re* Ward, 837 F.2d 124, 127 (3d Cir. 1988); Shaw v. County of San Bernardino (*In re* Shaw), 157 B.R. 151, 152–53 (B.A.P. 9th Cir. 1993); *In re* Shah, No. 99-34723, 2001 WL 423024, at *4 (Bankr. E.D. Pa. Apr. 10, 2001); Carpio v. Smith (*In re* Carpio), 213 B.R. 744, 745 (Bankr. W.D. Mo. 1997); Groupe v. Hill (*In re* Hill), 156 B.R. 998, 1007 (Bankr. N.D. Ill. 1993); Bryant v. Woodland (*In re*

In *In re Miller*,[134] the court observed that many courts have "merely assumed the applicability of section 549 to section 362, often without any analysis at all of the textual, structural, and policy arguments underlying the two sections."[135] It noted that courts may have an "instinct" to validate even a stay violating procedure "where a good faith purchaser is involved" and observing a "normal bias the system has toward good faith purchasers."[136] It nonetheless followed what it described as the better reasoned view that section 549(c) does not protect good faith purchasers in transfers that violate the automatic stay.[137]

In *T.F. Stone Co. v. Harper*,[138] the Fifth Circuit considered whether a "peppercorn price" received in a non collusive post petition tax foreclosure sale (not in violation of the automatic stay) could constitute the "present fair equivalent value" of the real property thus protecting the transfer from avoidance under section 549(c).[139] Stone Companies filed for bankruptcy relief in July of 1989. It did not pay ad valorem property tax to the county for 1989, but failed to list the county or the debt on its schedules. In October of 1990, an Oklahoma county treasurer conducted a tax foreclosure sale of a five acre parcel of the debtor's real property following the debtor's default on its taxes.[140] Nobody bid at the sale. So under Oklahoma law, the property, appraised at $65,000, was transferred to the county in satisfaction of the tax debt.[141] After Stone Companies' two-year redemption period expired, in June 1993, the county conducted a tax resale of the property and sold it to a married couple for $325. In October 1993, Stone Companies as debtor in possession sued under section 549 to avoid the transfer to the county and the subsequent sale to the individuals.[142]

The bankruptcy court granted summary judgment for the county on grounds

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Bryant), 103 B.R. 95 (Bankr. E.D. Pa. 1989); *In re* King, 35 B.R. 530, 531 (Bankr. N.D. Ga. 1983). One commentator described this view as the receding majority position. *See Does § 549(c) Protect a Good Faith Purchaser in a Post-Petition Foreclosure Sale Conducted in Violation of the Automatic Stay?* 23 BANKR. L. LETTER, Aug. 2003, at 2 ("[A] growing minority of lower courts hold that § 549(c) has no applicability whatsoever to a transfer of real property in violation of the automatic stay"); *see also Lusardi*, 329 F.3d at 1083 ("[N]umbers are on the side of finding section 549(c) to create an exception"). Further controversy exists over whether a creditor, such as a lien holder on the property, has standing to avoid the transfer. *Compare* Lily v. FDIC (*In re* Natchez Corp.), 953 F.2d 184, 187 (5th Cir. 1992) (suggesting creditor lacks standing to bring avoidance actions under section 549(a)), *and* City of Farmers Branch v. Pointer (*In re* Pointer), 952 F.2d 82, 87–88 (5th Cir. 1992) (noting trustee, but not creditor, is authorized to exercise avoidance powers of section 549(a)), *with* United States v. Miller (*In re* Miller), No. Civ.A.5:02-CV-0168-C, 2003 WL 23109906, at *5 (N.D. Tex. Dec. 22, 2003) (indicating secured creditor has standing to avoid transfer in violation of the automatic stay under section 362). *But see* Bryce v. Stivers (*In re* Stivers), 31 B.R. 735 (Bankr. N.D. Cal. 1983) (automatic stay gives junior lien holders and other parties interested in the property no substantive rights).

[134] *In re Miller*, 2003 WL 23109906, at *5.

[135] *Id*. at *13; *see, e.g.*, *In re* McDonald, 210 B.R. 648, 650 (Bankr. S.D. Fla. 1997).

[136] *In re Miller*, 2003 WL 23109906, at *14.

[137] *Id*. at *16.

[138] T.F. Stone Co. v. Harper (*In re* T.F. Stone Co.), 72 F.3d 466 (5th Cir. 1995).

[139] *Id*. at 467.

[140] *Id*.

[141] *Id*.

[142] *Id*. at 468.

that the price obtained at the county's foreclosure sale was presumptively its "present fair equivalent value."[143] The Fifth Circuit affirmed. It held that the Court in *BFP* "expressly eschewed any consideration of the substantive value received in a forced-sale context and instead pinned the validity of the transfer on whether the forced sale was non collusive and conducted in compliance with state law."[144] Congress may have meant "fair equivalent value" in section 549 to mean something different than "reasonably equivalent value" in section 548, but the court could not find a "meaningful difference" between the two phrases.[145] "In a forced-sale context, a value that is 'reasonably equivalent' is also fair equivalent,' and vice versa."[146] Any other result "would require policy judgments which are inappropriate for courts" and that the "essential state interest in ensuring 'security of the titles to real estate' is equally salient in both mortgage foreclosure sales and tax sales of real property."[147] The court declined to invoke footnote three to distinguish *BFP* on its facts. "The Court's disclaimer on the breadth of its decision . . . did not preclude extension of its reasoning to a case such as this one, where traditional rules of statutory construction and deference to state regulatory interests support the same outcome."[148]

Similarly, the court in *In re Shah*[149] rejected the contention that the purchaser did not pay "present fair equivalent value." Under *BFP*, the price paid at a non collusive foreclosure sale, even a post petition tax sale, is both the "reasonably equivalent" and "present fair equivalent" value of the property.[150]

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[143] *Id*. at 468.

[144] *Id*. at 470.

[145] Stone Companies argued that "present fair equivalent value" excluded as value transfers on account of antecedent debt, that the transfer of property to the county in satisfaction of ad valorem property tax debt was such antecedent debt, and thus not "present" value. *Id*. at 469. The court rejected this argument, noting that at least part of the ad valorem property tax debt arose post petition. *Id*. at 469–70.

[146] *Id*. The court noted that the Supreme Court used the words "reasonably" and "fair" "in such a manner as to belie the notion that they have different meanings." *Id*. at 470 ("[A] fair or proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at [a lawfully conducted] foreclosure sale . . . .") (citing BFP v. Resolution Trust Corp., 511 U.S. 531, 545 (1994)).

[147] *Id*. at 471. The court specifically rejected Stone Companies' argument that the language "present fair equivalent value" in section 549(a) set a stricter standard for value equivalence than "reasonably equivalent value." *Id*. at 471–72. The court noted that even if Congress intended a stricter requirement of equivalence under section 549, the stringency need not be reflected in the assessment of value equivalence. The court noted that section 549(c) limits the transferee's immunity to the trustee's avoiding power under section 549(a) beyond just a showing that the transfer was for "present fair equivalent value." The transferee must also be "a good faith purchaser without knowledge of the commencement of the case." 11 U.S.C. § 549(c) (2000). Stone Companies did not notify the County of its bankruptcy filing. *In re T.F. Stone Co*., 72 F.3d at 470–71.

[148] *Id*. at 472. The Fifth Circuit expressly declined to follow Shaw v. County of San Bernardino (*In re* Shaw), 157 B.R. 151, 153–54 (B.A.P. 9th Cir. 1993) (noting different language in section 549(c) required use of fair market value evidence of value of property for comparison).

[149] No. 99-34723, 2001 WL 423024, at *1 (Bankr. E.D. Pa. Apr. 10, 2001).

[150] *Id*. at *11; *accord In re* McDonald, 210 B.R. 648, 651 (Bankr. S.D. Fla. 1997) (holding price received at foreclosure sale conducted in compliance with state law constituted present fair equivalent value of property).

But, not all courts have taken this view. In the similar sounding *In re Shaw*,[151] the Ninth Circuit Bankruptcy Appellate panel held that "present fair equivalent value" in section 549(c) required use of fair market value as evidence of the value of the property for purposes of ascertaining whether the transfer price was a "fair equivalent."[152] In *40235 Washington Street Corp. v. Lusardi*,[153] the court held in dicta that "[d]etermining 'present fair equivalent value' requires a comparison between the price actually paid, $269,500 and its worth or 'benchmark' value, $615,000."[154] "In the foreclosure context, the use of 'present' shows that the proper § 549(c) benchmark should not be the winning bid at a foreclosure sale."[155]

C. Regulated Transfers to the Foreclosing Creditor Under Section 547

By the end of the 1980s, several bankruptcy courts had held that an over secured creditor who acquired collateral at a non collusive foreclosure sale by bidding in its debt received an avoidable *preferential* transfer.[156] The trick for the trustee in a preference attack on a regulated transfer is to satisfy subsection 547(b)(5), the so-called "improvement in position" test, as to the secured creditor/transferee.[157] Typically, a transfer to a fully secured creditor does not satisfy the improvement in position test because in a chapter 7 case, a fully secured creditor is entitled to a distribution at least equal to the property it received in the challenged pre petition transfer.[158] Where the collateral subject to the creditor's lien and transferred to the foreclosing creditor has a fair market value greater than the bid-in debt, as would be the case whenever a creditor is oversecured, the trustee can argue that the creditor received the difference between the collateral value and the debt and to that extent improved its position relative to what it would have received

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[151] 157 B.R. 151 (B.A.P. 9th Cir. 1993).

[152] *Id*. at 154 n.7. The court in *D'Alfonso v. A.R.E.I. Inv. Corp.* (*In re D'Alfonso*), 211 B.R. 508, 518 (Bankr. E.D. Pa. 1997) rejected the argument that *BFP* controlled the meaning of "present fair equivalent value" in section 549(c). It did not suggest an alternate meaning but found only that the transferees failed to establish that the foreclosure price was "anything close to the 'present fair equivalent value' of the property." *Id*. In a pre *BFP* case, *Purnell v. Citicorp Homeowners Servs., Inc.* (*In re Purnell*), 92 B.R. 625, 630 (Bankr. E.D. Pa. 1988), the bankruptcy court held that a mort gagee bidding its debt at a post petition foreclosure sale is not a good faith purchaser under section 549(c). In *In re Shah*, however, the court rejected the contention that the purchaser could not be a good faith purchaser because the transferor's bankruptcy case was a matter of public record and any purchaser at a tax sale should have conducted a search to ascertain the status of the transferor. It recognized that tagging the purchaser with such constructive notice "would swallow the exception under section 549(c) as to all purchases resulting from tax sales, and for that matter mortgage foreclosures . . . ." *In re* Shah, 2001 WL 423024, at *8.

[153] 177 F. Supp. 2d 1090 (S.D. Cal. 2001); *see also In re D'Alfonso*, 211 B.R. at 508.

[154] *Lusardi*, 177 F. Supp. 2d at 1097.

[155] *Id*. at 1099.

[156] *See, e.g*., Winters v. First Union Nat'l Bank (*In re* Winters), 119 B.R. 283, 284 (Bankr. M.D. Fla. 1990); *In re* Park N. Partners, Ltd., 80 B.R. 551, 554 (Bankr. N.D. Ga. 1987); Fed. Nat'l Mortgage Ass'n v. Wheeler (*In re Wheeler*), 34 B.R. 818, 822 (Bankr N.D. Ala. 1983); Morris Plan Co. v. Fountain (*In re* Fountain), 32 B.R. 965, 967–68 (Bankr. W.D. Mo. 1983).

[157] 11 U.S.C. § 547(b)(5) (allowing trustee to avoid any transfer of an interest of debtor in property "that enables such creditor to receive more than such creditor would receive" if three conditions are met).

[158] *Id*. § 506(a).

in a hypothetical chapter 7 liquidation.

Just as the court must decide whether the transfer price is a "reasonable equivalent value" for the property under section 548, the court in a preference action must determine whether the value of the property transferred is "more" than a creditor/transferee would have received in a hypothetical chapter 7 distribution assuming the challenged transfer had not been made.[159] On this question, Congress has been only the tiniest bit more forthcoming. "While courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition of use of the subject property."[160]

The Ninth Circuit rejected the argument that a non collusive, regularly, conducted foreclosure proceeding could constitute an avoidable preferential transfer. In *Ehring v. Western Community Moneycenter*,[161] the foreclosing creditor acquired property at a foreclosure sale for about $200,000 and sold it later for $390,000.[162] The court held that creditor did not receive "more" from the transfer than it would have in a chapter 7 distribution. It noted that a third party could have outbid the creditor and obtained the property not subject to avoidance (under *Madrid*.) "[I]t is difficult to see why the existence of a preference should turn on the status of the purchaser as a creditor."[163]

In contrast, in *In re Andrews*,[164] a chapter 13 debtor sought to avoid sheriff's sale of his real property as a preferential transfer. The foreclosing creditor who acquired the property at the sale sought relief from the stay to institute ejectment proceedings against the debtor. The court held that the trustee could avoid the sheriff's sale as a preferential transfer because the transfer price (the "bid-in" debt) was substantially less than property's fair market value.[165] The only litigated issue was whether the trustee satisfied the "improvement in position test" as to the foreclosing creditor.[166] The creditor/transferee asked the court to ignore the stipulated fair market value of the property and find instead that the price achieved at a non collusive, regularly conducted sheriff's sale was the value of the defendant's lien, so that it could not have received "more" than it would have received in a chapter 7 case.[167] The court refused, noting that the defendant received a "windfall"

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[159] *Id*. § 547(b)(5) (requiring courts to determine whether creditor received "more" than such creditor would receive under specified conditions).

[160] *See* S. REP. NO. 95-989, at 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854; *see also* 11 U.S.C § 506(a) (2000) (requiring that the "value" of creditor's interest in estate's interest in property secured by a lien be "determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . .").

[161] 900 F.2d 184 (9th Cir. 1990).

[162] *Id*. at 185–86.

[163] *Id*. at 188.

[164] Norwest Bank Minn. v. Andrews (*In re* Andrews), 262 B.R. 299, 306 (Bankr. M.D. Pa. 2001).

[165] The court found that *BFP* had no application. *Id*. at 304 ("I have determined that *BFP* has absolutely no bearing on the instant issue . . . .").

[166] *See id*. at 302.

[167] *Id*. at 303.

by way of the transfer.[168] The court washed its hands of any adverse effect on state foreclosure systems. "There may be ramifications on state foreclosure law, but that is a legislative matter."[169]

In *In re FIBSA Forwarding, Inc.*,[170] the court held that *BFP* "speaks to" the question of whether a creditor who acquires property through a regulated transfer receives "more" for purposes of the improvement in position test under section 547(b)(5), and that any excess of value over bid-in debt is not a windfall to the transferee/creditor.[171] "If the price received at a foreclosure sale is reasonably equivalent to the value of the property sold, then parity of reasoning would suggest that such a foreclosure sale would not have the effect of 'enabl[ing] such creditor to receive more than such creditor would receive' in a chapter 7."[172]

III. WHAT "REASONABLY EQUIVALENT VALUE" SHOULD MEAN

In *BFP*, the Court clarified the meaning of reasonably equivalent value in section 548(a)(1)(B). Against a strident dissent, the majority held that for a real property foreclosure, the price achieved at a non collusive, regularly conducted judicial sale is the reasonably equivalent value of the real property, although it departs from the fair market value of the property.[173] Because the Court limited its holding to judicially supervised real property foreclosures, it left the door ajar for bankruptcy courts to ignore the Court's reasoning and determine the reasonableness of a regulated transfer price in other contexts *ad hoc*. Although the door is open, the room on the other side is dark. What characteristics other than irregularity in the conduct of the sale, or collusion of the parties, might justify avoidance? The majority in *BFP* did not address this question. The dissent observed only that bankruptcy courts will know an unreasonable regulated transfer price when they see

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[168] *Id*. at 305. The court held that permitting the creditor to retain such a "windfall" was inconsistent with the purposes of section 547 "which is to prevent a creditor, or creditors, from stripping the debtor of assets that could be distributed to all creditors just prior to the filing of the bankruptcy." *Id*. at 304. The court called the comparison between fair market value and transfer price a "simple mathematical approach" that does "not ignore the windfall to creditors of equity that would otherwise be distributed [in a hypothetical chapter 7 case]." *Id*. at 306.

[169] *Id*. at 305.

[170] Newman v. FIBSA Forwarding, Inc. (*In re* FIBSA Forwarding, Inc.), 230 B.R. 334 (Bankr. S.D. Tex. 1999), *aff'd*, 244 B.R. 94 (S.D. Tex. 1999).

[171] It noted that although some purchasers sell the property for more than the "bid in" debt, others do not. "Some foreclosing creditors fail to sell the property for even a fraction of the amount of the bid at the foreclosure sale. This seeming anomaly is due, in some measure, to the fact that creditors who bid at foreclosure almost always are bidding the amount of a pre-existing claim rather than investing fresh cash." *Id*. at 96 n.2. The bankruptcy court had relied on the *BFP* reasoning concerning the effect of avoidance on an important state interest. *In re FIBSA Forwarding, Inc*. 230 B.R. at 341. "The apparent lesson of *BFP* is that if a creditor is oversecured, the Debtor must file a bankruptcy petition (or creditors must file an involuntary petition) before foreclosure to prevent the secured creditor from reaping a windfall at the expense of other creditors. If the Debtor does not do so, there would appear to be no protection for unsecured creditors who do not have knowledge of the foreclosure in time to file an involuntary petition." *Id*. at 341.

[172] 244 B.R. at 96.

[173] BFP v. Resolution Trust Corp., 511 U.S. 531, 548–49 (1994).

one.[174]

The Court's failure to resolve completely the meaning of reasonably equivalent value is understandable. The persistent uncertainty over the term is a visible tip of a larger controversy about both bankruptcy policy and fraudulent transfer law. The Bankruptcy Code does not unambiguously reveal a coherent policy as to the scope of the trustee's avoiding powers. We know that Congress intended the trustee's fraudulent transfer avoiding powers to protect creditors against certain unreasonable wealth depleting, pre petition transfers. The Code, however, is silent as to what attributes of a wealth depleting transfer make it unreasonable.

On this issue, the Bankruptcy Code is no more opaque than state law. Until the late twentieth century with the emergence of constructive fraud as grounds for avoidance, state and federal fraudulent transfer law required the challenger to present evidence that collusion or bad faith on the part of the transferee depressed the transfer price and thus made the transfer unreasonable. But, by the time the Court decided *BFP* in 1994, the transferee's collusive manipulation of the transfer price, in the minds of some observers, lost its role as the touchstones of the unreasonableness of a transfer price. Although collusion and bad faith were out, no articulated criteria for unreasonableness arose to replace them. Few observers noted the resulting void. Instead, most commentators and some courts embraced an essentially fraud free conception of fraudulent transfer avoidance by which courts could decide whether the transfer caused an unfair wealth depletion based solely on the size of the wealth depletion, without regard to the cause of it.[175] The constructive fraud language in section 548(a)(1)(B) supports this fraud free conception of fraudulent transfer law it as do articulations of constructive fraud under state law.[176]

Abandoning the search for collusion in favor of a direct assessment of the reasonableness of the transfer made sense from creditors' perspective. Because parties are adept at concealing their causal role in depressing a transfer price, the cause of a wealth depletion typically appears only as an inference from observable facts. A key fact on which causation rests is a large unexplained difference between the transfer price and the fair market value of property. The fact that the transfer occurred for far less than the fair market value of the property may be powerful evidence supporting an inference that collusion between the transferor and transferee depressed the transfer price in fraud of creditors. But, the fraud free conception of fraudulent transfer law goes one step further. It elevates the presence of a difference between transfer price and market value of property to the *sina qua non* of unreasonableness, without regard to the traditional inferential link between the difference and the parties' role in creating it in fraud of creditors.

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[174] *See supra* notes 98–100 and accompanying text.

[175] *See* Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 823 (7th Cir. 1988) (an irrebuttable presumption that a regulated transfer price is the "reasonably equivalent value" of the property is "inconsistent with [section 548(a)(1)(B)'s] purpose of permitting the trustee to avoid transfers as constructively fraudulent, irrespective of the parties' actual intent."); case cited *supra* note 85.

[176] 11 U.S.C. § 548(b) (2000); *e.g.*, UFTA §§ 4(a)(2), 5(a), 7A Pt. II U.L.A. 339 (1999).

Although the fraud free conception significantly streamlines creditors' burden in a constructive fraud challenge, its premise is flawed. Both federal and state law articulations of constructive fraud render only *unreasonably* wealth depleting transfers avoidable. If only size matters so that the reason why a transfer caused a wealth depletion for the debtor is not relevant, then there is no objectively defensible basis for ascertaining whether any particular wealth depleting transfer is reasonable. This is true because the reasonableness of a particular transfer depends entirely on who is asking. Unsecured creditors and their representative, the bankruptcy trustee, will find every wealth depleting transfer, no matter how small the wealth depletion, to be *per se* unreasonable simply because it increases their risk of loss. In contrast, from a transferee's perspective, any arms' length transfer by which they win and creditors lose is *per se* reasonable, no matter how large the loss to creditors.

The regulated transfer at issue in *BFP* presented the difficult case where the cause of a below market transfer price is definitively not collusion but rather a state sanctioned price setting procedure. Justice Souter apparently assumed that section 548(a)(1)(B) made the cause of the wealth depleting transfer (and the negative effect on creditors) irrelevant in assessing the reasonableness of a transfer. For him, bankruptcy policy supplies the missing perspective by which to evaluate the reasonableness of a transfer. Proponents of his view read the trustee's avoiding powers broadly as an equitable tool to enhance the estate for the benefit of the debtor or unsecured creditors at the expense of parties who have obtained an advantage by transfer. They assert variously that the purpose of the avoiding powers is to preserve the value of the estate, facilitate the rehabilitation of the debtor, distribute the debtor's estate fairly among his creditors, and afford the debtor a fresh start.[177] What Justice Souter did not address, however, is that fairness for unsecured creditors is necessarily achieved at the expense of transferees, who under the same bankruptcy policy are also entitled to fairness. Unsecured creditors' claim to fairness is no stronger than that of the transferee, who has done nothing wrong other than invoke its rights to foreclose on the debtor's property under non bankruptcy law.

Justice Souter's view of the trustee's constructive fraud transfer avoiding powers

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[177] *E.g.*, *BFP*, 511 U.S. at 563 (Souter, J. dissenting) (opining that avoidance of foreclosure sales for low prices ensures fresh start for debtors and allows for maximum and equitable distribution for creditors, which are core policies of federal bankruptcy law); *In re Bundles*, 856 F.2d 815, 824 (stating purpose of avoidance is to preserve assets of estate); Grissom v. Johnson (*In re* Grissom), 955 F.2d 1440, 1446–47 (11th Cir. 1992) (finding purpose is to prevent unnecessary depletion of estate); Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 B.R. 434, 447 (Bankr. D. Utah 1982) (declaring that section 548 fosters equitable distribution of debtor's property); Ryker v. Current (*In re* Ryker), 272 B.R. 602, 605 (Bankr. D.N.J. 2002) (holding purpose of section 548 is to "rectify pre petition depletion of the debtor's estate."). One commentator notes that "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," but "authorities disagree about where the proper limits of fraudulent transfer law should be drawn." Basil H. Mattingly, *Reestablishment of Bankruptcy Review of Oppressive Foreclosure Sales: The Interaction of Avoidance Powers as Applied to Creditor Bid-Ins*, 50 S.C. L. REV. 363, 369 (1999).

reflects an analogous understanding of the scope of state law on constructively fraudulent transfers. Commentators note that the purpose of fraudulent transfer law is to protect creditors from "harm"[178] or to impose "standards of right and wrong in debtor-creditor relationships."[179] Despite these lofty pronouncements, state fraudulent transfer law does not protect creditors from *all* harm from wealth depleting transfers, just from those that are unreasonable. Nonetheless, for most commentators, the idea that the reasonableness of a transfer depends entirely on who is asking is heretical.[180]

The other school of thought ascribes a different purpose to the trustee's avoiding powers. Its adherents include Justice Scalia and the justices joining his opinion in *BFP*. This view rejects the notion that Congress intended the trustee's avoiding powers to provide bankruptcy courts with the discretion to subsidize a reorganization or fresh start at the expense of transferees, or that a bankruptcy policy of "fairness" to creditors justifies taxation of one group of claimants solely to benefit another.[181] Rather, the avoiding powers should be understood as furthering the goal of efficiency. A transferee ought to bear loss from the debtor's default and insolvency instead of creditors only when the transferee is the cheaper bearer of such loss.[182] If at the time of transfer, the transferee knew or should have known that it would have a wealth depleting effect borne by an insolvent transferor's creditors, his failure to act to prevent or insure against creditors' loss is the cause of creditors' loss. Transfer avoidance creates an efficient incentive on such a transferee to detect and protect creditors from risk of loss because he can do so at the time of the challenged transfer more cheaply than creditors can *ex ante*.

This theory of transfer avoidance is starkly at odds with the idea that avoidance can be based on an *objective*, *ex post* assessment of the reasonableness of the transfer. The key to identifying the transferee's relative advantage in avoiding or insuring against loss is the information available to him at the time of the transfer regarding the debtor's financial condition and the loss externalizing effect of the

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[178] Jack F. Williams, *Revisiting the Proper Limits of Fraudulent Transfer Law*, 8 BANKR. DEV. J. 55, 64 (1991) (reasoning constructive fraudulent transfer law is justified by "reasoned creditors' harm heuristic" that protects creditors from significant harm unless diminution of debtor's estate is not unjust).

[179] Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 510 n.17 (1997).

[180] *E.g.*, GLENN, *supra* note 17, at 73 (claiming it is obvious that purpose of fraudulent transfer law is protection for creditors of their collective right to fair distribution of debtor's estate).

[181] *See, e.g.*, Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 834 (1985); John C. McCoid II, *Constructively Fraudulent Conveyances: Transfers for Inadequate Consideration*, 62 TEX. L. REV. 639, 664 (1983); Marie T. Reilly, *The Latent Efficiency of Fraudulent Transfer Law*, 57 LA. L. REV. 1213, 1225 (1997).

[182] Douglas Baird and Thomas Jackson posited that fraudulent transfer law "should be viewed as a species of contract law, representing one kind of control [over debtor conduct] that creditors generally would want to impose and that debtors generally would agree to accept." Baird & Jackson, *supra* note 181, at 836; *see also* Reilly, *supra* note 181, at 1226–27 (stating transfer should be avoidable only if, at time of transfer, transferee was cheaper avoider, or insurer, against risk of loss from debtor's breach and insolvency, relative to debtor's creditors).

transfer on the debtor's creditors.[183] For example, a transfer to a colluding party who *knew* that the debtor was using the transfer to hide assets from his creditors ought to be avoidable because such a transferee's knowledge gave him an unquestionable advantage over unsecured creditors to prevent creditors' loss. In contrast, a transfer to a party who *could not have known* of the debtor's financial troubles or that the transfer would externalize loss to creditors ought not be avoidable because such a transferee has no advantage in avoiding or insuring against such loss, relative to creditors.[184] A bridge between the two theories can be drawn by equating the transferee's relative advantage in preventing or insuring against creditors' with the reasonableness of the wealth depletion to creditors. A wealth depleting transfer to a colluding transferee is unreasonable. But, a wealth depleting transfer to a non colluding transferee is not unreasonable, even though it leaves a transferee with a great bargain and creditors holding an empty bag.

The problem the Court faced in *BFP* is that the Bankruptcy Code does not explicitly support an efficiency based assessment of the reasonableness of a transfer price. Indeed, Congress appears to have moved away from efficiency as the purpose of the trustee's avoiding powers to the extent that it has diminished the importance of the transferee's mental state to the scope of those powers. We have considered the change from subjective "fair consideration" in the UFCA to "reasonably equivalent value."[185] Consider also that a transferee to a transferee "in good faith" and "for value" is subject to constructive fraud avoidance under section 548(a)(1)(B) if, *inter alia*, if the transfer price is "less than a reasonably equivalent value." A good faith transferee for value of a constructively fraudulent transfer must relinquish the transferred property or its value, but is entitled to a lien on the property to the extent of the value she gave for it.[186] This provision, affording a "good faith" transferee a lien on the property subject to avoidance, makes sense only if a transferee can, in good faith, give "less than a reasonably equivalent value." This can occur only if the reasonableness of the value a transferee gives is ascertainable without regard to the transferee's good faith.

Another example of Congress's diminution of the importance of the transferee's mental state on the trustee's avoiding powers is the change to the definition of a preferential transfer in section 547(b). At the same time that Congress adopted the term "reasonably equivalent value" in section 548, it eliminated from the definition of a preferential transfer the requirement that the creditor/transferee knew or should

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[183] *See* Reilly, *supra* note 181, at 1246.

[184] *Id*.

[185] *See supra* text accompanying notes 21–24.

[186] *See* 11 U.S.C. § 548(c) (2000) (notwithstanding sections 544, 545, and 547, transferee or obligee who takes transfer or obligation "for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such a transfer or obligation."); *see also id*. § 549(c) ("[G]ood faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given . . . .").

have known of the debtor's insolvency.[187] The change was ostensibly to further the "equality principle."[188] But, the change did not entirely eliminate the relevance of the transferee's state of mind in favor of ostensibly fault neutral "equality." Congress preserved the relevance of the transferee/creditor's state of mind in the "ordinary course of business" exception to preferential transfer avoidance.[189] This exception recognizes that a transfer made in the debtor's and creditor's "ordinary course," is *not* avoidable, no matter how unequal the resulting distribution of property among creditors.[190] Although the exception is not stated in terms of the transferee/creditor's state of mind, courts understand it to encompass those transfers that the transferee understood as "business as usual," and not as nakedly self-protective measures extracted by a powerful creditor/transferee in anticipation of the debtor's insolvency.[191]

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[187] The Bankruptcy Act required proof that the allegedly preferred creditor had "reasonable cause" to believe the debtor was insolvent at the time of the transfer. *Compare* Bankruptcy Act of 1898, ch. 541, § 60(b), 20 Stat. 544, 562 (1898) (repealed 1978), *with* 11 U.S.C. § 548(b).

[188] *See, e.g.*, Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 512 (1977) ("[T]ransfers resulting in better than equal treatment on the eve of liquidation proceedings should be undone—and may actually be undone in bankruptcy proceedings as voidable preferential transfers."); *see also* H.R. REP. NO. 95–595, at 178 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6139 ("[C]reditor's state of mind has nothing whatsoever to do with the policy of equality of distribution, and whether or not he knows of the debtor's insolvency does little to comfort other creditors similarly situated who will receive that much less from the debtor's estate . . . ."); *id*. at 177–78, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138 ("[T]he preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor."); David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 215–19 (1995) (relating equality principle to purported federalist aims of bankruptcy law, such as creation of national markets and extinguishing preferences for local creditors over distant creditors); Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 726 (1985) (one purpose of preference concept is to preserve equality within various classes of creditors); Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 WIS. L. REV. 1439, 1479, 1484 (1993) (basic policy of preference law is to "ensure substantial equality."); Charles Jordan Tabb, *Rethinking Preferences*, 43 S.C. L. REV. 981, 986–95 (1992) ("Equality is fairer and more equitable, it is more efficient, it makes more logical sense, and it is simpler and easier to administer than fault-based theories of preference recovery."). The equality principle quickly breaks down, however, upon inquiry into the attributes that make creditors "similarly situated" or not. *See* Countryman, *supra*, at 748 ("[W]ith creditors classified for distribution purposes on the basis of liens and priorities, no bankruptcy policy of 'equality' exists."). Moreover, the ideal of "equality" among creditors often masks the ideal of "maximizing the value of the estate for the benefit of creditors" or "marshalling." *See, e.g.*, Andrew DeNatale & Prudence B. Abram, *The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors*, 40 BUS. LAW. 417, 418 (1985) (suggesting broad purposes of bankruptcy law, including marshalling of assets, should be factored into determining whether result is fair or just, and acknowledging "[a]lthough the orchestral functions [of bankruptcy law] are marshalling and distribution, the contrapuntal theme is intended to be equality of distribution.").

[189] *See* 11 U.S.C. § 547(c)(2) (2000). The trustee's power to avoid a preference depends on application of the statutory definition of preferential transfer in section 547(b) and the non application of an exception in section 547(c).

[190] *See generally* TABB, *supra* note 10, at 350–51.

[191] *See, e.g.*, Speco Corp. v. Canton Drop Forge, Inc. (*In re* Speco Corp.), 218 B.R. 390, 401 (Bankr. S.D. Ohio 1998) (concluding debtor's subjective intent is relevant to ordinariness of payment); *In re* Vogel Van & Storage, Inc., 210 B.R. 27, 36 (Bankr. N.D.N.Y. 1997) (finding phone calls urging payment can sometimes take payment out of ordinary course of business, but such phone calls can at other times constitute normal

Even if we assume that the articulation of constructive fraud in section 548(a)(1)(B) supports an efficiency based interpretation of the reasonableness of a transfer, we have not solved the problem. Courts would still search in vain for the way to assess the reasonableness of a wealth depleting, non collusive *regulated* transfer. Such transfers, because they are not based on competition and assent but rather on regulation, are by definition inefficient. The party who pays less than the fair market value for property at a regulated transfer *knows* he is getting a steal. He knows or at least should know both of the debtor's insolvent condition, and of the loss externalizing effect of the transfer on the debtor's unsecured creditors. It is not surprising that courts that have declined to apply *BFP* to regulated transfers note that the procedure at issue does not yield a transfer price that establishes the "value" of the property.[192] While these courts may believe they are assessing "all the facts and circumstances," they are really reaching the inevitable conclusion that the particular forced transfer procedure is inefficient relative to a hypothetical fair market transfer. They conclude that the inefficient procedure makes the resulting transfer unreasonable and avoidable under section 548(a)(1)(B).

The case of the regulated transfer falls through the cracks of the Bankruptcy Code. Like collusive transfers, regulated transfers are inefficient. But, unlike collusive transfers, state law expressly authorizes the inefficiency. The question of the avoidability of an obviously inefficient regulated transfer raises a problem of federalism in a way that Justice Scalia perhaps hoped to avoid by limiting the holding in *BFP* to judicial real estate foreclosure sales. Justice Breyer may not have fully appreciated this problem.

The Constitution gives Congress the power to make laws affecting bankruptcy.[193] The property regime in which bankruptcy law operates is established by non bankruptcy law,[194] much of which may not be as protective of debtors as Congress would like. Congress may have intended section 548(b)(1) to limit states' power to enact regulation of property transfers that have the effect of injuring debtors or their creditors when those transfers occur within a year prior to the debtor's bankruptcy case and while the debtor was insolvent.[195] It may be that the

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debt collection practices). *But see In re* Graphic Prods. Corp., 176 B.R. 65, 71 (Bankr. S.D. Fla. 1994) (downplaying relevance of subjective intent by finding "debtor's motive for making a payment or state of mind cannot alone establish 'unusual' or 'extraordinary' actions by the debtor.").

[192] *See, e.g.*, Sherman v. Rose (*In re* Sherman), 223 B.R. 555, 559 (B.A.P. 10th Cir. 1998); 40235 Wash. St. Corp. v. Lusardi, 177 F.2d 1090, 1099 (S.D. Cal. 2001); Wentworth v. Town of Acton, (*In re* Wentworth), 221 B.R. 316, 320 (Bankr. D. Conn. 1998); D'Alfonso v. A.R.E.I Ivest. Corp. (*In re* D'Alfonso), 211 B.R. 508, 518 (Bankr. E.D. Pa. 1997); *see also* BFP v. Resolution Trust Corp., 511 U.S. 531, 558–59 (Souter, J., dissenting); Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 824 (7th Cir. 1988) (instructing bankruptcy court to "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.").

[193] U.S. CONST. art. I, § 8, cl. 4.

[194] Butner v. United States, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law.").

[195] A parallel inquiry is whether the federal antitrust laws recognize the immunity of states in adopting anti competitive policy. *See generally* John E. Lopatka & William H. Page, *State Action and the Meaning of*

purpose of section 548(b)(1) is to eliminate the negative effect of this subset of regulated transfers on an individual debtor's fresh start, or on unsatisfied unsecured creditors.[196]

Several responses to this assertion come to mind. First, the Court seems to have rejected this view in *BFP*. Although the Court could have been clearer, its reasoning recognized that regulation of transfers like foreclosure upon debtor default is "an essential state interest."[197] It expressly declined to "specify a federal 'reasonable' foreclosure sale price" absent "clear textual guidance."[198] Second, the assertion is in conflict with the "ordinary course" exception to preferential transfer avoidance in section 547(c)(2). Although regulated transfers do not occur in the "ordinary course," a regulated transfer that is non collusive and conducted in accordance with state law is arguably an "ordinary" regulated transfer. Such a transfer, although wealth depleting, ought to be immune from avoidance for the same reason that ordinary course wealth depleting preferential transfers are immune from avoidance. Third, since the Court decided *BFP*, Congress has at least in part negated the premise that it intended section 548 to be a tool to protect individual debtors' equity against the ravages of pre petition regulated transfers. As part of the 1994 amendments to the Bankruptcy Code, Congress eliminated an individual chapter 13 debtor's right to "cure and reinstate" a home mortgage once the mortgagee foreclosed on the property by a sale "in accordance with applicable non bankruptcy law."[199]

If bankruptcy courts were to permit the trustee to avoid non collusive regulated transfers whenever the regulated transfer price was less than the hypothetical, unregulated, fair market price of the property, the medicine might in the end harm

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Agreement Under the Sherman Act: An Approach to Hybrid Restraints, 20 YALE J. ON REG. 269 (2003) (analyzing Court's use of state action immunity to resolve conflicts between federal antitrust laws and state policies, and offering solutions).

[196] In *Grissom v. Johnson* (*In re Grissom*), 955 F.2d 1440 (11th Cir. 1992), the court held that "reasonably equivalent value" depends on the circumstances of the regulated sale including but not limited to the size of the disparity between transfer price and fair market value. *Id*. at 1449. It also held that the foreclosing party has duty to take all commercially reasonable steps to recover the debtor's equity. *Id*. at 1446. Perhaps reflecting the court's sensitivity the balance of rights between an individual consumer debtor and the mortgagee of the consumer's home it noted: "[w]e allow the interests of secured creditors to trump bankruptcy policy when we give a commercial lender carte blanche to ignore the equity interests of a borrower as long as that lender follows minimal requirements of state foreclosure law." *Id*. at 1447. The court remanded for an evidentiary hearing on whether the foreclosing creditor "took the reasonable commercial steps necessary to ensure that the foreclosure proceedings attempted to protect the debtor's equity in the property." *Id*. at 1448.

[197] *BFP*, 511 U.S. at 544.

[198] *Id*. at 543 (rationalizing departures from long standing common law require congressional intent to deviate).

[199] 11 U.S.C. § 1322(c) (2000).

> Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law . . . .

Id.

the patient as the Court recognized in *BFP*. The possibility that a regulated transfer would be avoidable in bankruptcy case filed within one year after the transfer could chill whatever competition for such property might exist under the applicable regulation to the detriment of the debtors that proponents of the distributional approach desire to benefit. Most courts considering the issue have upheld a non collusive regulated transfer against the trustee's constructive fraud avoiding powers. The chilling impact of cases where courts distinguish *BFP* so far appears to be relatively small because the courts tend to justify avoidance based on an assessment of the unique facts of the particular case.

CONCLUSION

The persistent uncertainty and discord among courts about the meaning of "reasonably equivalent value" is a product of two factors: (1) the logically impossible objectification of state and federal constructively fraudulent transfer law; and (2) the Court's failure in *BFP* to negate completely the possibility that bankruptcy courts can avoid transfers sanctioned by state law without evidence of collusion, fraud or irregularity that depressed the price.

There is no easy way to assess the reasonableness of a transfer price relative to the value of property. Evaluating transfers after the fact for evidence supporting an inference of irregularity or collusion is expensive and frequently unsatisfying. Although proof of irregularity or collusion is an obstacle for the trustee, courts should not abandon it without fully appreciating its function. Sifting unreasonable and therefore avoidable transfers from unavoidable ones allocates value between unsecured creditors and a transferee. Where a transferee has manipulated the transfer process, either unilaterally or in collusion with the transferor, imposing the loss on him is easy. The difficult case is where the transferee did nothing wrong, yet still wound up with a fabulous bargain while the transferor's creditors look on with empty pockets. Notwithstanding popular rhetoric, the transferee at a regulated transfer for less than fair market value does not receive a "windfall." Rather, he accessed state regulation designed for the purpose of accomplishing involuntary transfers other than on the "fair market." If state law and not collusion or irregularity accounts for the difference between transfer price and hypothetical fair market value, then the transfer price is the reasonably equivalent value because state law deems it so and no federal reason justifies a different result.

Under this interpretation of reasonably equivalent value, there is still much for bankruptcy courts to do. A court considering a constructive fraud challenge to a regulated transfer must consider whether the transfer occurred according to a price setting procedure sanctioned by state law. If it did, the court must determine whether a deviation from sanctioned procedure increased the difference between transfer price and fair market value beyond what it would have been but for the deviation. Regulated transfers, even ones that comply in all respects to the technical requirements of state law, are ripe for manipulation by collusion between transferees and persons in control of the defaulting debtor. Bankruptcy courts play

a critical role in safeguarding unsecured creditors from loss caused by this kind of collusion even in the context of a regulated transfer. In this role, bankruptcy courts serve a federal purpose that does not duplicate state law. Although no single creditor may have enough at stake to challenge a regulated transfer under state law, a bankruptcy trustee acting for unsecured creditors collectively may have a sufficient incentive. A federal test for reasonably equivalent value that equates reasonableness with the absence of material irregularity or collusion provides uniformity and equality of treatment that Congress may have envisioned when it enacted a federal fraudulent transfer avoiding power.