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Bankruptcy: Nonjudicial Foreclosures as Fraudulent Transfers under Section 548 of the Bankruptcy Code

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BANKRUPTCY: NONJUDICIAL FORECLOSURES AS FRAUDULENT TRANSFERS UNDER SECTION 548 OF THE BANKRUPTCY CODE—*Madrid v. Lawyers Title Insurance Corp.*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

I. INTRODUCTION

Prior to 1980, most attorneys assumed that the only way to protect an insolvent debtor's property from foreclosure[1] was to commence bankruptcy proceedings before a foreclosure sale took place.[2] The filing of a bankruptcy petition under the Bankruptcy Code[3] automatically stayed any attempt to enforce a lien against a debtor's property. Once a foreclosure sale occurred and the sale was recorded, however, the purchaser was presumed to have clear and marketable title to the property.[4] The United States Court of Appeals for the Fifth Circuit later challenged this presumption in *Durrett v. Washington National Insurance Corp.*[5]

In *Durrett*, the Fifth Circuit held that a prepetition, nonjudicial foreclosure sale could be avoided as a fraudulent transfer of the debtor's property, pursuant to section 67d of the Bankruptcy Act,[6] if

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1. Some bankruptcy courts had allowed a trustee to use state statutory redemption rights to recover a debtor's property after a foreclosure sale. *See* Hamblen v. Federal Savings & Loan Ins. Corp. (*In re* Thomas J. Grosso Investment, Inc.), 457 F.2d 168 (9th Cir. 1972) (state court retains jurisdiction to set aside a sale for inadequacy of the bid price during the redemption period). Yet, only about half of the states give defaulting debtors a statutory right to redeem their property after it is sold at foreclosure. G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW §§ 7.1, 8.4 (1979) [hereinafter cited as REAL ESTATE FINANCE]. Moreover, only thirteen states have statutory redemption following a nonjudicial foreclosure sale. ALA. CODE § 6-5-230 (1975); ARK. STAT. ANN. § 51-1112 (1971); COLO. REV. STAT. § 38-39-102 (1973); MICH. COMP. LAWS ANN. § 600.3240 (West 1980); MINN. STAT. ANN. § 580.23 (West Supp. 1984); MO. ANN. STAT. § 443.410 (Vernon 1952); MONT. CODE ANN. § 71-1-228 (1983); N.C. GEN. STAT. § 1-339.36 (1969); N.D. CENT. CODE § 35-22-20 (1980); R.I. GEN. LAWS § 34-23-3 (1984); S.D. CODIFIED LAWS ANN. § 21-52-1 (1979); TENN. CODE ANN. § 66-8-101 (1982 & Supp. 1984); WYO. STAT. § 1-18-103 (1977).

2. Coppell & Kann, *Defanging* Durrett: *The Established Law of "Transfer,"* 100 BANKING L.J. 676, 676 (1983).

3. 11 U.S.C. § 362(a) (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 371.

4. Coppell & Kann, *supra* note 2, at 676.

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

6. Section 67d of the act (currently revised as section 548 of the code) provided in pertinent parts:

> (1) For the purposes of, and exclusively applicable to, this subdivision: . . . (e) consideration given for the property or obligation of a debtor is "fair" (1) when, in good faith, in exchange and as a fair equivalent therefor, property is transferred . . . .
>
> (2) Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition [initiating a proceeding under this Act] by or against him is fraudu-

the property was sold for less than fair consideration.[7] In application, however, the *Durrett* rule fails to allow an examination of the particular facts and circumstances of each case in determining whether fair consideration exists.[8] Instead, the *Durrett* rule suggests that only a sale price which is less than seventy percent of the property's fair market value may be avoided for lack of fair consideration.[9] Although *Durrett* has facilitated the rehabilitation of bankrupt estates and increased the chances for unsecured creditors to be paid, it has also had a negative impact on both the enforcement of valid liens by secured creditors, and on the certainty and marketability of titles held by purchasers of foreclosed properties. Consequently, the *Durrett* decision has been justly criticized for lacking a balance between the policy issues underlying both bankruptcy and real estate foreclosure law.[10]

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lent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; . . .

(6) A transfer made or an obligation incurred by a debtor adjudged a bankrupt under the Act, which is fraudulent under this subdivision d against creditors of such debtor having claims provable under this Act, shall be null and void against the trustee, except as to a bona fide purchaser, lienor, or obligee for a present fair equivalent value: . . . *Provided, however*, That such purchaser, lienor, or obligee, who without actual fraudulent intent has given a consideration less than fair, as defined in this subdivision, for such transfer, lien, or obligation, may retain the property, lien, or obligation as security for repayment . . . .

Act of June 22, 1938 (Chandler Act), ch. 575, § 67d, 52 Stat. 840, 877–78, *amending* Bankruptcy Act of 1898, ch. 541, § 67e, 30 Stat. 544, 564 (repealed 1978) (emphasis in original).

7. *Durrett*, 621 F.2d at 204. Section 548(a)(2)(A) of the code requires the trustee to establish only that the debtor received "less than a reasonably equivalent value," whereas section 67d(e) of the act required the trustee to show that the debtor did not receive "fair consideration." "Fair consideration" for property sold was defined in the act as "fair equivalent" received in "good faith." The code thus appears to make a transfer by an insolvent debtor, or one resulting in insolvency, somewhat easier to avoid than was possible under the act. *Compare* 11 U.S.C. § 548(a)(2)(A) (1982) *with* Act of June 22, 1938 (Chandler Act), ch. 575, § 67d, 52 Stat. 840, 877–78, *amending* Bankruptcy Act of 1898, ch. 541, § 67e, 30 Stat. 544, 564 (repealed 1978).

8. The *Durrett* decision dealt with a sale of foreclosed property for 57.7% of its appraised value. However, the *Durrett* rule has been characterized to mean that a prepetition foreclosure sale, resulting in a sale price of less than seventy percent of the property's fair market value, may be avoided as a fraudulent transfer when the sale ocurred within a one-year period before the filing of the bankruptcy petition and the debtor was insolvent at the time of sale or rendered insolvent as a result of the sale. Zinman, Houle & Weiss, *Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits*, 39 BUS. LAW. 977, 979 (1984) [hereinafter cited as Zinman].

9. *See generally* Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the* Durrett *Problem*, 38 BUS. LAW. 1605 (1983) [hereinafter cited as Alden].

10. *See, e.g.*, Abramson v. Lakewood Bank and Trust Co., 647 F.2d 547, 549 (5th Cir. 1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982); Alsop v. Alaska, 14 Bankr. 982 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982). *See also* Pasion & Altizer, *Effect of Bankruptcy on Prepetition Nonjudicial Foreclosure Sales*, 17 BEV. HILLS 11 (1982); Zinman, *supra* note 8; Comment, *Mortgage Foreclosure as Fraudulent Conveyance: Is Judicial Foreclosure an Answer to the* Durrett *Problem?*, 1984 WIS. L. REV. 195.

Recently, the United States Court of Appeals for the Ninth Circuit rejected the *Durrett* rule in *Madrid v. Lawyers Title Insurance Corp.*[11] The *Madrid* court asserted that the enforcement of a valid lien was not intended to be covered by section 548 of the Bankruptcy Code.[12] The *Madrid* decision criticized the *Durrett* court's reliance on the broad definition of "transfer" under section 1(30) of the Bankruptcy Act[13] and the *Durrett* court's creation of a de facto redemption period.[14] Despite the overwhelming number of courts that have accepted *Durrett*'s reliance on section 1(30) of the act,[15] *Madrid* instead relied on section 548(d)(1),[16] which was mistakenly viewed as narrowing the definition of "transfer" for purposes of section 548. Although recognizing the negative impact on secured creditors and purchasers, the *Madrid* court refused to acknowledge the positive impact that de facto redemption would have on unsecured creditors and the rehabilitation of the bankrupt estate. Thus, the *Madrid* decision itself can be criticized for lacking a balance between the public policy considerations underlying bankruptcy law and real estate foreclosure law.

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11. 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

12. *Id.* at 1200.

13. Section 1(30) of the act provided in pertinent parts:

> "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or within judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor . . . .

11 U.S.C. § 1(30) (1976) (repealed 1978).

14. Section 548(a) allows a trustee to bring an action to avoid a transfer made within one year prior to the filing of a bankruptcy petition. 11 U.S.C. § 548(a) (1982) (amended 1984). Thus, the *Durrett* decision has been said to create a one-year period of redemption for a debtor to reclaim this property. However, in reality, the period of redemption could be as long as three years since under section 108(a)(2) of the code a trustee or debtor-in-possession has two years to bring an action to recover the property after the bankruptcy filing. *Id.* § 108(a) (1982) (amended 1984).

15. *See Abramson*, 647 F.2d 547, 548 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982); Federal Nat'l Mortgage Assoc. v. Wheeler, 34 Bankr. 818, 820 (Bankr. N.D. Ala. 1983); Berge v. Sweet, 33 Bankr. 642, 648 (Bankr. W.D. Wis. 1983); Calaiaro v. Pittsburgh Nat'l Bank (*In re* Ewing), 33 Bankr. 288, 291–92 (Bankr. W.D. Pa. 1983); Bates v. Two Rivers Constr., 32 Bankr. 40, 41 (Bankr. E.D. Cal. 1983); Moore v. Gilmore, 31 Bankr. 615, 617 (E.D. Wash. 1983); Coleman v. Home Savings Assoc., 21 Bankr. 832 (Bankr. S.D. Tex. 1982).

16. Section 548(d)(1) provides:

> For the purposes of this section, a transfer is made when such transfer becomes so far perfected that a bona fide purchaser from the debtor against whom such transfer could have been perfected cannot acquire an interest in the property that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer occurs immediately before the date of the filing of the petition.

11 U.S.C. § 548(d)(1) (1982), *amended by* Bankruptcy Amendments and Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 379.

This casenote will focus primarily on the Ninth Circuit's interpretation and application of section 548 in light of the Fifth Circuit's decision in *Durrett v. Washington National Insurance Co.*, and recent congressional amendments to the Bankruptcy Code.[17] In addition, the policy considerations behind the creation of a de facto redemption period under section 548 of the code will also be examined. Finally, the note will analyze the value of the *Madrid* decision for future cases dealing with avoidance of foreclosure sales under section 548 of the Bankruptcy Code.

II. FACTS AND HOLDINGS

In September 1979, the plaintiff, Judith Madrid, acquired a home near Lake Tahoe for $290,000, giving the seller a $125,000 cash down payment and a one-year note for $165,000 secured by a deed of trust.[18] The down payment was financed through the defendant, Del Mar Commerce Company,[19] and secured by a second deed of trust.[20] Madrid subsequently defaulted on payments that were due on each of the notes. The trustee of the second deed of trust invoked the deed's power of sale clause[21] and sold the property at a nonjudicial foreclosure sale in January 1981.[22] Defendant Donald Turney, the sole bidder, acquired the property for the remaining amount due[23] on the second deed of trust.[24] Turney took the property subject to the first deed of trust,[25] which was in the process of being foreclosed.[26]

Seven days after the foreclosure sale, Madrid filed a petition for reorganization[27] under Chapter 11 of the Bankruptcy Code.[28] Madrid,

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17. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333.

18. Madrid v. Lawyers Title Ins. Co., 725 F.2d 1198 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984). A deed of trust is a conveyance of real estate from a borrower to a lender as security for the payment of a debt. A deed of trust generally includes a power of sale clause which allows the lender to nonjudicially foreclose on the property upon the debtor's default. IV AMERICAN LAW OF PROPERTY § 16.206 (1952).

19. Lawyers Title Insurance Corporation was later substituted as trustee under the second deed of trust. *Madrid*, 725 F.2d at 1198.

20. *Id.*

21. *See supra* notes 18–20 and accompanying text.

22. *Id.*

23. At the time of sale, approximately $176,000 was due on the first deed and approximately $80,000 was due on the second deed. *Id.*

24. *Id.*

25. Therefore, Turney was obligated to pay the amount due on the first note which was secured by the deed of trust because the property was encumbered, and the obligation to honor the note ran with the property. *See* IV AMERICAN LAW OF PROPERTY § 16.127 (1952).

26. *Madrid*, 725 F.2d at 1198.

27. Chapter 11 reorganization is an option for some debtors seeking to rehabilitate rather than liquidate assets. 11 U.S.C. §§ 1101–74 (1982) (amended 1984).

28. *Madrid*, 725 F.2d at 1198.

as a debtor-in-possession,[29] initiated an action in the United States Bankruptcy Court for the District of Nevada to set aside the sale as a fraudulent transfer pursuant to section 548 of the Bankruptcy Code.[30] Applying the *Durrett* rule,[31] the bankruptcy court[32] set aside the sale, finding that a transfer occurred at the foreclosure and that less than reasonably equivalent value[33] was paid by the debtor.[34] The United States Bankruptcy Appellate Panel[35] for the Ninth Circuit reversed, holding that reasonably equivalent value is paid as a matter of law[36] when there is a regularly conducted foreclosure sale.[37] On appeal, the United States Court of Appeals for the Ninth Circuit[38] affirmed the appellate panel's judgment, but on different grounds.[39] The Ninth Circuit Court of Appeals held that the only transfer[40] of the debtor's property occurred at the time the deed of trust was recorded and that no transfer for purposes of section 548 occurred at foreclosure.[41]

III. BACKGROUND

The historical development of fraudulent conveyance law[42] and its

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29. Normally, in Chapter 11 cases, the debtor continues to manage its business. Such a debtor is referred to as a debtor-in-possession and is given most of the duties and powers of a bankruptcy trustee. 11 U.S.C. § 1107 (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 384.

30. *Madrid*, 725 F.2d at 1198.

31. *See supra* note 8 and accompanying text.

32. Madrid v. Del Mar Commerce Co., 10 Bank. 795 (Bankr. D. Nev. 1981), *rev'd*, 21 Bankr. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

33. *See supra* note 7 and accompanying text.

34. *Madrid*, 10 Bankr. at 801.

35. Lawyers Title Ins. Corp. v. Madrid, 21 Bankr. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

36. *Id.* at 427. The dissent referred to the majority opinion as having established a conclusive or irrebuttable presumption that the final bid at a nonjudicial foreclosure sale is reasonable. *Id.* at 428.

37. *Id.* at 427.

38. *Madrid*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

39. For a complete explanation of the appellate panel's holding see Note, *Regularly Conducted Noncollusive Mortgage Foreclosure Sales: Inapplicability of Section 548(a)(2) of the Bankruptcy Code*, 52 FORDHAM L. REV. 261, 271–73 (1983).

40. *Madrid's* holding is sometimes referred to as the "one transfer" rule. *Madrid*, 725 F.2d at 1204.

41. *Id.* at 1199. The deed of trust was recorded sixteen months before the filing of the bankruptcy petition, thus the *Madrid* court held that the only transfer of the debtor's property did not occur within section 548's one-year statutory period. *Id. See also infra* note 49.

42. Under Roman law, a tort action known as a "Pauline action" could be brought by a defrauded creditor to avoid a fraudulent conveyance by an insolvent debtor. Zinman, *supra* note 8, at 987 (citing M. RADIN, HANDBOOK OF ROMAN LAW 153 (1923)).

In England, fraudulent conveyance laws were enacted to curtail the abuses of ancient "sanctuary laws." *Id.* Under these "sanctuary laws," debtors could defraud creditors by selling or collu-

incorporation into bankruptcy law[43] signifies that such laws were originally intended to protect creditors from debtors who transfer assets in a form detrimental to creditors' claims.[44] Typically, creditors who have reduced their claim to a judgment against a debtor, initiate fraudulent conveyance actions[45] after learning that a debtor has previously transferred assets in a way which hinders, delays, or precludes a creditor's claim.[46] Under bankruptcy law, however, fraudulent conveyance remedies[47] are available to a trustee[48] under section 548 of the Bankruptcy Code.[49] Pursuant to section 548, a trustee may avoid a transfer if actual intent to hinder, delay, or defraud a creditor is shown,[50] or if less than a reasonably equivalent value is received for the debtor's

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sively transferring their property within consecrated grounds; thereby avoiding the crown's process. *Id.* In 1376, Parliament passed a statute allowing creditors to execute upon land and chattels collusively conveyed. *Id.* at 988. Later, in 1476, Parliament passed another statute that avoided fraudulent gifts or chattels made in trust. *Id.* However, the English statute which served as the model for all modern American fraudulent conveyance laws was the statute of 13 Elizabeth, enacted in 1570. *Id.* The statute of 13 Elizabeth, was also incorporated into the revised bankruptcy laws in the English Bankruptcy Act of 1623. *Id.*

43. Section 548 of the Bankruptcy Code is an adaptation of the Uniform Fraudulent Conveyance Act, as was § 67d of the Bankruptcy Act. 4 COLLIER ON BANKRUPTCY ¶ 548[1] (15th ed. 1981).

44. *See* Zinman, *supra* note 8, at 987.

45. *See generally* UNIF. FRAUDULENT CONVEYANCE ACT, 7A U.L.A. 161 (1918).

46. 5 DEBTOR-CREDITOR LAW ¶ 22.01 (1984).

47. Since the use of state fraudulent conveyance law is not limited to actions by creditors, under section 544(b) of the code a trustee may stand in the shoes of any creditor against whom a lien is invalid under state law. Therefore, section 544(b) is an alternative to avoiding a transfer under section 548. 11 U.S.C. § 544(b) (1982).

48. A bankruptcy trustee is an officer appointed by the court to investigate the acts and conduct of the debtor and to manage the bankrupt's estate. *See* 11 U.S.C. § 704 (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 355, 381.

49. 11 U.S.C. § 548 (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 378–79. Section 548(a) provides:

> The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor—
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> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or
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> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
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> (ii) was engaged in business, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
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> (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

Id. § 548(a).

50. *Id.* § 548(a)(1).

interest.[51]

Since the Fifth Circuit's decision in *Durrett v. Washington National Insurance Co.*,[52] section 548(a)(2)[53] of the Bankruptcy Code has been frequently used as a means of attacking nonjudicial foreclosure sales[54] that do not bring a "reasonably equivalent value" in exchange for the foreclosed property. *Durrett* was the first decision to hold that a foreclosure sale made within a year prior to bankruptcy is a transfer by the debtor which is subject to avoidance as a fraudulent transfer if less than reasonably equivalent value is paid for the property.[55]

Courts that considered the issue of nonjudicial foreclosure as fraudulent transfers have generally accepted *Durrett*.[56] Nevertheless, not all of these courts have fully adopted the *Durrett* rule.[57] Instead, these courts have concluded that reasonably equivalent value should be determined on the basis of the facts and circumstances of each case.[58] Moreover, a few courts have expressed concern over setting aside a foreclosure which is otherwise valid and final under state law.[59]

The only court, other than the Court of Appeals for the Ninth Circuit in *Madrid v. Lawyers Title Insurance Corp.*,[60] which has to-

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51. *Id.* § 548(a)(2).

52. 621 F.2d 201 (5th Cir. 1980).

53. *See supra* note 49.

54. One reason *Durrett* remains at the center of controversy is its potential impact on other areas of fraudulent conveyance law. *See* Alden, *supra* note 9, at 1623–24; Zinman, *supra* note 8, at 983–85.

55. *But see supra* note 1.

56. Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982); Richard v. Tempest, 26 Bankr. 560 (Bankr. D.R.I. 1983); Cooper v. Smith, 24 Bankr. 19 (Bankr. W.D.N.C. 1982); Gillman v. Preston Family Investment Co. (*In re* Richardson), 23 Bankr. 434 (Bankr. D. Utah 1982); Perdido Bay Country Club Estates, Inc. v. Equitable Trust Co., 23 Bankr. 36 (Bankr. S.D. Fla. 1982); Coleman v. Home Savings Assoc., 21 Bankr. 832 (Bankr. S.D. Tex. 1982) (executive sale); *In re* Thompson, 18 Bankr. 67 (Bankr. E.D. Tenn. 1982); Marshall v. Spindale Savings & Loan Assoc., 15 Bankr. 738 (Bankr. W.D.N.C. 1981).

57. *See supra* note 8 and accompanying text. A number of courts have refused to adopt the Fifth Circuit suggestion that nothing less than 70% of the fair market value constitutes fair consideration or reasonably equivalent value. *See infra* note 58.

58. *See Richard*, 26 Bankr. at 563 (sale price of $31.00, which is less than 1% of either the mortgagor's equity in the property, or the property's fair market value, is not a reasonably equivalent value); *Smith*, 24 Bankr. at 19 (the benchmark proposed by *Durrett* may have to be adjusted above 70% as the total dollar amount at issue increases. The court held a sale price of $35,363 reasonably equivalent to the $46,000 net fair market value of the property); *In re Richardson*, 23 Bankr. at 448 ("[i]n some cases no less than 100 percent of fair market value may be a reasonable price," but the court denied summary judgment in favor of trustee's claim for avoidance because of a factual dispute as to the value of, and debtor's equity in, the foreclosured property). *See also* Home Life Ins. Co. v. Jones, 20 Bankr. 988, 994 n.23 (Bankr. W.D. Pa. 1982) (in dictum, rejected the *Durrett* 70% test and reasoned that determination of reasonably equivalent value must be done on a case by case basis). *See also* Alden, *supra* note 9.

59. *See Smith*, 24 Bankr. at 23; *Jones*, 20 Bankr. at 994.

60. 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

tally rejected the *Durrett* decision has been the United States Bankruptcy Court for Alaska in *Alsop v. Alaska*.[61] In that case, the bankruptcy court concluded that after the debtor transferred legal title to the creditor at the time the deed of trust was recorded, the debtor could no longer pass an interest in the property which was superior to that of the creditor's.[62] Thus, at the time of foreclosure, the debtor's transfer of remaining interests was deemed to relate back to the date when the deed was recorded.[63] Under this reasoning, a deed recorded more than a year prior to the filing of a bankruptcy petition would be beyond the scope of section 548(a).[64] *Durrett*'s creation of a de facto redemption period was also criticized in *Alsop*. The court believed that the effects of *Durrett* would cloud title to foreclosed property, chill foreclosure sale participation, and reduce creditors' willingness to lend by questioning their ability to reach the security.[65]

Reaction to the *Durrett* rule has also prompted congressional proposals to amend the Bankruptcy Code. The first proposed amendment[66] recommended that a purchaser who obtains title to a debtor's property pursuant to a prepetition foreclosure, takes the property for reasonably equivalent value within the meaning of section 548.[67] The anti-*Durrett* amendment, however, never received final Senate support.[68] Meanwhile, in the House of Representatives, another proposal was recommended which would explicitly include, under section 101(41),[69] "foreclosure of the debtor's equity of redemption" as part of the definition of transfer.[70] This pro-*Durrett* language was approved by both houses and

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61. 14 Bankr. 982 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982).

62. *Id.* at 986.

63. *Id.*

64. *Id.*

65. *Id.* at 987.

66. The proposed amendment to § 548 of the code provided that:

> [a] secured party or third party purchaser who obtains title to an interest of the debtor in property pursuant to a good faith prepetition foreclosure, 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.

S. 445, 98th Cong., 1st Sess. § 360 (1983).

67. This Senate proposal also received the support of the American Bar Association at its annual meeting on August 3, 1983. Zinman, *supra* note 8, at 980 n.18 (citing ABA, Summary of Action of the House of Delegates, Aug. 2–3, 1983, at 31).

68. This amendment did not appear in the final version of S. 445. *Id.* at 980 n.17.

69. Section 101(41) of the code provided:

> "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest.

11 U.S.C. § 101(41) (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 364, 366, 368.

70. H.R. 5174, 98th Cong., 2d Sess., 130 CONG. REC. (1984).

is included in the 1984 amendments to the Bankruptcy Code.[71] Thus, the *Durrett* rule has received general acceptance not only by a substantial number of jurisdictions, but by Congress as well.

IV. ANALYSIS

A. A Short Circuit in Madrid's *Interpretation of Section* 548(d)(1)

The amended language of section 101(48) of the Bankruptcy Code[72] clearly supports the conclusion reached in *Durrett v. Washington National Insurance Co.*,[73] that a foreclosure sale constitutes a transfer of a debtor's interest in property.[74] Yet, even before this revision, the definition of transfer under section 101(41) of the Bankruptcy Code and section 1(30) of the Bankruptcy Act[75] was considered by most authorities to be broad enough to include the disposition of a debtor's equity in property at a foreclosure sale.[76] Despite persuasive authority, the United States Court of Appeals for the Ninth Circuit, in *Madrid v. Lawyers Title Insurance Corp.*,[77] declared that applying section 101(41) to foreclosure sales "would be ignoring the applicable, narrow definition of transfer set out in [section] 548(d)(1)."[78]

Although the *Madrid* court did not elaborate on how it defined "transfer" (under section 548(d)(1)) to exclude the disposition of a debtor's equity in property at a foreclosure sale, its reliance on *Alsop v. Alaska*[79] for support would indicate that the *Madrid* analysis parallels *Alsop*.[80] *Alsop* recognized that the conveyance of property interests at a foreclosure sale satisfies the definition of "transfer" in section

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71. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 364, 366, 368 (to be codified at 11 U.S.C. § 101(48)).

72. Section 101(48) of the Bankruptcy Code which was formerly section 101(41) (*see supra* note 69) provides that:

> "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest *and foreclosure of the debtor's equity of redemption*
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> . . . .

Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 364, 366, 368 (to be codified at 11 U.S.C. § 101(48)) (emphasis added).

73. 621 F.2d 201 (5th Cir. 1980).

74. *Id.* at 204.

75. *See supra* note 13.

76. *See, e.g.*, cases cited *supra* note 56. *See also* 4 COLLIER ON BANKRUPTCY ¶ 548.01 (15th ed. 1981).

77. 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

78. *Id.* at 1201.

79. 14 Bankr. 982 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1981).

80. *Madrid*, 725 F.2d at 1201.

101(41);[81] however, the court concluded that section 101(40) did not control the meaning of "transfer" for section 548.[82] Rather, the *Alsop* court relied on section 548(d)(1).[83] The court in *Alsop* read section 548(d)(1) to mean that once the debtor transferred legal title for security to the creditor, the debtor could no longer pass an interest in the property superior to that of the creditor. The *Alsop* court concluded, therefore, that any transfer of the debtor's remaining interest relates back to the time the deed of trust was recorded.[84] Hence, the *Madrid* court asserted that the only transfer of property occurred sixteen months before the filing of the bankruptcy petition—when the second deed of trust was recorded, and thus the avoidance of the foreclosure sale was not within section 548's one-year limitation period.[85]

This interpretation of section 548(d)(1) by the *Madrid* court and the *Alsop* court would treat the debtor's transfer of title for security as indistinguishable and inseparable from the debtor's transfer of equity and possession.[86] Technically, a transfer of title occurs when a deed of trust is recorded. Nevertheless, the debtor's remaining interests in equity and possession cannot be viewed as a transfer until after a foreclosure sale has occurred. Between the time the deed was recorded and the time of the foreclosure sale, the debtor retains a right to alienate his or her equity and possessory interests to a bona fide purchaser.[87] Moreover, until the debtor defaults, such equity and possessory interests are not in jeopardy.[88] Thus, *Madrid*'s interpretation of section 548(d)(1) improperly treated the transfer of title as inseparable from the transfer of possession and equity.

A proper interpretation would view section 548(d)(1) not as a definitional section, but as a section which delegates to state law the authority to determine when a transfer occurs. In other words, section 548(d)(1) only determines *when* the debtor's equity of redemption and possessory interest is transferred and not whether the debtor's equity of redemption and possessory interest are transfers within the meaning of the Bankruptcy Code. Treating section 548(d)(1) as a definitional section would not only allow state law to determine *when* a transfer occurs, but also *if* a transfer has occurred. Yet, as the *Madrid* court ac-

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81. *See supra* note 69.

82. *Alsop*, 14 Bankr. at 986.

83. *See supra* note 17 and accompanying text.

84. *Alsop*, 14 Bankr. at 986.

85. *Madrid*, 725 F.2d at 1199.

86. F. Kennedy, Comments on Subtitle I of S. 445 Technical Amendment to Title I, at 9 (1983) (on file with University of Dayton Law Review).

87. REAL ESTATE FINANCE, *supra* note 1, § 7.20.

88. Under Nevada law a creditor cannot invoke his or her power of sale until a notice of breach and election to sell is recorded. NEV. REV. STAT. § 107.030 (1979).

knowledged, whether a particular occurrence is a transfer under the Bankruptcy Code is a matter of federal characterization, whereas, when a transfer is perfected is a matter of state determination.[89] Thus, for purposes of section 548, "transfer" is more properly defined by section 101(41) of the Bankruptcy Code, rather than section 548(d)(1).[90]

The *Madrid* court's definition of transfer hinged not only on its interpretation of section 548(d)(1) but also on its interpretation of section 548(a).[91] The Ninth Circuit in *Madrid* agreed with the dissent's assertion in *Abramson v. Lakewood Bank and Trust Co.*,[92] that a foreclosure sale is not a transfer *by a debtor*, as it interpreted section 67d of the Bankruptcy Act and section 548(a) of the Bankruptcy Code to require.[93] The *Abramson* decision was decided under section 67d of the act which pertained to "[e]very transfer made and every obligation incurred by a debtor."[94] The wording of this section is ambiguous because "transfer" could refer to "every transfer made" or to "every transfer made . . . by the debtor." Nevertheless, the *Madrid* court failed to notice that the ambiguity in section 67d of the Bankruptcy Act was removed in section 548(a) of the Bankruptcy Code by use of a simple comma. Section 548 clearly pertains to "any transfer of an interest of the debtor in property, *or* any obligation incurred by the debtor."[95] Thus, the *Madrid* court should have relied on the unambiguous language of section 548(a) and concluded that a foreclosure sale is a "transfer of an interest of the debtor in property."[96]

Recent revision of the Bankruptcy Code[97] also supports the contention that a foreclosure sale is a transfer of a debtor's interest in property. Section 101(48) of the amended Bankruptcy Code redefines "transfer" to explicitly include "foreclosure of the debtor's equity of redemption."[98] Since section 548 relies on section 101(48) for the definition of transfer, *Madrid*'s assertion that "the enforcement of a valid lien was not intended to be covered by section 548" is clearly inconsis-

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89. *Madrid*, 725 F.2d at 1200.

90. *See supra* note 69 and accompanying text.

91. *Madrid*, 725 F.2d at 1201–02. For the specific language of section 548(a), see *supra* note 49.

92. 647 F.2d 547 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982).

93. *Id.* at 549 (Clark, J., dissenting).

94. Act of June 22, 1938 (Chandler Act), ch. 575, § 67d, 52 Stat. 840, 877–78, *amending* Bankruptcy Act of 1898, ch. 541, § 67e, 30 Stat. 544, 564 (repealed 1978).

95. 11 U.S.C. § 548(a) (1982), *amended by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333, 378–79 (emphasis added).

96. *Id.*

97. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333.

98. *See supra* note 72.

tent with congressional intent. Thus, Congress has reaffirmed its intent to grant the trustee of a bankrupt estate the power to avoid transfer in order to maximize the pool of assets available to all creditors.

B. Balancing Federal Bankruptcy Policy against State Foreclosure Policy

Bankruptcy proceedings are designed to achieve two fundamental goals: the rehabilitation of the bankrupt estate, and the fair distribution of assets to creditors.[99] Guided by these goals, courts have liberally construed the Bankruptcy Code's fraudulent transfer provision to enable the trustee to maximize the value of the bankrupt's estate.[100]

The *Durrett* rule[101] allows a trustee or a debtor-in-possession to regain the debtor's equity in the property from the foreclosure sale purchaser. Regaining the debtor's equity during the one-year redemption period[102] allows the trustee to increase the pool of assets available to satisfy the claims of unsecured creditors. *Madrid* contends that avoiding a foreclosure sale as a fraudulent transfer is not necessary to preserve the debtor's equity for creditors, since other means[103] are available to a debtor or an unsecured creditor.[104] Nevertheless, federal policy clearly favors the distribution of equity in a debtor's foreclosure property to the debtor's creditors than to a foreclosure sale purchaser who pays a bargain price and then realizes the value of the debtor's equity as profit upon resale.[105] Hence, federal bankruptcy policy supports *Durrett*'s creation of a de facto period.

The Ninth Circuit in *Madrid* also criticized *Durrett*'s creation of a de facto redemption period for its adverse effects on state commercial and real estate laws.[106] *Madrid* took the view of other *Durrett* critics[107] that:

> creation of a *de facto* right of redemption would significantly chill participation at foreclosure sales, where sales prices—not subject to the usual economic competitive forces—already are frequently lower than the actual value of the property sold . . . . Negative repercussions would also be likely in the lending arena, where creditors would be less willing to

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99. *See* REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93rd Cong., 1st Sess. 75–81 (1973) [hereinafter cited as COMMISSION REPORT].

100. Comment, *supra* note 10, at 215–16.

101. *See supra* note 8 and accompanying text.

102. *See supra* note 14 and accompanying text.

103. *See supra* notes 1, 47, 54 and accompanying text.

104. *Madrid*, 725 F.2d at 1202.

105. COMMISSION REPORT, *supra* note 99.

106. *Madrid*, 725 F.2d at 1202.

107. *See supra* note 10.

lend funds on the security of a mortgage or deed of trust.[108]

Madrid appears to overstate the effect of the *Durrett* rule in the lending area. The *Durrett* rule increases the chances that an unsecured creditor will be paid from the remaining assets of a bankrupt estate. Reducing the risks and costs to unsecured creditors encourages these creditors to reduce interest rates and to increase the amount of funds available to future borrowers. *Durrett*'s effect on secured creditors has also been overstated, particularly in states which allow statutory redemption following nonjudicial foreclosure sales.[109] In these states, bankruptcy courts have allowed a trustee or debtor-in-possession to use state statutory redemption rights to recover property after a nonjudicial foreclosure sale. Thus, the impact of *Durrett* in these states has only been to provide a duplicated means to recover a debtor's property.

Although the *Madrid* court contends that the *Durrett* rule will discourage the participation of third party bidders, thereby further depressing the bids at foreclosure proceedings, such a contention ignores two additional factors—the application of section 548(c),[110] and the structural deficiencies already built into the foreclosure process. Section 548(c) allows a transferee, who takes a foreclosed property for value[111] in good faith, to place a lien on the property. Since other methods are available to void a foreclosure sale,[112] avoidance of a sale as a fraudulent transfer under section 548 would not discourage third party bidders to any greater extent than would these alternative methods.[113] Moreover, owing to certain structural deficiencies in the foreclosure process, there are few, if any, third parties to deter.[114] In the vast number of foreclosure sales the sole participant is the mortgagee who bids

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108. *Madrid*, 725 F.2d at 1202 (citation omitted & emphasis in original).

109. *See supra* note 1.

110. Section 548(c) of the code provided:

> Except to the extent that a transfer of obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on any interest transferred, may retain any lien 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 transfer or obligation.

11 U.S.C. § 548(c) (amended 1984).

111. Section 548(d)(2) of the code provides:

> In this section—
>
> (A) "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) (1982).

112. *See supra* notes 1, 47, 54 and accompanying text.

113. *See supra* notes 1, 47, 54 and accompanying text.

114. Comment, *supra* note 10, at 225.

an amount similar to the amount of the debt to recover the original investment.[115] There are three reasons for the lack of participation by third parties in foreclosure sales: (1) notice of sale is given not to attract buyers, but rather to satisfy legal requirements, (2) real estate is a nonfungible asset which does not trade well in an auction market, and (3) most potential buyers are not able to make cash purchases on the spot.[116] Thus, fear that avoidance of foreclosure sales under section 548 would discourage the participation of third parties seems trivial compared to the real problems facing the present foreclosure process.

Given the nature of the foreclosure process, it would appear that a strict application of the *Durrett* rule[117] would invalidate many foreclosure sales. It must also be recognized that allowing a trustee to avoid a foreclosure sale, as *Madrid* suggests, runs counter to state policy according finality to such sales.[118] Yet, section 548 is sensitive to the need and appropriateness of balancing the federal bankruptcy policy against state foreclosure policy.[119] Section 548 of the code attempts to achieve this balance by: avoiding only transfers in which reasonably equivalent value is not received; limiting the statutory period for avoiding a transfer to only one year; and affording good faith purchasers protection by awarding liens. Given the need to strike the appropriate balance between competing federal and state policies, a rigid statistical formula to determine what constitutes reasonably equivalent value does not seem to be an appropriate means to accomplish this goal. Instead, reasonably equivalent value should be determined, as courts have suggested,[120] on the basis of the facts and circumstances of each case.[121]

V. CONCLUSION

In *Madrid v. Lawyers Title Insurance Corp.*,[122] the United States Court of Appeals for the Ninth Circuit explicitly rejected the holding in *Durrett v. Washington National Insurance Co.*[123] Based upon a misapplication of section 548(d)(1)[124] of the Bankruptcy Code, the *Madrid* court held that a nonjudicial foreclosure sale that took place a year or more after a deed of trust was recorded was not a fraudulent "transfer" of debtor's property because (1) after a debtor transfers ti-

115. *Id.*
116. *Id.* at 211 n.105.
117. *See supra* note 8 and accompanying text.
118. *Madrid*, 725 F.2d at 1202. *See also* Kennedy, *supra* note 86, at 10.
119. *Id.*
120. *See supra* note 58.
121. *See* Alden, *supra* note 9, at 1615.
122. 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).
123. 621 F.2d 201 (5th Cir. 1980).
124. *See supra* note 16 and accompanying text.

tle, there is no other remaining interest which is superior, and (2) a nonjudicial foreclosure is not a transfer of property by the debtor. Although the Ninth Circuit's interpretation of section 548(d)(1) seems plausible, it conflicts with the weight of authority[125] and congressional intent.[126] The majority of jurisdictions have relied on section 101(41) of the code[127] to provide the definition of "transfer" for purposes of section 548. Section 101(41) has always been given a broad construction—broad enough to include a "transfer" of a debtor's interest in property at a foreclosure sale. Recent congressional amendments[128] to the Bankruptcy Code have expressly included foreclosure sales as transfers under section 101(48).[129] In addition, section 101(48) makes it clear that "transfers" can be either voluntary or involuntary on the part of a debtor. The Ninth Circuit Court of Appeals in *Madrid*, therefore, was clearly mistaken in holding that section 101(48)[130] of the Bankruptcy Code does not control the meaning of "transfer" for purposes of section 548.

Despite its misinterpretation of section 548, the *Madrid* court was properly concerned with the impact that invoking powers pursuant to section 548 to avoid nonjudicial foreclosure sales would have on real estate law and financing.[131] It should be recognized that avoiding foreclosure sales as fraudulent transfers runs counter to state policy according finality to such sales; nevertheless, this is only one of several competing policies. Federal bankruptcy policy, on the other hand, favors avoidance in order to maximize the value of the bankrupt estate and thus facilitate the rehabilitation of the debtor's estate and the fair distribution of assets to all creditors.[132] Section 548 is sensitive to the need and appropriateness of balancing these competing policies.

One of the main ingredients which section 548 uses to achieve this balance is the requirement that "reasonably equivalent value" be paid for all transfers of property.[133] Thus, *Madrid*'s criticism of the *Durrett* rule [134] is justified because *Durrett* fails to require an examination of

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125. *See, e.g.*, cases cited *supra* note 56.

126. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333. *See also supra* note 72 and accompanying text.

127. *See supra* note 69 and accompanying text.

128. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S. CODE CONG. & AD. NEWS (98 Stat.) 333.

129. *See supra* note 72 and accompanying text.

130. *See supra* note 72 and accompanying text.

131. *Madrid*, 725 F.2d at 1202.

132. COMMISSION REPORT, *supra* note 99.

133. 11 U.S.C. § 548(a) (1982) (amended 1984).

134. *See supra* note 8 and accompanying text.

the facts and circumstances which surround a sale to determine what is a reasonable price. The nature of foreclosure sales makes it difficult to comply with the *Durrett* rule's requirement that a sales price be at least 70% of the property's fair market value. Therefore, the standard of review which a court uses to determine whether a sale price is the reasonably equivalent value of the property should not be based on the statistical ratio but rather on the factual circumstances of each case. Reasonably equivalent value should be a question of fact, rather than a question of law as suggested by *Durrett*. The ultimate question for the trier of fact would therefore be—what could reasonably be expected to be paid under the same or similar circumstances?

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