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The Emperor Still Has Clothes: Fraudulent Conveyance Challenges after the BFP Decision, 47 S.C. L. Rev. 563 (1996)

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THE EMPEROR STILL HAS CLOTHES: FRAUDULENT CONVEYANCE CHALLENGES AFTER THE *BFP* DECISION

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I. INTRODUCTION

In a controversial decision, the United States Supreme Court has set forth the grounds upon which a trustee in bankruptcy may avoid (i.e., invalidate) a real estate foreclosure sale as a fraudulent conveyance under section 548 of the Bankruptcy Code.[1] Justice Scalia, writing for the majority in *BFP v. Resolution Trust Corp.*,[2] held that section 548 does not enable a trustee in bankruptcy to rely upon a judicially created federal standard of "fair price" to avoid a validly conducted, noncollusive state foreclosure sale.[3] The Court held that, if the amount bid at the foreclosure sale complied with the applicable state's foreclosure laws, and if the sale were both noncollusive and conducted in accordance with the state's foreclosure laws, the amount bid at the sale would be deemed to constitute the "reasonably equivalent value" required under section 548. Thus, such a sale may not be set aside as a fraudulent conveyance under the Bankruptcy Code.[4]

BFP has caused a great stir among the bankruptcy and real estate bar and among the real estate developers and lenders that they represent. The decision has been both praised and criticized for its perceived impact,[5] yet many of the decision's proponents and critics share the misperception that the ruling negates any genuine possibility for a borrower or a junior lender[6] to challenge a foreclosure sale as a fraudulent conveyance except in the most egregious cases of fraud or unconscionability.[7] This author contends, however, that although *BFP* may have cleared the immense federal cloud on title to property purchased at a foreclosure sale, state-law-based challenges continue to hover

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1. 11 U.S.C. §§ 101-1330 (1988 & Supp. 1995).

2. 114 S. Ct. 1757 (1994). Justice Scalia was joined by Chief Justice Rehnquist and Justices O'Connor, Kennedy, and Thomas; Justice Souter was joined in dissent by Justices Blackmun, Stevens, and Ginsburg.

3. *Id.* at 1765.

4. *Id.*

5. *See, e.g.*, Timothy J. Boyce, *Nightmare on* Durrett *Street: The Bad Dream Is Over*, PROB. & PROP., Nov.-Dec. 1994, at 44, 48 (concluding that "lenders can rest a little easier than they have for quite some time. With the Supreme Court's holding in *BFP*, the bad dream is finally over."); *Symposium: Foreword: A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair To All Involved*, 28 LOY. L.A. L. REV. 235, 247, 265 (1994) [hereinafter *Symposium*] (expressing a critical view that, under *BFP*, a "peppercorn" could be bid at a noncollusive and procedurally regular foreclosure sale without fear of avoidance as a fraudulent conveyance).

6. The term "junior lender," as used throughout this article, refers to a creditor who is either an unsecured creditor or a secured creditor whose lien is junior in priority to the lender holding the senior lien on the real property being foreclosed upon.

7. *See Symposium*, *supra* note 5, at 235, 247, 265. *But see* Kenneth M. Block & Jeffrey B. Steiner, *Ending the Threat of* 'Durrett':'BFP' *Settles Application of Fraudulent Transfer to Foreclosures*, N.Y.L.J., July 20, 1994, at 5, 7 (speculating that after the Supreme Court's decision in *BFP*, a foreclosure sale might be set aside as a fraudulent conveyance if there are "inconsequential deviations from state law"); Martin I. Klein, *The Demise of* 'Durrett', N.Y.L.J., June 13, 1994, at 1, 5 (warning that "the possibility remains that this hoped for certainty [to real estate title] will be undermined by debtors who will instead utilize the bankruptcy courts to challenge not the price but irregularities in state court foreclosure sales").

over foreclosure sales upon a debtor's bankruptcy. Indeed, under existing state laws, a borrower or junior lender can challenge a foreclosure sale on numerous grounds that do not necessarily rise to the level of fraud or unconscionability.[8]

This article has two goals. First, it identifies and analyzes the remaining grounds upon which a borrower or junior lender may raise a fraudulent conveyance challenge to a foreclosure sale.[9] The article determines (1) the actions by the foreclosing mortgagee that might cause the sale to be set aside as "collusive," and (2) the circumstances in which a bid for less than the fair market value of the real estate or a failure to comply with the state's foreclosure laws will enable a trustee in bankruptcy to set aside the sale.

Second, the article assesses whether the Supreme Court correctly interpreted the phrase "reasonably equivalent value" to mean the amount bid at a noncollusive, regularly conducted foreclosure sale. Stripping away the competing modes of statutory construction that the majority and dissenting opinions employ in interpreting section 548, one detects that the heart of the disagreement in *BFP* rests on requiring a federally defined fair foreclosure price rather than relying on the protections accorded to the mortgagor under the applicable state's foreclosure laws. This author believes that the dissenting Justices incorrectly assume that existing state foreclosure laws permit a party to bid a "peppercorn" for a valuable piece of property. The view that state foreclosure laws work poorly to protect the mortgagor's interest in the mortgaged property caused the dissenting Justices to interpret the phrase "reasonably equivalent value" to mean something more than the price bid at a noncollusive, regularly conducted foreclosure sale. In light of the numerous state law challenges that mortgagors can raise to invalidate an unfair sale and empirical studies that show that lenders are not made whole under existing foreclosure laws,[10] the majority in *BFP* correctly interpreted "reasonably equivalent value" to mean the amount realized at a noncollusive, regularly conducted foreclosure proceeding. State foreclosure laws are compatible with fraudulent conveyance laws and are not so inconsistent with bankruptcy

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8. See Parts IV and V, *infra*, regarding the grounds under various states' laws for invalidating a foreclosure sale.

9. This article will focus on fraudulent conveyance challenges under § 548 of the Bankruptcy Code and will not address state-law fraudulent conveyance challenges that can be raised even when the borrower has not filed for bankruptcy. As of early 1994, thirty states had adopted the Uniform Fraudulent Transfer Act, which, similar to the *BFP* decision, creates an irrebuttable presumption that a noncollusive and validly conducted foreclosure sale is not a fraudulent conveyance. However, in those states that have not adopted the uniform act, this presumption does not necessarily exist, and a fraudulent conveyance challenge can be raised on the basis that the amount bid was not adequate consideration. *See* Debra A. Cafaro, *How Lenders Can Avoid Foreclosure Sale Avoidance (with Checklist)*, PRAC. REL. EST. LAW., Nov. 1994, at 13.

10. *See infra* Part VI.B.

objectives as to make Congress's intent to preempt state laws manifestly clear.[11]

Because the Supreme Court's decision does not eliminate the protection of the mortgagor's equity in the foreclosed property, but instead substitutes the protections of state foreclosure law, fraudulent conveyance challenges to foreclosure sales will not disappear, even after *BFP*. These challenges, however, will be brought in a fashion that may be unfamiliar to lenders and borrowers since 1980 and the *Durrett*[12] decision. In satisfying its first goal, that of identifying and analyzing the likely basis of these challenges, the article (1) briefly summarizes the concept of fraudulent conveyances under the common law and under section 548 of the Bankruptcy Code; (2) reviews and analyzes *BFP*; (3) reviews and analyzes state and federal bankruptcy decisions that address the issue of collusion in the context of a foreclosure sale; and (4) reviews the various grounds upon which a foreclosure sale can be invalidated under state foreclosure laws.

The article also examines the implications of *BFP* on the conduct of secured lenders, third-party bidders, junior creditors, and borrowers in the foreclosure process and provides recommendations to these parties.

II. FRAUDULENT CONVEYANCES UNDER THE COMMON LAW AND UNDER SECTION 548 OF THE BANKRUPTCY CODE

Since the end of the sixteenth century, the Statute of Fraudulent Conveyances[13] has allowed English courts to invalidate any conveyance by a debtor that was intended to hinder, delay, or defraud creditors. The statute aimed to protect a debtor's creditors rather than the debtor. Because of the inherent difficulty of proving subjective intent, English courts began to allow creditors to prove intent by the presence of certain indicative facts, known as "badges of fraud" (such as a secretive conveyance by a debtor to his relatives or a conveyance for grossly inadequate consideration), that created a rebuttable presumption that the debtor intended to defraud his creditors.[14]

American courts adopted the concept of fraudulent conveyances as part of the common law inherited from England. By 1918 the National Conference of Commissioners on Uniform State Laws ("NCCUSAL") created the Uniform Fraudulent Conveyance Act ("UFCA")[15] to foster uniformity in the applica-

11. *See infra* Part VI.

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

13. An Act Against Covinous and Fraudulent Conveyances, 27 Eliz., ch. 4 (1585) (Eng.).

14. Twyne's Case, 76 Eng. Rep. 809 (Star Chamber 1601); *see* Metcalfe v. Pulvertoft, 35 Eng. Rep. 71 (1813) (holding that bona fide purchaser who renders, as consideration, only one-third of the value of an item is not protected by the statute and is subject to presumption of fraud, because one-third of value is "very" inadequate); Matthews v. Feaver, 29 Eng. Rep. 1165 (1786) (stating that "entirely inadequate" consideration will be presumed fraudulent).

15. UNIF. FRAUDULENT CONVEYANCE ACT, 7A U.L.A. 427 (1918) (enacted by 24 states

tion of fraudulent conveyance law. The UFCA retained the concept of badges of fraud. In 1984 the NCCUSAL created the Uniform Fraudulent Transfer Act ("UFTA")[16] to replace the UFCA. The UFTA removed the concept of fraudulent conveyances based upon transfers that were not made in "good faith" and for "fair consideration" and substituted the concept of fraudulent conveyances based upon transfers that were not made for "reasonably equivalent value."

Sections 544 through 549 of the Bankruptcy Code set forth the powers of a trustee in bankruptcy or a debtor in possession to avoid certain defined transfers. Section 548 specifies two types of transactions that may be avoided: (1) transfers made with actual intent to defraud, and (2) transfers in which the value received in exchange for the debtor's property is not "reasonably equivalent" to the value of the debtor's property that was transferred.[17] Section 548 further limits the application of this avoiding power to transfers that occur within one year prior to the filing of the bankruptcy petition and where the debtor either is insolvent on the date of the transfer or becomes so as a result of the transfer.[18] An amendment to the Bankruptcy Code in 1984 amended the term "transfer" to include "foreclosure of the debtor's equity of redemption."[19]

III. SCALIA'S OPINION IN THE *BFP* CASE

A. Rejection of a Federal Standard of "Reasonably Equivalent Value" in Support of State Foreclosure Law

BFP, a partnership, owned a house subject to two mortgages securing debt in the aggregate sum of $556,000. After default, the house was foreclosed upon. A third party successfully bid $433,000 at the foreclosure sale. Approximately three months after the foreclosure sale, BFP filed a Chapter 11 bankruptcy petition and attempted to avoid the foreclosure sale as a fraudulent conveyance under section 548(a). BFP claimed that the value of the home was $725,000 at the time of the foreclosure sale and that the sale, consequently,

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without substantive revisions); *see* Johnny L. Woodruff, Note, *Certiorari to* In re BFP: *The Eve of Decision to a Dozen Years of* Durrett *Conflict — Will Resolution of the Issue Solve the Real Problem?*, 24 MEM. ST. U. L. REV. 773, 781 (1994) (discussing the reason for the creation of the UFCA).

16. UNIF. FRAUDULENT TRANSFER ACT, 7A U.L.A. 639 (1984). The UFTA has been enacted by approximately 30 states, many of which had enacted the UFCA. *See* Woodruff, *supra* note 15, at 781-82; *see also supra* note 9.

17. 11 U.S.C. § 548(a) (1988).

18. *Id.*

19. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 § 421(i), 98 Stat. 368 (codified as currently amended at 11 U.S.C. § 101(54) (Supp. 1994)).

was not for reasonably equivalent value as required by the Bankruptcy Code.[20] The question presented to the Supreme Court was whether the amount received at the foreclosure sale was "reasonably equivalent" to the value of the real estate conveyed.[21]

In answering this question, the majority in *BFP* rejected the interpretation of section 548 that permits avoidance of a validly conducted, noncollusive foreclosure sale if the successful bid does not reflect, in the bankruptcy court's judgment, a fair price (calculated as a percentage of the fair market value of the property or otherwise).[22] In the absence of a clear expression of congressional intent to preempt state foreclosure law, the majority was unwilling to interpret section 548 in a manner that would abrogate state foreclosure laws.[23]

Prior to *BFP*, several United States Circuit Courts of Appeals, in interpreting and applying section 548, had ruled that if a borrower filed a bankruptcy action within one year of a foreclosure sale, the sale could be avoided if the successful bid was seventy percent or less of the fair market value of the property foreclosed upon.[24] Any bid less than this threshold amount was deemed not to be reasonably equivalent value. Other United States Circuit Courts of Appeals rejected this approach and instead sought to determine whether the successful bid constituted reasonably equivalent value by reviewing all the facts and circumstances of the foreclosure sale, with a rebuttable presumption that the foreclosure sale price was reasonably equivalent value.[25]

Justice Scalia rejected both approaches because of his reluctance to override state foreclosure law absent clear congressional intent and because these approaches would be inconsistent with his goal of interpreting the Bankruptcy Code in harmony with state foreclosure law. Justice Scalia argued that, because a foreclosure sale is a forced sale of property, it makes no sense to attempt to arrive at and require a price based upon the fair market value of the property.[26] The fair foreclosure price should vary from state to state

20. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1759 (1994).

21. *Id.* at 1760.

22. *Id.* at 1765.

23. *Id.* See Part VI.A, *infra*, for an evaluation of Justice Scalia's use of canons of construction in interpreting congressional intent.

24. *See, e.g.*, Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 203 (5th Cir. 1980) (holding that the sale of real estate at a foreclosure sale for 57.7% of its fair market value was not for reasonably equivalent value and, thus, was voidable).

25. *See, e.g.*, Grissom v. Johnson (*In re* Grissom), 955 F.2d 1440, 1445-47 (11th Cir. 1992) (presuming that a valid foreclosure sale yields reasonably equivalent value, but listing several factors relevant to the determination of reasonable equivalency); Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 824 (7th Cir. 1988) (holding that reasonably equivalent value should depend on the facts of each case, and that the "court must focus ultimately on the fair market value as affected by the fact of foreclosure").

26. *BFP*, 114 S. Ct. at 1761-62. See Part VI.B, *infra*, for an evaluation of Justice Scalia's

depending upon the requirements of that state's foreclosure laws, and a requirement that the bid reflect a fair price would impose a federal standard of reasonableness.[27] Justice Scalia also noted that such decisions had caused a "federally created cloud" on title in reaction to which title insurance companies have "includ[ed] specially crafted exceptions . . . for properties purchased at foreclosure sales."[28]

B. The Supreme Court's Interpretation of "Reasonably Equivalent Value"

To harmonize bankruptcy law with state foreclosure law, the Supreme Court adopted the approach of the United States Courts of Appeals for the Sixth and Ninth Circuits in interpreting reasonably equivalent value. Under this approach, according to Justice Scalia, "the consideration received at a noncollusive, regularly conducted real estate foreclosure sale constitutes a reasonably equivalent value under section 548(a)(2)(A)."[29]

Although the Supreme Court's ruling in *BFP* should lift the federal cloud on title purchased at a foreclosure sale, it is important to recognize that the decision leaves open the very real, although now more narrow, possibility of a foreclosure sale being set aside by a bankruptcy court as a fraudulent conveyance under section 548, even if the foreclosure sale is not tainted by actual fraud. In the event that a mortgagor enters bankruptcy within one year of the foreclosure sale, a bankruptcy court could invalidate the foreclosure sale as a fraudulent conveyance if the sale were determined to be either (1) "collusive" or (2) not conducted in accordance with the applicable state's foreclosure laws.[30]

The dissent in *BFP* criticized the majority for failing to give any real role to the bankruptcy courts in applying the reasonably equivalent value test (and, consequently, interpreting the Bankruptcy Code in a manner not intended by Congress) and for permitting the exchange of a "peppercorn" for a "California beachfront estate."[31] The dissent argued that "[t]here is a persuasive case that collusive or seriously irregular real estate sales were already subject to avoidance in bankruptcy . . . ."[32] Thus, the dissent reasoned, the majority's holding was inconsistent with the intent of Congress to require more in section 548(a)(2)(A) than that which was already required elsewhere in the Bankruptcy

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application of economic principles and consideration of conflicting policies in the *BFP* decision.

27. *BFP*, 114 S. Ct. at 1763.

28. *Id.* at 1765.

29. *Id.* at 1761.

30. *Id.* at 1765.

31. *Id.* at 1767 (Souter, J., dissenting).

32. *BFP*, 114 S. Ct. at 1770 (Souter, J., dissenting).

Code; otherwise, Congress would not have enacted the 1984 amendment to the Bankruptcy Code.[33]

The majority countered the dissent's argument by emphasizing that its interpretation of section 548(a)(2)(A) did not render the section ineffective. Scalia asserted that, under the majority's interpretation of the section, the section would

> continue to be an exclusive means of invalidating some foreclosure sales. Although *collusive* foreclosure sales are likely subject to attack under § 548(a)(1), which authorizes the trustee to avoid transfers "made . . . with actual intent to hinder, delay, or defraud" creditors, that provision may not reach foreclosure sales that, while not intentionally fraudulent, nevertheless fail to comply with all governing state law.[34]

1. Fraudulent Conveyance Challenges Based upon Noncompliance with State Foreclosure Laws

a. Will Noncompliance with Any Aspect of a State's Foreclosure Laws Trigger a Successful Fraudulent Conveyance Challenge?

In several places in the majority opinion, Justice Scalia asserted that the price received at a foreclosure sale will be conclusively presumed to constitute reasonably equivalent value, "so long as all the requirements of the State's foreclosure law have been complied with."[35] Scalia described the typical requirements of various states' laws regarding judicial foreclosures or foreclosures by private sale, emphasizing that each of the states "have created diverse networks of judicially and legislatively crafted rules governing the foreclosure process, to achieve what each of them considers the proper balance between the needs of lenders and borrowers."[36] Among the typical requirements, Scalia noted, are requirements of notice to the defaulting borrower, substantial time before commencement of foreclosure, publication of notice of the sale, and "strict adherence to prescribed bidding rules and auction procedures."[37]

Based upon the previously described portions of the opinion, one might read the case to require that all the requirements of the state's foreclosure laws be complied with for the bid price conclusively to be presumed to constitute

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33. *Id.* (Souter, J., dissenting).
34. *Id.* at 1765.
35. *Id.*
36. *Id.* at 1763.
37. *BFP*, 114 S. Ct. at 1763.

reasonably equivalent value, regardless of whether a violated procedure or requirement was material and prejudicial and regardless of whether a party could bring an action under state law in connection with the noncompliance.[38] Such a reading of Scalia's decision would be inconsistent, however, with Scalia's basic goal of harmonizing state foreclosure law with bankruptcy law. In addition, Scalia specifically stated:

> Any irregularity in the conduct of the sale *that would permit judicial invalidation of the sale under applicable state law* deprives the sale price of its conclusive force under section 548(a)(2)(A), and the transfer may be avoided *if* the price received was not reasonably equivalent to the property's actual value at the time of the sale (which we think would be the price that would have been received if the foreclosure sale had proceeded according to law).[39]

Scalia's goal of interpreting the Bankruptcy Code in harmony with state law suggests that mere noncompliance with state foreclosure law should not cause the bid price to lose its presumption of reasonably equivalent value, unless such noncompliance would serve as the basis for invalidation of the sale under the applicable state's foreclosure laws.[40] It would also likely follow that, if a claim is stale under state foreclosure law, it can no longer serve as the basis to avoid the foreclosure sale under the Bankruptcy Code.[41]

Indeed, some bankruptcy courts have already applied *BFP* in a manner consistent with this interpretation of the latter portion of Justice Scalia's decision. In *In re Cummings*, the bankruptcy court noted that under Georgia law "not every irregularity or deficiency provides a basis for voiding a foreclosure sale under power, '[t]he crucial point of the inquiry . . . is to [e]nsure that the sale was not chilled and the price bid was in fact market value.'"[42] Because a procedural defect that does not prejudice the borrower

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38. Indeed, since *BFP*, bankruptcy courts have quoted from this portion of the decision, but have found that all of the foreclosure law requirements have been met. *See, e.g.*, *In re* Osborn, 176 B.R. 941, 949 (Bankr. E.D. Okla. 1994) (finding that the highest bid at a validly conducted, adequately advertised, and well-attended auction was reasonably equivalent value). On the other hand, some bankruptcy courts have quoted from this portion of the *BFP* decision, yet required that the defect be one that would cause the sale to be invalid under the state's foreclosure laws. *See, e.g.*, Cummings v. Anderson (*In re* Cummings), 173 B.R. 959, 961-63 (Bankr. N.D. Ga. 1994) (setting aside a foreclosure sale because of a faulty assignment, which was sufficient to invalidate the sale under Georgia law); *see also BFP*, 114 S. Ct. at 1761, 1765.

39. *BFP*, 114 S. Ct. at 1765 (emphasis added).

40. See Part V, *infra*, regarding noncompliance that will lead to an invalidation of a foreclosure sale and noncompliance that will not.

41. *See infra* Part V.A.

42. *In re Cummings*, 173 B.R. at 963 (quoting Stripling v. Farmers & Merchants Bank, 332 S.E.2d 373 (Ga. Ct. App. 1985)).

or a junior lender would not serve as the basis to set aside a foreclosure sale under Georgia's laws, the court ruled that such a defect also would not serve as the basis to set aside the sale under the Bankruptcy Code.[43]

The Georgia foreclosure laws noted in *In re Cummings* are consistent with many states' foreclosure laws in providing that purely procedural defects will not serve as the basis for invalidating a foreclosure sale.[44] Indeed, under some states' laws, the entry of a decree of foreclosure creates a presumption of compliance with the procedural requirements. For example, in *In re Barr*,[45] the court held that under South Carolina law a decree of foreclosure ordered by a Special Referee conclusively establishes that a procedurally correct judicial sale was to be scheduled. Thus, based upon the Special Referee's execution of the deed and certain affidavits, the bankruptcy court concluded "that the judicial sale was, in all respects, consistent with South Carolina procedural foreclosure law."[46] Of course, even in a jurisdiction where procedural defects cannot be raised after judicial confirmation of a sale, a borrower can challenge the sale after confirmation for failure to comply with a substantive state-law requirement, such as whether the bid was so low as to shock the judicial conscience.[47]

Returning to Scalia's above-quoted pivotal statement explaining the types of irregularities that will lead to a successful section 548 challenge, it is important to keep in mind that the analysis does not end when a bankruptcy court determines that a foreclosure sale was collusive or failed to comply with a state's foreclosure laws. The second half of the quotation, beginning with "if", makes clear that the noncompliance or collusion must result in a bid which is for less than reasonably equivalent value at the time of the sale.[48] How, then, is reasonably equivalent value determined in a forced sale when the sale was not conducted pursuant to the state's foreclosure laws? The majority opinion states that reasonably equivalent value in such a context is the price that would have been received if the sale had proceeded according to the state's foreclosure laws.[49] But how does one ascertain that? Equally perplexing is that the Court seemingly qualified its statement of how to determine reasonably equivalent value by adding the words "we think." Further uncertainty arises in allocating the burden of proving that the amount bid was or was not reasonably equivalent value after the presumption of reasonably equivalent value is lost.

43. *Id.*
44. *See infra* Part V.A.
45. Barr v. Allen (*In re* Barr), 170 B.R. 772 (Bankr. E.D.N.Y. 1994).
46. *Id.* at 776.
47. *Id.* at 776-77. See Part V.A, *infra*, on the approaches taken by various states on this issue.
48. *BFP*, 114 S. Ct. at 1765.
49. *Id.*

The two relevant bankruptcy decisions rendered after *BFP* do not shed much light on these questions. In *In re Garrett*,[50] the court did not attempt to address the issue of whether the bid was less than the amount which would have been bid had there been a noncollusive sale. In *In re Cummings*, the court did mention that the noncompliance with Georgia law chilled bidding, but did not expressly state that the amount bid was less than the amount that would have been bid had the sale been conducted in accordance with Georgia law.[51]

b. Can a Party Now Bid a "Peppercorn" for a Valuable Piece of Real Estate?

Contrary to the dissent's assertion, a bidder at a foreclosure sale can bid neither a nominal nor a grossly inadequate amount for the real property being foreclosed upon as a result of *BFP*. If a "peppercorn" is bid at a foreclosure sale, the bid will violate state foreclosure laws and serve as a basis for invalidating the foreclosure sale under state law.[52] Pursuant to *BFP*, if the amount bid is invalid under state law, then the bid will lose its presumption of constituting reasonably equivalent value under the Bankruptcy Code. As Justice Scalia stated, there is no minimum price that must be bid "beyond what state foreclosure law requires."[53] Each state has a different approach regarding minimum bids. Justice Scalia noted that "some forbid the property to be sold for less than a specified fraction of a mandatory presale fair-market-value appraisal . . . [or] if the price is so low as to 'shock the conscience or raise a presumption of fraud or unfairness.'"[54] As will be discussed in detail, under most states' laws, if a grossly inadequate amount is bid and there is an irregularity in the sale (the irregularity in many states may be based upon something less than fraud, like mistake or technical error which prejudices a party), the sale may be set aside.

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50. Garrett v. Walker (*In re* Garrett), 172 B.R. 29 (Bankr. E.D. Ark. 1994).

51. *In re Cummings*, 173 B.R. at 963.

52. *See, e.g.*, IOWA CODE ANN. § 626.81 (West 1950 & Supp. 1995); KAN. STAT. ANN. § 60-2415(b) (1994); NEB. REV. STAT. § 25-1531 (1989); OR. REV. STAT. ANN. § 23.490 (1987). *See also infra* Part V.

53. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1764 (1994). However, in an earlier portion of the decision, Scalia stated that, under English common law, grossly inadequate consideration is a "badge of fraud" raising a rebuttable presumption of actual fraudulent intent. *Id.* at 1763. It would seem to follow that a grossly inadequate bid price potentially could raise a rebuttable presumption of a fraudulent conveyance under section 548(a)(1), if the applicable state law has adopted such an approach.

54. *Id.* at 1763-64 (citations omitted). For example, Alaska permits a court to set a minimum bid amount in a judicial foreclosure proceeding as a prerequisite to confirmation of the sale. A requirement of a minimum bid of 65% of value has been upheld. *See* Hayes v. Alaska USA Fed. Credit Union, 767 P.2d 1158 (Alaska 1989).

2. *Fraudulent Conveyance Challenges Based upon "Collusion"*

Justice Scalia's opinion does not elaborate on the precise meaning of a "collusive" foreclosure sale. As will be discussed in detail, the classic example of collusion is when two or more parties act in concert for the purpose of chilling bidding and, consequently, with an actual intent to defraud. Justice Scalia referred to collusive foreclosure sales as being subject to attack under section 548(a)(1), the section involving actual intent to defraud.[55] By also referring to section 548(a)(2)(A) in this context, Justice Scalia might have opened the door to a finding of collusion based upon badges of fraud as opposed to the more difficult task of proving actual fraudulent intent. Yet Justice Scalia, in summarizing the decisions of the Sixth and Ninth Circuit Court of Appeals, stated that consideration received at a "noncollusive" regularly conducted foreclosure sale is deemed by such courts to constitute reasonably equivalent value under section 548(a)(2)(A).[56] It appears, then, that collusion in some circumstances might involve an actual intent to defraud, delay, or hinder creditors of the debtor (hence the reference to section 548(a)(1)), but on other occasions might not rise to that level (hence the reference to section 548(a)(2)), depending upon whether the acts constitute "collusion" sufficient to invalidate a foreclosure sale under state law.[57]

If the alleged collusion is not based upon a showing of an actual intent to defraud under section 548(a)(1), however, it must be shown that the collusion led to a bid price that was less than the reasonably equivalent value for the sale to be a fraudulent conveyance under section 548(a)(2).

IV. BID RIGGING, PRICE FIXING, AND OTHER PREFORECLOSURE SALE ARRANGEMENTS THAT MAY CONSTITUTE COLLUSION AND INVALIDATE A FORECLOSURE SALE

A. *Preforeclosure Sale Arrangements That Definitely Support a Claim of Collusion*

Although collusion in connection with a foreclosure sale can take many forms, there are two basic scenarios from which a classic case of collusion arises. In one scenario, the foreclosing lender and a potential third-party bidder agree on an amount to be bid on the property in order to obtain the property at a lower bid price than would otherwise be possible. In this situation, the borrower is harmed by the presale agreement and may challenge

55. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1765 (1994).

56. *Id.* at 1761.

57. *See infra* Part IV.

the foreclosure sale based on the unlawful bid rigging arrangement. As one court has stated:

> It is well settled that any arrangement or combination designed to prevent free and fair competition among bidders at a mortgage foreclosure sale for the purpose of chilling the sale and purchasing the property for less than its market value results in a voidable sale at the option of the mortgagor.[58]

In *Fitzpatrick*, the mortgagor claimed that the lender conspired not to bid against the only other party bidding at the foreclosure sale and to split any profits from having bought the property at a lower price. The mortgagor also claimed that the real owner of the note had fraudulently held itself out to be acting as the mortgagor's agent to secure a buyer of the property, but had made no effort to obtain a buyer and actually discouraged other potential buyers. The lender bid $25,000, and the other bidder bid $25,050. The mortgagor alleged that the lender agreed not to outbid the other bidder in order to cut off the mortgagor's statutory right of redemption (if the lender were the successful bidder, the foreclosure sale would not cut off the mortgagor's equity of redemption).[59] The Missouri Supreme Court held that the mortgagor had stated a cause of action for equitable relief.[60]

In the second scenario, a borrower who is personally liable to two mortgage lenders makes an arrangement with the senior mortgage lender to foreclose the senior lien and wipe out the junior lien. Because a borrower who is personally liable on two mortgage debts may not bid at the foreclosure sale of the senior lien and thereby extinguish the junior lien,[61] the foreclosing senior lender enters into a secret arrangement with the borrower and a third party. The third party takes title to the property either prior to the foreclosure sale or at the foreclosure sale with the understanding that the third party will convey an interest in the property back to the borrower after the foreclosure sale. The party harmed in the second scenario is the junior lender, who will challenge the foreclosure sale based upon the collusive presale arrangement among the other parties: the senior lender, the borrower, and the third party.[62]

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58. Fitzpatrick v. Federer, 315 S.W.2d 826, 829 (Mo. 1958) (citations omitted).

59. *Id.* at 828.

60. *Id.* at 829.

61. *See* Holland v. Fulbert, Inc., 371 N.Y.S.2d 509 (App. Div. 1975) (holding that a mortgagor of a second mortgage is estopped from disputing the lien of a second mortgagee even in the absence of fraud because the mortgagor has usually warranted good title in the second mortgage or covenanted to protect the title of the second mortgagee).

62. *See, e.g.*, Lawrence Ave. Group, USA, Inc. v. Parnes, 520 N.Y.S.2d 762 (App. Div. 1987) (allowing a junior mortgagee who alleged fraud and collusion between the mortgagors and the senior mortgagee's assignee to file a responsive pleading in a mortgage foreclosure action

For example, in *Lawrence Avenue Group, USA, Inc. v. Parnes*,[63] the junior mortgagee alleged that there was collusion among the original mortgagee of the senior mortgage, the party to whom the original mortgagee assigned his interest in the senior mortgage, the borrower, and the party to whom the borrower conveyed his interest in the property. The junior mortgagee filed an answer to the foreclosure action alleging a collusive arrangement among these parties to extinguish his junior mortgage lien. In support of the claim of collusion, the junior mortgagee made three arguments. First, the assignment of the mortgage and transfer of the deed were recorded simultaneously, and both contained a notation that they should be returned to the same attorney. Second, the new owner of the property listed his address care of the same agent as the assignee of the mortgage. Third, there was evidence that the new owner paid less than $10,000 for the property, which was considerably less than the amount of the first mortgage. The court in *Lawrence* held that these allegations of fraud and collusion were sufficient to permit the junior lender to file an amendment to his complaint to include these allegations.[64]

B. Preforeclosure Sale Arrangements That Might Support a Claim of Collusion

As described in Part IV.A above, a foreclosure sale will be invalid under state law if the parties engage in certain actions that are proven to be for the purpose of defrauding either the borrower or a junior lender. An agreement among potential bidders at a foreclosure sale on the amount each will bid is the classic example of a collusive preforeclosure sale arrangement. Such an agreement will cause the foreclosure sale to be invalidated under state law and also subject to attack under section 548(a)(1) of the Bankruptcy Code. If a foreclosing lender engages in any other preforeclosure sale activities that cause the mortgagor to receive less than it might otherwise receive, are such activities sufficient to constitute collusion?

For example, if a third party interested in purchasing the property in foreclosure approaches the lender, can the lender agree to sell the property to the third party if the lender is the successful bidder at the foreclosure sale, or is the lender required to encourage the third party to bid at the foreclosure sale? Is there a rebuttable presumption of collusion if the foreclosing lender enters into a contract to sell property on the same day that the lender bids? Is

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brought by the senior mortgagee); *Holland*, 371 N.Y.S.2d 509 (refusing to allow an owner of the equity of redemption to cut off the junior mortgagee by purchasing the senior mortgage at a foreclosure sale).

63. 520 N.Y.S.2d 762.

64. *Id.* at 763.

there a rebuttable presumption of collusion if the foreclosing lender finances a third party's bid at the foreclosure sale after refusing to refinance the mortgage that is in foreclosure?

1. Is There Collusion if a Foreclosing Lender Arranges with a Third Party That the Lender Will Bid at the Foreclosure Sale and Immediately Thereafter Convey the Property to the Third Party?

The court in *Stockman v. Money, Inc.*,[65] addressed whether there was fraud and collusion between a foreclosing lender and a party who agreed to purchase property from the lender on the day of a foreclosure sale. The borrower alleged fraud and collusion between the lender and the purchasing party based upon the fact that the lender and the purchasing party entered into an agreement to purchase and sell the property on the same day that the lender purchased the property at the foreclosure sale.[66] The court first noted that a facially valid judicial sale is presumed to have been conducted in accordance with the law, and that the party attacking the foreclosure sale bears the burden of proving the contrary.[67] In response to the claim of collusion, the court affirmed the trial court's holding that there was no evidence of fraud, collusion, or ill practices between the lender and the purchasing party.[68] In reaching this conclusion, the court noted that (1) none of the directors or incorporators of the corporation purchasing the property from the lender were directors or incorporators of the lender; (2) the parties carried out the sale of the property in the usual and customary manner, with the lender receiving the sales price in cash; and (3) the purchaser was actively engaged in the real estate business.[69]

This dicta suggests that the court might have held that the lender's arrangement to bid at the foreclosure sale and promptly thereafter convey the property to a third party was collusive if the third party was not truly a "third party" (i.e., an entity unrelated to the lender), and the sale was not carried out in the usual and customary manner to a party who regularly engages in the acquisition of real estate. This inference is problematic, however, in light of the fairly common practice of lenders to purchase at a foreclosure sale and immediately or soon thereafter convey the property to a related entity. This practice might protect against liability or serve purposes other than to defraud

65. 277 So. 2d 504 (La. Ct. App. 1973).
66. *Id.* at 508.
67. *Id.* at 506.
68. *Id.* at 508.
69. *Id.*

or to affect adversely the borrower. It seems unlikely that the court intended this dicta to cover this type of pre-sale arrangement.

The court's analysis of the collusion issue in *Stockman* appears incomplete because the court did not address the purchase price paid by the third party.[70] If this price were significantly and inexplicably higher than the amount that the lender bid at the foreclosure sale, then the court might construe the price as evidence of collusion sufficient to invalidate the foreclosure sale. Such a price might indicate that the presale arrangement chilled the bidding process to the detriment of the borrower.

The key issue when a lender bids at the foreclosure sale and immediately conveys the property to a third party at a substantially higher price is this: Why wouldn't the third party simply bid at the foreclosure sale and obtain title to the property at a lower price? Often a third party purchases property from the foreclosing lender after the foreclosure sale because the third party wishes to secure financing, review the physical condition of the property, review the property's income stream and expenses, and perform other items of due diligence customary to a voluntary sale situation. The third party also might wish to secure representations and warranties from the lender that would not be available if the third party bid at the foreclosure sale. The ability to purchase under these circumstances might very well yield a higher purchase price than the foreclosure sale without raising an issue of collusion.

When a foreclosing lender purchases at a foreclosure sale and shortly thereafter contracts to sell the property to a third party, the problem is the possibility that the lender and the third party had entered into a secret arrangement prior to the foreclosure sale to reduce the amount actually bid at the sale. As the court in *Polish National Alliance v. White Eagle Hall Co.*,[71] stated in discussing the collusion issue, "[t]he essence of a judicial sale is a full and free opportunity for bidders to compete, and any agreement that unfairly restricts that opportunity is contrary to public policy."[72] The *PNA* decision sheds light on an issue not specifically addressed in *Stockman*; namely, the relevance that a court will find in the amount that a lender receives from the third party in relation to the amount that the lender bid at the foreclosure sale and the amount due to the lender under its mortgage loan.

In *PNA*, the lender, PNA, held a mortgage securing a debt of approximately $92,000. The debtor, White Eagle Hall Company, defaulted on the mortgage and failed to pay real estate taxes, leading the city of New York to take title to the property in an in rem foreclosure proceeding. Both PNA and

70. The court in *Stockman* noted that the bid was $56,600, the lender submitted an appraisal of the property of $60,000, the borrower submitted an appraisal of $103,000, and the sheriff submitted an appraisal of $75,000. *Stockman*, 277 So. 2d at 504.

71. 470 N.Y.S.2d 642 (App. Div. 1983).

72. *Id.* at 650 (citations omitted).

White Eagle found purchasers to redeem the property. After the redemption, White Eagle again defaulted on its interest payments to PNA, and PNA resumed its foreclosure action. PNA purchased the property at the sale for $150 (PNA did not seek a deficiency judgment for the balance owed of $97,017, and that amount, plus the costs of the sale, was credited to the amount that PNA bid) and assigned its bid to the party that redeemed the property from the tax sale.[73]

The borrower filed suit to set aside the sale, claiming that it had not been served with notice of the sale, that the price bid was grossly inadequate, and that there was collusion between PNA and the assignee to suppress bidding.[74] The court noted that under

> early common law, all agreements not to bid at judicial sales were condemned, but we have come to recognize that such an agreement may be valid if made for an honest purpose such as protecting an existing interest in property or to enable individuals to bid as a group when they would have been unable to do so individually.[75]

In such cases, the lawful purposes override any negative effects. In light of these principles, "if a mortgagee agrees not to bid on condition that a prospective bidder will satisfy the debt if successful in bidding, the agreement is valid because the mortgagee would not be expected to bid in excess of the mortgage balance in any event."[76] Nevertheless, the court concluded that the mortgagor's claim of collusion between PNA and the assignee might have merit, depending upon the amount paid by the assignee to the mortgagee for the assignment.[77]

If the consideration for the assignment is not greater than the amount of the foreclosure judgment, then the assignment is valid because it represents a purchase of the mortgage. However, if the consideration for the assignment is more than the foreclosure judgment, then the mortgagee will receive a bonus in excess of the sum due on the mortgage, causing a diversion of the surplus from the bid price in contravention of public policy.[78] Thus, the court remanded the case for evidence on the issue of the consideration for the assignment.

The *PNA* decision provides a useful bright-line test for determining the types of presale bidding arrangements that will be deemed collusive and those

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73. *Id.* at 645-46.

74. *Id.* at 646; see also Part V, *infra*, for a discussion of the avoidance of a foreclosure sale due to inadequate notice and/or grossly inadequate bid price.

75. *Polish National Alliance*, 470 N.Y.S.2d at 650 (citations omitted).

76. *Id.* (citations omitted).

77. *Id.* at 651.

78. *Id.*

that will not. If, pursuant to a presale arrangement, a prospective bidder pays to a foreclosing mortgagee only the outstanding balance of the loan, then the presale arrangement will not be deemed collusive. If, however, a foreclosing mortgagee receives an amount in excess of the balance of the loan from a prospective bidder, then this transaction will be deemed to be a collusive, presale arrangement harmful to the mortgagor.[79]

A review of case law relating to allegations of collusive foreclosure sales reveals that a court will insist upon evidence of a collusive presale agreement, rather than presume the existence of such an agreement based upon the fact that the foreclosing lender successfully bids at the foreclosure sale and shortly thereafter conveys the property to a third party for an amount substantially higher than the original bid. For example, in a pre-*BFP* Ninth Circuit Bankruptcy Appellate Panel decision, the court held that a foreclosure sale could not be set aside as a fraudulent conveyance even though two months after the foreclosure sale the lender was able to resell the property at a profit of approximately two hundred percent.[80] In that case, the debtor apparently did not challenge the sale on the grounds that it was collusive, but instead argued that the lender received a windfall. The court, however, found "no windfall where the property is sold at the lien value in a non-collusive [sic] regularly held foreclosure sale."[81]

The debtor in *Kellett v. Pocahontas Federal Savings & Loan Ass'n*[82] alleged that the foreclosing lender had attempted to discourage a potential bidder. The debtor presented evidence that on the day of the foreclosure sale the lender sold the property for $87,500, although the lender had acquired the property for only $75,000. Moreover, the purchaser divided the property into three parcels and sold it for a total of $100,000 approximately one month later.[83] The chancellor found no evidence either that the party who purchased from the lender or the subsequent purchasers were discouraged from bidding, or that other irregularities existed with regard to their purchases.[84] The chancellor did not set aside the foreclosure sale, but reduced the deficiency amount due the lender to reflect the $85,000 that the lender received later on the day of the sale. The court on appeal affirmed this ruling, and did not have

79. *Id.*; *see also* Hoge v. Kane, 670 P.2d 36, 40 (Haw. Ct. App. 1983) (noting in dicta that "there is no problem" with a pre-auction arrangement between a bidder at a foreclosure sale and a mortgagee who otherwise might have bid. "[A]s long as no bonus is involved a bidder may agree to satisfy an existing mortgage which the sale is terminating . . . ." The unarticulated premise is that the mortgagee would not bid more than the amount of its lien.).

80. Ehring v. Western Community Moneycenter (*In re* Ehring), 91 B.R. 897 (Bankr. 9th Cir. 1988).

81. *Id.* at 901.

82. 756 S.W.2d 926 (Ark. Ct. App. 1988).

83. *Id.* at 927.

84. *Id.*

to rule on whether there was collusion or any other irregularity that would justify setting aside the foreclosure sale because the debtor failed to show that the chancellor abused his discretion in finding that the amount bid was inadequate.[85]

2. Is There Collusion if the Foreclosing Lender Finances a Third-Party Bidder After Refusing to Refinance the Mortgage Being Foreclosed upon?

A review of state-court decisions makes clear that an agreement in which the foreclosing bank provides the third-party bidder with financing of the sale is not, by itself, indicative of collusion that would justify a court in exercising its equitable power to set aside a foreclosure sale.[86] However, one court qualified its ruling by stating, "[w]e do not reach the issue of the validity of a trustee's sale other than for cash where there are other cash bidders or where the holder of the note or the trustee so act as to lead the debtor to believe he will be protected if he does not bid."[87] In that case, the borrower sought to set aside the foreclosure sale because he was not given the opportunity to make payment at the sale by a note and deed of trust to the foreclosing lender. Although the court agreed that a borrower is entitled to bid at the foreclosure sale and that a failure to bid by reason of deception should invalidate the sale, the court disagreed with the claim that a borrower is entitled to receive financing by the foreclosing lender for the bid simply because the lender extends financing to a third-party bidder.[88] The court also noted that there was no allegation that the amount bid was unfair.[89]

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85. *Id.* at 928. This case is also illustrative of the safe harbor concept. *See infra* Part IV.C.

86. *See, e.g.*, Richmond v. Stanzler, 97 N.E.2d 200, 202 (Mass. 1951) (holding that a mortgagee may extend credit to the purchaser at a foreclosure sale); Euge v. Golden, 657 S.W.2d 689, 690-91 (Mo. Ct. App. 1983) (upholding a foreclosure sale where the third-party bidder paid the bid price with a note and deed of trust, although the trustee refused to allow the defaulting property owner to give such a note and deed of trust); Manufacturers & Traders Trust Co. v. Niagara Square Assocs., 608 N.Y.S.2d 22, 23 (App. Div. 1993) (stating that "[t]he mortgagee bank's conduct in entering into an agreement with a prospective bidder for the financing of a bid at the sale does not indicate fraud or collusion . . . .").

87. *Euge*, 657 S.W.2d at 691 n.1. See Part V.C, *infra*, for deception as a defect that may justify invalidating a foreclosure sale.

88. *Euge*, 657 S.W.2d at 691.

89. *Id.*

C. *Safe Harbors*

Some cases provide general guidance on the type and degree of collusion that would serve to rebut the presumption that the successful bid at a foreclosure sale constitutes reasonably equivalent value. The court in *In re Bennett*[90] applied the test first enunciated in *In re Madrid*[91] and embraced by the Supreme Court in *BFP* that the amount received at a "regularly conducted" and "noncollusive" foreclosure sale would be deemed to be reasonably equivalent value.[92] In *In re Bennett*, the borrower charged that the foreclosure sale was fraught with collusion. The court ruled that even if the senior lender and the junior lender had colluded to cause the pledged property to be foreclosed upon,[93] "the appropriate focus of an inquiry into collusion must be on the sale itself, as opposed to events leading up to the commencement of the foreclosure."[94] Furthermore, the court appeared to provide a safe harbor even if collusion relating to the sale has occurred. The court ruled that "for purposes of [Bankruptcy] Code § 548(a)(2), the effect of the collusion must be evident in the price received for the property and, accordingly, must manifest itself in bid rigging or some other form of price fixing."[95] Although the *In re Bennett* court cited another Bankruptcy Code section to support its interpretation of collusion,[96] the court in *Megabank Financial Corp. v. Alpha Gamma Rho Fraternity*[97] similarly reasoned in dicta that, in order for a claim of collusion to constitute a fraudulent conveyance under section 548(a)(2), the debtor's estate must be unjustly diminished as a result of the claimed collusion, and that "'no injury can result from a sale of an asset at its fair value.'"[98]

V. LIKELY FRAUDULENT CONVEYANCE CHALLENGES UNDER VARIOUS STATE FORECLOSURE LAWS

Before summarizing the types of claims that can be raised to invalidate a foreclosure sale under state law, it is important to recognize that each state has arrived at its own approach to balancing the frequently conflicting interests

90. Bennett v. Genoa Ag Center, Inc. (*In re* Bennett), 154 B.R. 140 (Bankr. N.D.N.Y. 1992).

91. Lawyers Title Ins. Co. v. Madrid (*In re* Madrid), 21 B.R. 424 (Bankr. 9th Cir. 1981).

92. *In re Bennett*, 154 B.R. at 146-47.

93. The two lenders in that case could not agree on the sharing of the proceeds of a sale of the pledged property, thus causing a foreclosure to occur. *Id.* at 144.

94. *Id.* at 147.

95. *Id.; see also* Kellett v. Pocahontas Fed. Sav. & Loan Ass'n, 756 S.W.2d 926, 928 (Ark. Ct. App. 1988) ("Having failed to show an inadequate sale price, the issue of fraud or irregularities is irrelevant in the case at bar.").

96. *In re Bennett*, 154 B.R. at 147 n.5 (citing 11 U.S.C. § 363(n) (1988)).

97. 841 P.2d 318 (Colo. Ct. App. 1992).

98. *Id.* at 320 (citations omitted).

of the mortgagor, senior mortgagee, junior mortgagee, and third-party bidders. Thus, each state has crafted different foreclosure procedures. Some states permit a power of sale;[99] others require a judicial foreclosure.[100] Some states allow the statutory right of redemption to continue after the foreclosure sale;[101] others allow the statutory right of redemption to expire prior to the foreclosure sale.[102] Moreover, the requirements of notice and advertising, as well as numerous other matters relating to the procedures and requirements of the sale, vary from state to state.

However, in reviewing cases where a mortgagor or another interested party has challenged the validity of a foreclosure sale, one can detect certain common types of claims. This section reviews the most common claims raised to set aside a judicial sale or a trustee's sale as a fraudulent conveyance.[103]

A. The Standard for Claims Raised at the Judicial Confirmation of the Sale Versus the More Difficult Standard to Vacate or Appeal the Confirmation of the Sale

In jurisdictions that require judicial foreclosure, rather than power of sale, statutes ordinarily require that a court confirm or ratify the sale shortly after the foreclosure sale is conducted. Such statutes provide the grounds upon which a court may elect not to confirm the sale, and these grounds are easier to meet than the more limited grounds upon which an order to confirm the sale may be vacated or appealed.[104] For example, according to Illinois case law,

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99. In order to effectuate a power of sale, a lender or a trustee can conduct the sale without a court order. *See, e.g.*, CAL. CIV. CODE § 2924 (West 1993 & Supp. 1996); COLO. REV. STAT. ANN. § 38-38-101 (West Supp. 1995); D.C. CODE ANN. § 45-715 (1990); NEV. REV. STAT. ANN. § 107.080 (Michie 1994).

100. In order to effectuate a judicial sale, a court action must be brought by the mortgagee against the mortgagor and any other necessary parties, a judgment against those parties must be entered by the court, the court must authorize the sale, and the court must confirm the sale after its completion. *See, e.g.*, ILL. COMP. STAT. ch. 735, para. 5/15-1403 (Smith-Hurd 1993); OHIO REV. CODE ANN. § 2329.31 (Anderson 1995); 42 PA. CONS. STAT. ANN. rule 1141 (1987).

101. Examples of state statutes providing for a redemption period after the sale are: ALASKA STAT. § 09.35.220 (1994); COLO. REV. STAT. ANN. § 38-38-302 (West Supp. 1995); NEV. REV. STAT. ANN. § 21.210 (Michie 1986).

102. Examples of state statutes providing for a redemption period before the foreclosure sale are: CAL. CIV. CODE § 2924c(a)(1) (West 1993); FLA. STAT. ANN. § 45.0315 (West 1994); ILL. COMP. STAT. ch. 735, para. 5/15-1603(b) (Smith-Hurd 1993); N.Y. REAL PROP. ACTS. LAW § 1341 (McKinney 1979).

103. Many of the cases reviewed involve judicial sales, but some also involve claims to set aside a sale through a power of sale. Indeed, certain challenges have been successfully raised in the context of a power of sale that were not successfully raised in a judicial sale context. *See infra* Part V.

104. *See, e.g.*, Kellett v. Pocahontas Fed. Sav. & Loan Ass'n, 756 S.W.2d 926, 927 (Ark Ct.

a court may refuse to confirm a foreclosure sale for inadequacy of the bid alone (usually because the bid is considered grossly inadequate); however, to set aside a confirmed sale, inadequacy of the bid by itself would be insufficient (unless the bid was unconscionable) and must be accompanied by fraud, unfairness, mistake, or oppression in connection with the proceeding attendant upon the sale.[105]

Courts are more lenient in setting aside a foreclosure sale before confirmation because the sale is not considered consummated until its confirmation. In *Levy* the supreme court of Illinois recognized that

> [s]tability must be given to judicial sales which have reached the point where title has vested in the purchaser, otherwise bidding would be discouraged. But where a bidder does not become vested with any interest in the land, but has only made an offer to buy, subject to the approval of his offer by the court, and he bids with that condition, there can be no good reason why bidding would be discouraged by reason of the court's power to approve or disapprove the sale for gross inadequacy of bid.[106]

After a judicial sale has been confirmed or ratified, it is more difficult to challenge the sale. Generally, in order to vacate or modify a confirmed judicial sale, the borrower or junior lender must show not only a grossly inadequate bid price, but also some other irregularity in the conduct of the foreclosure sale such as fraud, accident, mistake or collusion.[107]

App. 1988) (stating that courts will refuse to confirm a sale if the price is greatly inadequate and there are other "slight circumstances" justifying the refusal); Straus v. Anderson, 9 N.E.2d 205, 208 (Ill. 1937) (noting that refusing to confirm a sale and vacating a confirmed sale fall into "different classification[s]" because after confirmation the sale has been completed, while before confirmation "the court, in legal contemplation, is the seller"); Levy v. Broadway-Carmen Bldg. Corp., 8 N.E.2d 671, 673-75 (Ill. 1937) (distinguishing a court's refusal to confirm a judicial sale, which is committed to the court's discretion, from vacating a confirmed sale, which requires "more than a mere inadequacy of price," and justifying the distinction on the need for stability in confirmed sales); Travelers Indem. Co. v. Heim, 388 N.W.2d 106, 108-09 (Neb. 1986) (recognizing that, although a confirmed sale is "final and complete," the court retains jurisdiction after confirmation to vacate the sale on the basis of fraud, mistake, accident, or other "special circumstances").

105. *See Straus*, 9 N.E.2d 205; *Levy*, 8 N.E.2d 671; *see also infra* Part V.B.

106. *Levy*, 8 N.E.2d at 673; *see also In re* Green, 219 S.E.2d 552, 553 (N.C. Ct. App. 1975) (following the long-standing rule that a confirmed sale "may be set aside only for 'mistake, fraud, or collusion'") (citations omitted).

107. *See, e.g.*, Sullivan v. Wright, 255 S.W. 848, 849-50 (Ky. 1923) (setting aside a sale due to misrepresentation by the auctioneer as to the actual nature of the property); Hersh v. Allnutt, 250 A.2d 629, 632 (Md. 1969) (stating that confirmation of a sale is res judicata, and that such confirmation may not be set aside absent fraud or illegality); Gottschalk Co. v. Samuelson, 97 A. 1003 (Md. 1916) (refusing to set aside a judicial sale because the plaintiff's evidence did not

Some jurisdictions further require that the alleged irregularity not be known to the complaining party at the time of the confirmation, and that the complaining party raise the complaint in a diligent manner. In order to set aside a confirmed judicial sale the borrower or other party challenging the sale must show that she is acting in good faith, with ordinary diligence, and with a meritorious defense or cause of action.[108] One court refused to set aside a foreclosure sale because the borrower delayed in moving to set aside a sale until almost six months after its confirmation, and thus did not act with ordinary diligence.[109]

The party challenging the confirmation of a foreclosure sale can appeal the confirmation order. However, as with any other appeal of a lower court order, the borrower will succeed on appeal only by showing that the lower court abused its discretion in failing to set aside a judicial sale.[110]

B. Claims Based upon an Inadequate Bid Amount

Under many states' laws, a foreclosure sale will not be set aside based upon mere inadequacy of price.[111] Courts will set aside a foreclosure sale, however, if the amount bid is so "grossly inadequate" that it shocks the court's

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support the assertion that title was not marketable); *Travelers,* 388 N.W.2d at 109-10 (requiring "special circumstances" such as fraud, mistake, or accident to set aside a confirmed sale); *In re Green,* 219 S.E.2d at 553-54 (ruling that without proof of fraud, mistake, or collusion, the judge had no authority to set aside the order of confirmation).

108. *See* Hughes v. Beltway Homes, Inc., 347 A.2d 837, 841 (Md. 1975).

109. *Id.* at 842; *accord Travelers,* 388 N.W.2d at 109 (holding that a borrower can bring an action to vacate or modify the confirmation of the sale "when there are special situations which have worked an injustice unknown to the complaining party at the time of confirmation, such as fraud, accident, or mistake").

110. *See, e.g.,* Jetton v. Jetton, 502 So. 2d 756, 759-60 (Ala. 1987) (stating that confirmation will not be overturned unless "palpably erroneous and manifestly unjust") (citations omitted); *Kellett,* 756 S.W.2d at 928 (finding that the trial judge did not abuse his discretion in confirming the sale despite possible inadequacy of price); Investors Sav. Bank v. Phelps, 397 S.E.2d 780, 781 (S.C. Ct. App. 1990) (ruling that the trial court did not abuse its discretion in refusing to confirm a sale of property valued at $45,000 for a high bid of $510); Cook v. Cook, 739 P.2d 90, 92 (Utah Ct. App. 1987) (stating that confirmation is committed to the sound discretion of the trial court); Benavides v. Shenandoah Fed. Sav. Bank, 433 S.E.2d 528, 530 (W. Va. 1993) (per curiam) (refusing to overturn the trial court's confirmation of a judicial sale unless such confirmation was "'plainly wrong'") (citations omitted).

111. *See, e.g.,* Campbell v. Campbell, 725 S.W.2d 585, 586 (Ark. Ct. App. 1987) (requiring at least "slight circumstances" in addition to greatly inadequate price to set aside a judicial sale); Pentad Joint Venture v. First Nat'l Bank, 797 S.W.2d 92, 95-96 (Tex. Ct. App. 1990) (following the rule that inadequacy of price alone will not justify setting aside a legal, fairly made judicial sale); *Benavides,* 433 S.E.2d at 530 (stating that a sale "will not be set aside for mere inadequacy of price") (citations omitted).

conscience,[112] or if the grossly inadequate bid is accompanied by some other defect such as fraud, collusion, unfairness, mistake, or oppression.[113]

In determining whether a bid price is "unconscionable," a court will compare the bid with the value the property at the time of the sale. Some courts have held that bids for fifty percent of value or more are not unconscionable, bids for ten percent of value or less are unconscionable, and bids between ten and fifty percent of value might be unconscionable depending upon the unique circumstances involved in the case.[114] In explaining the absence of a hard-and-fast rule for sales between ten and fifty percent of value, the *PNA* court stated that this absence was due to the variety of circumstances under which judicial sales take place and the substantial diversity in the types of real estate involved.[115] In that case, the court held that a bid for thirty-seven percent of value was not unconscionable because the property at issue was of a "specialized nature" (a large catering hall) and "likely of limited interest to those inclined to bid at forced sales" (bargain hunters).[116] Similar-

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112. *See, e.g.*, *Campbell*, 725 S.W.2d at 587 (stating that no other circumstances are necessary to set aside a sale if the price is so inadequate that the court's conscience is shocked); Glenville & 110 Corp. v. Tortora, 524 N.Y.S.2d 747, 749 (App. Div. 1988) (stating that, in the absence of collusion, fraud, mistake, or misconduct, a judicial sale will be set aside only if the inadequacy of price shocks the conscience of the court); *Benavides*, 433 S.E.2d at 530 (recognizing that a sale may be set aside if the price is so inadequate "as to shock the conscience of the court or to raise a presumption of fraud") (citations omitted).

113. *See, e.g.*, Lyons Sav. & Loan Ass'n v. Gash Assocs., 545 N.E.2d 412, 415-16 (Ill. App. Ct. 1989) (holding that a condemnation action did not constitute fraud or illegality sufficient to set aside a foreclosure sale); Manufacturers & Traders Trust Co. v. Niagara Square Assocs., 608 N.Y.S.2d 22, 23 (App. Div. 1993) (affirming a refusal to set aside a foreclosure sale where no evidence of fraud or collusion existed); Polish Nat'l Alliance v. White Eagle Hall Co., 470 N.Y.S.2d 642, 648 (App. Div. 1983) (requiring "additional circumstances" to justify setting aside a sale for inadequacy of price); Quinn v. Fidelity Fin. Servs., Inc. (*In re* Quinn), 69 B.R. 776, 779 (Bankr. W.D. Tenn. 1986) (holding that a failure to use "flags, signs, banners, and loud speakers" at a foreclosure sale was not an irregularity sufficient to justify setting aside the sale).

114. *See, e.g.*, Burge v. Fidelity Bond & Mortgage Co., 648 A.2d 414, 419 (Del. 1994) (noting in dicta that when the amount bid is less than 50% of value, special judicial scrutiny of the sale is applied because such a bid is considered grossly inadequate, but even a bid greater than 50% of value may be construed as grossly inadequate, depending upon the circumstances of the case); *Manufacturers & Traders Trust Co.*, 608 N.Y.S.2d at 23 (holding that a bid price over 50% of the highest appraised value of the property not unconscionable); Pisano v. Tupper, 591 N.Y.S.2d 888, 889 (App. Div. 1992) (finding that a total acquisition cost of less than 20% of value shocks the conscience of the court and may serve as the basis to set aside a foreclosure sale); Long Island Sav. Bank v. Jean Valiquette, M.D., P.C., 584 N.Y.S.2d 127, 129 (App. Div. 1992) (holding that a bid of 57% of value is not so low as to shock the conscience of the court); *Polish Nat'l Alliance*, 470 N.Y.S.2d at 649 (ruling that a $150 sale price for a $260,000 property was not unconscionable where the buyer also assumed a $96,000 mortgage).

115. *Polish Nat'l Alliance*, 470 N.Y.S.2d at 649.

116. *Id.* at 650.

ly, the court in *Connely v. Rue*[117] noted that in determining whether the bid at a foreclosure sale is grossly inadequate, the court can take into account whether the mortgagor retained a statutory right of redemption after the sale.[118]

Like the question of whether a bid is unconscionable, the determination of what "irregularity" in a sale that, together with a grossly inadequate bid price, will support setting aside the foreclosure sale is fact-dependent. The extent to which one factor exists will affect the degree to which the other factor must be present. "Great inadequacy [of bid price] requires only slight circumstances of unfairness in the conduct of the party benefitted by the sale to raise the presumption of fraud."[119] In describing circumstances that, together with grossly inadequate bid price, can invalidate a judicial sale, the *Levy* court stated:

> "[I]f . . . the purchaser has been guilty of any unfairness, or has taken any undue advantage, or if the owner of the property, or party interested in it has been, for any other reason, misled or surprised, then the sale will be regarded as fraudulent and void, or the party injured will be permitted to redeem the property sold."[120]

In addressing the type of irregularities that, together with a grossly inadequate bid price, could serve to invalidate a foreclosure sale, the *PNA* court emphasized factors that related to chilling the bidding, such as whether the sale was duly advertised or whether there was evidence of any irregularity that would have inhibited the attendance of other prospective bidders.[121]

C. Claims of Inadequate Notice Based upon Noncompliance with Statutory Notice Requirements, Deception, or Breach of Duty

Each state's foreclosure laws specify the requirements for notice of the foreclosure sale to the mortgagor and other parties of interest, as well as the timing and manner of advertising the foreclosure sale. For example, under New York foreclosure law, when the mortgagor fails to answer the complaint or appear and demand personal service of the notice, a mortgagee is required only to publish a notice of the foreclosure sale and need not deliver a personal notice to the mortgagor.[122]

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117. 35 N.E. 824 (Ill. 1893).

118. *Id.* at 827 (recognizing the presumption that third parties will bid less if the mortgagor enjoys a statutory right of redemption for a period of time after the foreclosure sale).

119. *Levy*, 8 N.E.2d at 675 (citations omitted).

120. *Id.* (citations omitted).

121. *Polish Nat'l Alliance*, 470 N.Y.S.2d at 650.

122. *See id.* at 646.

Generally, if notice has been given as required under the applicable foreclosure statute and under the instruments securing the loan, a party in interest cannot challenge the validity of the sale on the basis that adequate notice of the sale was not given.[123] It should be noted, however, that notice must also comply with the applicable state's civil procedure statutes. When the notice does not so comply, courts may invalidate the foreclosure sale.[124]

In many jurisdictions, a court will not set aside a foreclosure sale for failure to comply with the notice requirements of the foreclosure statute if the defect constitutes a mere de minimus or insubstantial variation from the requirements of the statute that does not prejudice (i.e., cause injury to) the party seeking to set aside the sale.[125] For example, in *Muñoz Bermudez v. Industrial Siderurgica, Inc.*, the court refused to set aside a judicial sale where the mortgagee published notice of the sale in a local newspaper once a week for two weeks and twice in another week, rather than once each week for four weeks as required by the applicable statute.[126] In *Hanover Funding Co. v. Keri Associates*, the court refused to set aside a foreclosure sale for the lender's failure to provide notice to the guarantor of the change in location of the sale and the lender's inaccurate advertising that the parcels would be sold separately.[127] The court ruled that the party challenging the foreclosure sale

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123. *Id.*; *see also* United States Cold Storage v. Great W. Sav. & Loan Ass'n, 212 Cal. Rptr. 232, 239-41 (Ct. App. 1985) (noting that the mortgagor received actual notice of and was present at the sale, but refused to bid); PAS Realty, Inc. v. Rayne, 418 A.2d 1222, 1226 (Md. Ct. Spec. App. 1980) (dismissing mortgagor's contention that an advertisement of a sale was inadequate and holding that the applicable foreclosure laws required only publication in a county newspaper); White v. Magee, 446 N.Y.S.2d 453, 454 (App. Div. 1981) (refusing to vacate a foreclosure sale when the plaintiff received both statutory and actual notice of the sale).

124. *See* Fincham v. Fincham, 443 So. 2d 312, 313 (Fla. Dist. Ct. App. 1983) (setting aside a foreclosure sale for failure to comply with the Florida Rules of Civil Procedure in delivering notice of the sale); Aetna Life Ins. Co. v. Avalon Orchards, Inc., 479 N.Y.S.2d 564, 565 (App. Div. 1984) (stating that "[p]arties to a foreclosure proceeding . . . are entitled to receive such notice in the ordinary manner in which papers are to be served upon a party in a pending action. Service of a notice of sale on defendants' attorney was essential; failure to comply necessitates vacatur of the foreclosure sale.") (citations omitted); Shaw v. Russell, 464 N.Y.S.2d 299, 301 (App. Div. 1983) (noting that New York law allows the court to set aside a foreclosure sale if notice of the sale is defective).

125. *See* Muñoz Bermudez v. Industrial Siderurgica, Inc., 672 F. Supp. 57, 59 (D.P.R. 1987); Hanover Funding Co. v. Keri Assocs., 580 N.Y.S.2d 530, 531 (App. Div. 1992); *see also* Ogden v. Gibraltar Sav. Ass'n, 620 S.W.2d 926, 929 (Tex. Civ. App. 1981) (refusing to set aside a sale even though the foreclosing mortgagee incorrectly addressed the notice to post office box "36151" rather than the correct number "3651," because a postal employee testified that he had seen the misnumbered notice and placed it in the correct mail box, and the mortgagor had actual notice of the sale prior to the date of the sale and did not take steps to prevent it), *rev'd on other grounds*, 640 S.W.2d 232 (Tex. 1982); *see* text accompanying note 138, *infra*, regarding the defective notice of acceleration causing an invalidation of the sale.

126. *Bermudez*, 672 F. Supp. at 60.

127. *Hanover*, 580 N.Y.S.2d at 531.

bears the burden to prove that it was injured by any irregularities in notice and advertising. Because the guarantor failed to present such evidence, the court did not set aside the sale.[128]

Courts have invalidated foreclosure sales for failure to comply with the notice requirements of the applicable state's foreclosure statutes, civil procedure statutes, or both, especially when the defect in notice results in the borrower or junior lender not receiving notice at all.[129] Sometimes courts use a technical notice defect as a means to affirm the setting aside of an unfair sale. For example, in *Bit-O-Sweden, Inc. v. Kittredge*[130] the debtor received the notice one day late and did not attend the sale under the mistaken belief that the property could be redeemed after the sale. The judgment creditor bid the amount of the judgment, $27,681.94, for property assessed at $223,040.-00. Although the court acknowledged that the defect in notice was minor, the court would not rule that the trial court abused its discretion in setting aside the sale because "it is impossible to conclude that proper notice would not have affected the outcome, and because the judgment creditor would have reaped a windfall by obtaining property valued far in excess of the debt for a fraction of its true value . . . ."[131]

In some instances, a court will set aside a confirmed foreclosure sale for lack of adequate notice even when the notice requirements contained in the applicable state's foreclosure laws have been satisfied.[132] Even if notice is properly given, but the mortgagee or trustee conducting the sale either breaches a duty to a party of interest or acts in a deceptive manner that causes the mortgagor or another possible bidder to believe that the sale will not occur

128. *Id.*

129. *See, e.g.*, Fenimore v. Gonzales County Sav. & Loan Ass'n, 650 S.W.2d 213, 214-15 (Tex. Ct. App. 1983) (setting aside a confirmed judicial sale because notice of the sale was sent only to a person whom the lender believed to be the borrower's only surviving family member and neither to the borrower prior to her death nor to her temporary administrator or her estate); *Avalon Orchards*, 479 N.Y.S.2d at 565 (setting aside a confirmed judicial sale because the mortgagee failed to serve notice of the foreclosure sale on the mortgagor and the grantor's attorneys as required pursuant to New York's civil procedure statute).

130. 566 So. 2d 364 (Fla. Dist. Ct. App. 1990).

131. *Id.* at 365 (footnote omitted).

132. *See* Tome v. Baer (*In re* Tome), 113 B.R. 626 (Bankr. C.D. Cal. 1990); Guilford v. First Am. Bank for Sav. & Urban Homes (*In re* Guilford), 52 B.R. 177 (Bankr. D. Mass. 1985); New York Guardian Mortgagee Corp. v. Rodriguez, 527 N.Y.S.2d 466 (App. Div. 1988). *But see* I.E. Assocs. v. Safeco Title Ins. Co., 702 P.2d 596, 600 (Cal. 1985) (holding that the rights and powers of trustees in a nonjudicial proceeding are strictly limited and defined both by the parties' contract and by statutes; the court would not require the trustee to give more notice than that required by statute based upon a duty to use reasonable efforts to notify the trustor of a default and a sale).

on the date and time set forth in the notice, the mortgagor or other party of interest can challenge the sale for lack of adequate notice.[133]

For example, a court might set aside a foreclosure sale if the complaining party can show that the lender's attorney misinformed the borrower's agent about the date of the sale. The court in *New York Guardian* held that although the published notice of sale satisfied statutory requirements, the borrowers were entitled to a hearing because of their contention that deception as to the date of the sale prevented them from tendering sufficient funds to satisfy the foreclosure judgment.[134]

The facts in *New York Guardian* pose an example of deception that, when causing prejudice to the borrower or a junior lender, would clearly lead to invalidation of a foreclosure sale. It is less likely, but possible, that a court might invalidate a foreclosure sale that was conducted in accordance with requisite procedures and free of deception if the lender's actions or inactions breached an affirmative duty to use reasonable diligence to protect the interest of the borrower. The borrower in *In re Guilford*[135] sought to have a court invalidate a foreclosure sale as improperly conducted because (1) the borrower was not personally notified of the date and time of the sale after repeatedly asking the lender for such notice; (2) the lender misled one potential bidder, a broker, into thinking there would be no sale; and (3) these actions led to an inadequate amount being bid at the sale.[136]

Although under Massachusetts law a debtor, in the absence of a special agreement, is entitled only to notice by publication the court ruled that the mortgagee had a duty to act in good faith and to use reasonable diligence to protect the interest of the mortgagor.[137] The court in *In re Guilford* reasoned that, because the debtor had repeatedly asked the mortgagee for personal notification and the mortgagee did not give such notice to the debtor, that the mortgagee failed to act in good faith to obtain the best price reasonably possible.[138] The court found that the mortgagee owed a duty to the mortgagor and the broker in light of the active interest that they expressed in purchasing the property at the foreclosure sale: "[W]here a party expresses an interest in the proceeding, it would appear consistent with mortgagee/secured creditor duty to use due diligence."[139] However, the court also pointed out that the broker

133. *New York Guardian*, 527 N.Y.S.2d at 467.

134. *Id.*

135. 52 B.R. 177.

136. *Id.* at 179-80.

137. *Id.* at 180.

138. *Id.* at 179. The court determined that the property was worth approximately $60,000, an amount substantially more than the $36,700 bid at the foreclosure sale, which was attended by only the auctioneer, the bank's representative, and the successful bidder, a realty company with a business relationship with the bank. *Id.*

139. *Id.* at 181 (footnote omitted).

engaged in deception (by stating that there would be no sale), providing further evidence that the foreclosure sale was not properly conducted and, therefore, should be set aside.[140]

Some jurisdictions recognize that the mortgagee, when executing a power of sale, is bound not only by the statutory procedural requirements, but also by a duty to protect the interests of the mortgagor (i.e., to obtain a "fair price" for the property) through the exercise of good faith and due diligence in the sale. The court in *Murphy v. Financial Development Corp.*,[141] held that the lender had exercised its rights under the power of sale in good faith, but not in a manner that satisfied the requirement that the sale be conducted with due diligence in order to obtain a fair and reasonable price for the property. The court concluded that the lender had acted in good faith by not mishandling or dealing unfairly with the borrower; the lender had, in fact, "engaged in serious efforts to avoid the foreclosure" and had agreed, at the borrower's request, to one postponement of the sale.[142] At the sale, however, the lender was the only bidder and bid the amount of the loan. The court found that the lender had breached its duty to obtain a fair price because the lender was aware of the debtor's $19,000 equity in the property, and thus should either have adjourned the sale when no other parties attended or have established a minimum bid price.[143] In determining that the lender breached its duty of diligence, and not its duty of good faith, the court found that the lender had reason to know that the bid was not fair and that the borrower had equity in the property.[144]

Other jurisdictions have narrowly construed the duty that a lender owes a borrower in the context of a foreclosure proceeding, even when the lender is exercising a power of sale. Courts favoring this narrow construction have defined the lender's duty as merely not to act affirmatively to deter prospective buyers, rather than taking a broader view that lenders have a general duty to take affirmative action to ensure a "fair " foreclosure sale. Such courts have allowed the lender to bid less than the appraisal value and to obtain a deficiency judgment.[145]

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140. *In re Guilford*, 52 B.R. at 180. The court stated that the sale must be set aside because

> publication was not made of the actual sale date, no notice by publication or otherwise was given of the continued date and, not only was no announcement made of an adjourned date but, in fact, erroneous information was given that no sale was contemplated in the future, . . . the effect of which was to chill the sale and discourage potential bidders.

Id. at 181.

141. 495 A.2d 1245 (N.H. 1985).

142. *Id.* at 1249.

143. *Id.* at 1250.

144. *Id.* at 1251.

145. Pentad Joint Venture v. First Nat'l Bank, 797 S.W.2d 92, 96 (Tex. Ct. App. 1990).

Like the *Murphy* court, the court in *In re Tome* expanded the duties of the trustee beyond that provided for by statute, perhaps due in part to the deceptive acts that took place in that case. The lender's agent in *In re Tome* provided false and misleading information concerning the balance of a note, thus preventing the debtors from satisfying the note prior to the foreclosure sale.[146]

In re Tome contains interesting dicta and rulings regarding the notice requirements in the context of a sale postponed by a bankruptcy filing by the mortgagor and the operation of the automatic stay.[147] In *In re Tome*, the sale had been postponed on numerous occasions, and at each postponement the trustee announced merely the new sale date and time to those present. The court held that if property is sold under a power of sale without giving the debtor notice of the new sale date by mail, the notice of the new date must be republished, even though the applicable California statute permits a sale to be postponed without republication of notice.[148] Other courts in California, such as the court in *United States Cold Storage v. Great Western Savings & Loan Ass'n*,[149] have taken the opposite view on this issue and have not required notice of a postponed sale different from that which the California statute requires. Some state's foreclosure statutes do not expressly address the type of notice required when a sale is adjourned or postponed for reasons other than that an appointed officer fails to appear, in which case some courts have held that notice of the new date and time of sale must be given in the same manner as that required for the initial sale.[150]

Although this section has focused on defects regarding the notice of sale, it should be noted that in a power of sale context, courts have also invalidated foreclosure sales when the lender provides inadequate notice of its intent to accelerate the loan or inadequate notice that the loan had been accelerated.[151]

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146. *In re Tome*, 113 B.R. at 635. The court's analysis in this case is inconsistent with Justice Scalia's analysis in *BFP* because it applies bankruptcy law rather than state law even though Congress has not expressly provided for the preemption of state law by bankruptcy law. This decision is probably no longer good law in light of *BFP*.

147. The filing of a bankruptcy petition forestalls all actions by mortgagees, *inter alia*, to bring or continue actions against debtors without leave of court. *See* 11 U.S.C. § 362 (1988).

148. *In re Tome*, 113 B.R. at 636-37.

149. 212 Cal. Rptr. 232, 239 (Ct. App. 1985).

150. *See, e.g.*, South Shore Fed. Sav. & Loan Ass'n v. Foreal Homes, Inc., 447 N.Y.S.2d 187, 189 (Sup. Ct. 1982) (noting that one cannot, at the originally scheduled sale date and time, adjourn the sale for six hours and notify a party of interest of the new time for the sale 45 minutes prior to the sale).

151. *See, e.g.*, *In re Tome*, 113 B.R. 626 (explaining that a sale is invalid when proper notice is not received within a reasonable time before the sale); *Ogden*, 640 S.W.2d at 234 (holding that notice that the debt has been accelerated is ineffective unless preceded by proper notice of intent to accelerate); Tamplen v. Bryeans, 640 S.W.2d 421, 422 (Tex. Ct. App. 1982) (requiring both notice of intent to accelerate and notice of acceleration for a valid sale).

D. Claims That the Trustee or Other Party Handling the Foreclosure Sale Improperly Handled the Sale

As one might expect, a mortgagor or other party in interest can raise a claim to invalidate a foreclosure sale if the sales price is inadequate and if the sale is conducted in accordance with neither the terms of the foreclosure decree nor the procedures set forth in the applicable foreclosure statute.[152] A borrower or junior lender might also successfully challenge a foreclosure sale if the sale is conducted in a manner that unnecessarily harms the borrower's or a junior lender's interest. For example, under certain circumstances, mortgaged property may be sold at a foreclosure sale *en masse* without first being offered in separate parcels. The court in *Roberts v. Goodin*[153] held that a "court is warranted in setting aside a sale, where property sold en masse [sic] is susceptible of division and sold in separate tracts, and where the decree provides for the sale of only so much as is necessary, and where the sale of the entire property is not necessary."[154] In *Roberts*, the manner of the sale caused the appellee to needlessly lose her homestead. Thus, the lower court ruled that the foreclosure and sale were brought about as a fraud on the marital rights of the appellee.[155] Similarly, the court in *Flemming v. Tallerday*[156] affirmed the setting aside of a foreclosure sale on the basis of fraud, where property sold *en masse* for a grossly inadequate sum was susceptible of division.[157]

Any other aspect of the manner of the foreclosure sale may be attacked, especially when the trustee sells the property under a power of sale rather than by a judicial sale and when the sale is proven to be "unfair," leading to a grossly inadequate price.[158] Such attacks are more likely to succeed in the

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152. *See, e.g.*, Quinn v. Fidelity Fin. Servs. (*In re* Quinn), 69 B.R. 776, 779 (Bankr. W.D. Tenn. 1986) (noting that a foreclosure sale must be legally held, conducted, and consummated, and if there is evidence of any irregularity, misconduct, fraud, or unfairness on the part of the trustee or mortgagee that caused or contributed to an inadequate price, a court of equity may set aside the sale).

153. 123 N.E. 559 (Ill. 1919).

154. *Id.* at 561.

155. *Id.* at 560-61.

156. 124 N.E. 613 (Ill. 1919).

157. *Id.* at 615-16. The Illinois Appellate Court has subsequently held that the irregularity must amount to fraud, mistake, or illegal practice in order for a court of equity to set aside a foreclosure sale due to an inadequate sales price. Lyons Sav. & Loan Ass'n v. Gash Assocs., 545 N.E.2d 412, 416 (Ill. App. Ct. 1989) (holding that the purchase of property by a village at a foreclosure sale would not be set aside based upon the inadequacy of the bid price because the court did not find that the condemnation procedures initiated by the village against the property, which depressed the bidding at the foreclosure sale, amounted to fraud or illegality).

158. *See, e.g.*, Ulster Sav. Bank v. Bash, 494 N.Y.S.2d 413, 414 (App. Div. 1985) (stating that the referee's refusal to sign the high bidder's checks so that the bidder could cash them

context of a power of sale where the trustee is given more discretion to handle the sale in a "fair and open" manner and secure the best bid price,[159] than in a judicial sale where a statute will prescribe the precise manner of the sale. For example, in *Ulster Savings Bank v. Bash* the court held that, although the statute required a cash bid, the referee conducting the sale improperly refused to accept payment from the highest bidder in the form of cash and two out-of-state bank checks. The court held that the referee's refusal to endorse the checks "without recourse" "cast an aura of unfairness" over the conduct of the sale, causing a lower bid to prevail and justifying the setting aside of the sale.[160] Focusing on the duty of the trustee to obtain the highest possible bid price, the court in *Bank of Seoul & Trust Co. v. Marcione* invalidated a foreclosure sale because the trustee did not explain to a junior lender's representative that its bid had to be specific and had to exceed the amount of the prior bid; the representative had merely stated "we bid."[161]

As previously mentioned,[162] the two basic factors, (1) an irregularity in the handling of the foreclosure or the sale and (2) a resulting inadequate bid price, are interdependent and inversely related. Only a slight irregularity will be necessary if there is a grossly inadequate price and vice versa. Thus, the court in *Whitman v. Transtate Title Co.*,[163] held that the trustee's denial of a request for a one-day postponement of a sale was at most a mere irregularity that would not be the basis to set aside the trustee's sale, but that the refusal, coupled with the grossly inadequate bid price, was sufficient to set aside the sale.[164]

Another example of claims regarding the manner in which a foreclosure sale was conducted is illustrated in *In re Quinn*.[165] There the borrower complained that a prebankruptcy foreclosure sale was avoidable as a fraudulent conveyance because the sales price was inadequate. The foreclosure sale was conducted contemporaneously with the sale of another property that drew considerable interest while the sale of the debtor's property by a trustee pursuant to a power of sale was conducted without flags, banners, or loud

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rendered the sale unfair and invalid); Polish Nat'l Alliance v. White Eagle Hall Co., 470 N.Y.S.2d 642, 650 (App. Div. 1983) (holding that a collusive agreement between a mortgagor and a buyer rendering the price inadequate invalidated the sale).

159. *See* Bank of Seoul & Trust Co. v. Marcione, 244 Cal. Rptr. 1, 3 (Ct. App. 1988).

160. 494 N.Y. S.2d at 414.

161. *Marcione*, 244 Cal. Rptr. at 3.

162. *See supra* Part IV.B.

163. 211 Cal. Rptr. 582 (Ct. App. 1985).

164. *Id.* at 589 (noting that the bid constituted only approximately 20% of the value of the property).

165. 69 B.R. at 777.

speakers. Instead, the sale was conducted under the county's normal procedure of reading aloud the notice and taking bids at the county courthouse.[166]

The court rejected the debtor's argument, finding "no requirement that a foreclosure sale be conducted by using flags, signs, banners or loud speakers."[167] Unwilling to add to the requirements of the Tennessee foreclosure statute, the court held that the sale was legally held, conducted, and consummated.[168] The court also refused to "infer that bidders from the other foreclosure sale would have bid at the foreclosure sale of the debtor's property had the sale been delayed" because the other sale related to a commercial property, and because nothing indicated that the bidders would have had any interest in the debtor's residential property.[169] By resolving the claim of defect due to concurrent sales in this manner, the court nevertheless may have left open the possibility of a claim of unfairness if sales of similar property occur concurrently.

E. Claims Based on Mistakes and Technical Errors

Although ordinarily a minor technical error or mistake in the foreclosure sale process will not serve as the basis for setting aside a sale,[170] some mistakes (typically those which are material in nature and prejudicial to a party in interest) constitute an irregularity that can result in a foreclosure sale being set aside.[171]

In assessing whether to set aside a sale, some courts are apparently influenced by whether the mistake is bilateral or unilateral. For example, the

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166. *Id.* at 777.

167. *Id.* at 779.

168. *Id.*

169. *Id.*

170. *See, e.g.*, Stockman v. Money, Inc., 277 So. 2d 504, 508 (La. Ct. App. 1973) (holding that a mere clerical error does not affect the validity of the judicial sale); Fidelity Bond & Mortgage Co. v. Lucas, 523 N.Y.S.2d 125, 125 (App. Div. 1987) (refusing to set aside a sale despite a failure to move to confirm the sale within the time period prescribed by the applicable statute because this failure did not prejudice any substantial right of any party); Associates Fin. Servs. v. Davis, 519 N.Y.S.2d 707, 708 (App. Div. 1987) (refusing to set aside a sale where the sale was held one day after the requisite time period following publication of notice), *appeal dismissed*, 527 N.Y.S.2d 770, *appeal denied*, 530 N.Y.S.2d 554 (1988).

171. *See, e.g.*, Rosner v. Worcester (*In re* Worcester), 811 F.2d 1224, 1230 (9th Cir. 1987) (setting aside a foreclosure sale where the mortgagor made a valid tender of payment of indebtedness, and a material irregularity existed because of a misdescription of the property in sale notice); Fernandez v. Suburban Coastal Corp., 489 So. 2d 70, 71 (Fla. Dist. Ct. App. 1986) (setting aside a foreclosure sale where a grossly inadequate sales price resulted from the abstract company's failure to attend the sale and bid up to the extent of the mortgage balance); Charles F. Curry Co. v. Yodah Group, Inc., 617 N.Y.S.2d 264, 267 (Sup. Ct. 1994) (holding that a foreclosure sale should be set aside where the property was sold for an inadequate price, and the referee and mortgagor made a mistake as to adjustment of sale date).

court in *Crossland Mortgage Corp. v. Frankel* refused to set aside a judicial sale when the foreclosing lender's representative made a unilateral error in bidding.[172] In *Crossland*, the lender's representative had received bidding instructions for another property and mistakenly ceased bidding at $43,000, although he was authorized to bid between $160,000 and $200,000, the approximate value of the property. As a result, the borrower's father successfully bid $55,000.[173] Similarly, the mortgagee's attorney in *Long Island Savings Bank of Centereach, F.S.B. v. Jean Valiquette, M.D., P.C.*[174] incorrectly believed, due to his own error, that the time of the sale was 10:00 a.m. rather than the actual time of 8:45 a.m. By 9:45 a.m., the time the attorney arrived, the sale had already been concluded. The court noted that there were seventeen other bidders present at the sale and that the successful bid was fifty-seven percent of the value of the property. The court thus held that this attorney's inattention to detail did not provide sufficient basis for setting aside the sale.[175]

Other courts have been willing to set aside a foreclosure sale when the mortgagee makes a unilateral mistake that leads to a grossly inadequate bid price,[176] or has a chilling effect on bidding,[177] or causes "unfairness" to a party in interest.[178] In *Fernandez* the mortgagee's representative failed to appear at the sale because the mortgagee had confused the date of the sale with the dates of two other foreclosures that the mortgagee was planning to attend. In the mortgagee's absence, the mortgagor successfully bid $100 for a property worth approximately $54,300. The court affirmed the trial court's determination that the mortgagee's mistake constituted neglect, mistake, or inadvertence sufficient to set aside the judicial sale.[179]

In *Rosner v. Worcester*, the trustee under a deed of trust filed a notice of the trustee's sale that incorrectly stated that the property being foreclosed included a forty-acre parcel rather than a four-acre parcel. A third party successfully purchased the property at the sale for $14,975. That person sold the property three weeks later for $130,000; an appraiser testified that the

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172. Crossland Mortgage Corp. v. Frankel, 596 N.Y.S.2d 130, 131 (App. Div. 1993). The court in Curry distinguished the case before it from *Crossland* because *Curry* involved a mistake by both the referee conducting the sale and the mortgagor rather than a unilateral mistake. *Curry*, 617 N.Y.S.2d at 267.

173. *Crossland*, 596 N.Y.S.2d at 131.

174. 584 N.Y.S.2d 127 (App. Div. 1992).

175. *Id.* at 128.

176. *See Fernandez*, 489 So. 2d at 72.

177. *See Rosner*, 811 F.2d at 1230.

178. Burge v. Fidelity Bond & Mortgage Co., 648 A.2d 414, 421 (Del. 1994) (rejecting *Crossland* and holding that it was within the court's discretion to set aside a sale based upon the mortgagee's unilateral mistake when the mistake prejudices the mortgagee).

179. *Fernandez*, 489 So.2d at 72.

property was worth $240,000. The trustor argued that the sale should be set aside because of the grossly inadequate bid price and the misdescription in the notice of sale.[180] The court agreed and set the sale aside, reasoning that the misdescription of the tract's size would have deterred bidders interested in the smaller parcel from attending the sale.[181] Although the third-party bidder argued that it was a bona fide purchaser without notice of the irregularity and that the sale should not be set aside, the court found that the purchaser was not without notice of the irregularity because the deed of trust, which was part of the record, contained an accurate description of the property.[182]

F. The Bona Fide Purchaser Defense to a Voidable Foreclosure Sale

The bona fide purchaser defense should be mentioned before completing the survey of potential state-law challenges to foreclosure sales. Even if a borrower or junior lender asserts sufficient grounds to convince a court to set aside a foreclosure sale, if a third party bids successfully at a foreclosure sale, bids without "notice" of a defect in the sale, and pays "valuable consideration" for the property, a "voidable" sale will not be set aside. On the other hand, if a foreclosure sale is "void," then such a sale, even to a bona fide purchaser, will be set aside. A sale is void if there is no right to sell the property; a sale is voidable if there is a right to sell the property, but there is a defect in the manner in which it is sold.[183] Notice in this context means actual knowledge of the defect, constructive notice of the defect (i.e., a matter of record), or inquiry notice of the defect (i.e., because of what a bidder actually knows or what is of record, the bidder is put on notice to inquire further and such inquiry would cause the bidder to discover the defect in question).[184] In this context, valuable consideration means something more than a nominal amount. For example, the court in *Steward v. Good*[185] held that a bid of $4,780 for property that two years earlier had sold for $64,000 constituted valuable consideration. The court also ruled that because the bidder

180. *Rosner*, 811 F.2d at 1226-27.

181. *Id.* at 1230.

182. *Id.* at 1232.

183. *See, e.g.*, Rosenberg v. Smidt, 727 P.2d 778, 783-84 (Alaska 1986) (requiring "substantial defects such as the lack of a substantive basis to foreclose" to render a sale void, but allowing "a defect in a foreclosure sale" to render it "merely voidable").

184. *Id.* at 783; *see also* Swindell v. Overton, 314 S.E.2d 512, 517 (N.C. 1984) (holding that, because two separate debts were advertised, a bidder had notice of a defect of the sale of two separate tracts of land together when they were secured by two separate deeds of trust but noting that the debtor's absence from the sale did not give the bidder notice of the defect of failure to give the debtor personal notice of the sale).

185. 754 P.2d 150, 153 (Wash. Ct. App. 1988).

did not know whether the debtor had equity in the property, the amount of the bid was not so inadequate as to put the bidder on notice of a prejudicial defect in the sale.[186] Once a bidder shows that it had no notice of the defect and that it paid valuable consideration, the burden shifts to the party challenging the foreclosure sale to show that the bidder was not a bona fide purchaser because the bid was so inadequate that it should have put the bidder on inquiry notice of a defect in the sale.[187]

In summary, each state's foreclosure procedure varies based upon the particular state balancing of the borrower's and junior lender's interest in obtaining a fair price for the property, the senior lender's interest in a simple and inexpensive recovery of the collateral pledged after a default, and the third-party bidder's interest in a secure purchase of property that will not likely be set aside in the future. In reviewing challenges to foreclosure sales, courts balance these competing interests. Generally, courts will set aside a foreclosure sale at the confirmation hearing if the bid is unconscionable. Depending upon the circumstances of the case, an unconscionable bid can be one as high as fifty percent of its fair market value, but is typically less than twenty percent. Courts will also set aside a foreclosure sale after the judicial confirmation of the sale if a party with an interest in the property can show both a grossly inadequate sales price and some irregularity in the sale such as mistake, fraud, collusion, inadequate notice, or some other unfairness. If a foreclosure sale is conducted strictly in accordance with the requirements of a state's foreclosure laws, and the bid is not unconscionable, the foreclosure sale likely will be upheld; but if there is a defect that leads to a grossly inadequate bid, or if some type of fraud or collusion that chills the bidding occurs, the sale likely will be set aside.

VI. DID THE SUPREME COURT CORRECTLY INTERPRET "REASONABLY EQUIVALENT VALUE" AS IT APPLIES TO FORECLOSURE SALES?

A. The Use of Extra-Textual Sources to Support Diverging Views of the Ordinary or Plain Meaning of Section 548 of the Code

Although Justice Scalia is well known for applying a strict textualist approach to statutory interpretation[188] under which the primary, if not the

186. *Id.*

187. *Id.* at 152. Because the only defect in this case was a technical defect regarding the timing of the recording of notice, and because the debtor was not prejudiced, the court held that the sale was not even voidable. *Id.* at 153.

188. *See* Peter H. Carroll, III, *Literalism: The United States Supreme Court's Methodology for Statutory Construction in Bankruptcy Cases,* 25 ST. MARY'S L.J. 143, 147 (1993); Jeffrey R.

exclusive, focus is on the text of the statute, he also utilized numerous extra-textual sources to support his interpretation of the section's ordinary meaning. Chief Justice Rehnquist and Justice Stevens, who joined with Justice Ginsburg in Justice Souter's dissenting opinion, are well known for employing a text-controlled or literalism mode of statutory interpretation.[189] Similar to Scalia's strict textualism, the text-controlled approach interprets a statute by focusing on the plain meaning of the words. Both approaches emphasize that such plain or ordinary meaning can be derived most, if not all, of the time. Both approaches also substitute to some extent the policy of promoting predictability through developing interpretive rules of general applicability for the goal of perfectly ascertaining congressional intent.[190] Surprisingly, however, when faced with interpreting the phrase "reasonably equivalent value," both the majority and dissenting Justices resorted to various extra-textual sources to support their divergent views of the plain or ordinary meaning of those words. Among the extra-textual sources that Justice Scalia applied in rendering the majority opinion were (1) canons of statutory construction; (2) the history of fraudulent conveyance and foreclosure laws; (3) the goals and policies of foreclosure; and (4) an economic analysis of the impact a foreclosure proceeding has on the "worth" of property being foreclosed upon.[191] In rejecting the majority's interpretation of "reasonably equivalent value," the dissenting opinion also utilized extra-textual sources. The dissenting opinion contains an analysis of the legislative history of the Bankruptcy Code, with an emphasis on the bankruptcy objective of preserving and maximizing the value of the debtor's estate, and posits a differing view on the legitimacy of applying a fair-market-value concept to the foreclosure sale process.[192]

In interpreting the "reasonably equivalent value" requirement in section 548 of the Bankruptcy Code, Justice Scalia stated that one inquires into "whether the foreclosed property was sold for a price that approximated its worth at the time of sale."[193] The Justices could not agree, however, on the proper approach for determining the "worth" of the foreclosed upon property.

Justice Scalia rejected the use of fair market value because the words "fair market value" do not appear in section 548 of the Bankruptcy Code;[194] instead, the novel phrase "reasonably equivalent value" is used. Justice Scalia then cited a canon of statutory construction that provides that courts will presume that Congress acts intentionally when it includes particular language

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Stern, *Preemption Doctrine and the Failure of Textualism in* Cipollone v. Liggett Group, 80 VA. L. REV. 979, 981 (1994).

189. Stern, *supra* note 189, at 981.

190. *See* Stern, *supra* note 189.

191. BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1760-64 (1994).

192. *Id.* at 1767-77 (Souter, J., dissenting).

193. *Id.* at 1762.

194. *Id.* at 1761.

in one section of a statute and omits it in another, especially when it is replaced with a neologism.[195] Justice Scalia offered additional extra-textual arguments in rejecting the application of fair market value as the basis to determine worth, focusing on the economic realities of real estate foreclosures; namely, that foreclosures affect the "worth" of the foreclosed property due to the unique foreclosure procedures of each state that govern sending notice, advertising the sale, and other matters that affect bidding on the property.[196] Consequently, Justice Scalia concluded that "reasonably equivalent value" means neither fair market value nor a specified percentage of fair market value.[197]

Justice Scalia also rejected the concept of a fair or reasonable foreclosure price as the basis for determining worth and supported his rejection with a discussion of the history of fraudulent conveyance and foreclosure laws. After reviewing the history of fraudulent conveyance law (focusing on the need for actual intent to defraud creditors or the presence of certain "badges of fraud") and the important goals involved in state foreclosure laws (including the goal of assuring clear title to purchasers at a foreclosure sale to encourage bidding and to allow the secured lender to recover on her collateral), Justice Scalia concluded that requiring a fair or reasonable foreclosure sales price would extend federal bankruptcy law beyond the traditional field of fraudulent conveyance law and would disrupt the four hundred year-old peaceful co-existence of foreclosure law and fraudulent conveyance law.[198] Justice Scalia also cited, as grounds for rejecting a federally defined fair or reasonable foreclosure price, the canon of construction that militates against preempting state laws unless the intent to preempt is clear.[199] Justice Scalia argued that the phrase "reasonably equivalent value" is compatible with pre-existing practice under state foreclosure law. Moreover, the *Durrett* approach of setting aside a foreclosure sale by utilizing a standard beyond state foreclosure law[200] preempted important state law, in violation of the canon against preemption.[201] "To displace traditional [s]tate regulation in such a manner, the federal statutory purpose must be 'clear and manifest.' Otherwise, the Bankruptcy Code will be construed to adopt, rather than to displace, pre-existing state law."[202]

195. *Id.*
196. *BFP*, 114 S. Ct. at 1761.
197. *Id.*
198. *Id.* at 1764.
199. *Id.* at 1764-65.
200. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980).
201. *BFP*, 114 S. Ct. at 1764.
202. *Id.* at 1765 (quoting English v. General Elec. Co., 496 U.S. 72, 79 (1989)).

Justice Scalia cited several prior United States Supreme Court decisions to support this statement. In one such case, *Midlantic National Bank v. New Jersey Department of Environmental Protection*,[203] the Supreme Court stated:

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications. If Congress wishes to grant the trustee an extraordinary exemption from nonbankruptcy law, "the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt."[204]

Another Supreme Court decision cited by Justice Scalia, however, states that "Congress need not 'affirmatively proscribe' the common law doctrine at issue. . . . '[C]ourts may take it as a given that Congress has legislated with an expectation that the [common law] principle will apply except "when a statutory purpose to the contrary is evident."'"[205] Thus, preemption may be inferred, but not lightly.[206] In order to avoid preempting state foreclosure law and disrupting the harmonious co-existence of fraudulent conveyance law and foreclosure law, Justice Scalia ruled that the proper measure of the worth of foreclosed property is the amount received for the property at a noncollusive and regularly conducted foreclosure sale.[207]

Justice Souter, writing for the dissenting Justices, argued that the majority had adopted an exception to section 548 of the Bankruptcy Code that was contrary to the "straightforward language" used by Congress and that would lead to a "peppercorn" being paid for a valuable piece of property in a "noncollusive and procedurally regular foreclosure sale."[208] According to

203. 474 U.S. 494 (1986).

204. *Id.* at 501 (quoting Swarts v. Hammer, 194 U.S. 441, 444 (1904)).

205. United States v. Texas, 113 S. Ct. 1631, 1634-35 (1993) (citations omitted).

206. One state supreme court has explained that such inferences can properly be made only when the inference is "compelled due to an unavoidable conflict between the state law and the federal law." Behles v. New Mexico Pub. Serv. Comm'n (*In re* Timberon Water Co., Inc.), 836 P.2d 73, 77 (N.M. 1992) (citation omitted).

207. *BFP*, 114 S. Ct. at 1765. It is interesting to note that Justice Scalia's holding in *BFP* is consistent with ideas that he had previously expressed in a law review article. *See* Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175 (1989). In the article, Justice Scalia articulated the need for a mode of statutory interpretation that does not confer discretion on lower court judges, but instead promotes predictability in results through the creation of clear rules. Although Justice Scalia did not refer to this article in *BFP*, the ideas expressed therein are another example of an extra-textual source that may have influenced Scalia's interpretation of section 548.

208. *BFP*, 114 S. Ct. at 1767 (Souter, J., dissenting).

Justice Souter, the plain meaning of section 548 is that "the bankruptcy court must compare the price received by the insolvent debtor and the worth of the item when sold and set aside the transfer if the former was substantially ('[un]reasonabl[y]') 'less than' the latter."[209]

Justice Souter also focused on the legislative history of the Bankruptcy Code to support his view that the majority had misinterpreted section 548. Justice Souter noted that, in amending the Bankruptcy Code in 1984 to clarify that involuntary transfers pursuant to foreclosures are covered in section 548, Congress considered but did not enact an amendment that would cause the avoidance power to be "confined to foreclosures involving collusion or procedural irregularity."[210] Justice Souter also argued that the avoidance power under section 548 covered collusive or seriously irregular real estate sales prior to the 1984 Amendments. Therefore, Justice Souter reasoned, limiting the application of section 548 to this type of challenge renders the amendment superfluous and the Court should have applied the canon of construction against interpretations which render portions of a statute superfluous.[211]

In responing to Justice Scalia's rejection of a fair-market-value standard, Justice Souter employed another canon of interpretation. He argued that the majority inconsistently interpreted "reasonably equivalent value" in acknowledging that "something 'similar to' fair market value may supply the benchmark of reasonable equivalence when such a sale is not initiated by a mortgage . . . . A common rule of construction calls for a single definition of a common term occurring in several places within a statute."[212]

Justice Souter also relied upon the goals of the Bankruptcy Code to support his interpretation of section 548, arguing that the bankruptcy goals of maximum, equitable distribution for all the creditors of a debtor and the assurance of a fresh start are undermined by the majority's interpretation of section 548.[213] Finally, Justice Souter argued that the canon of presumption against preemption does not apply in this situation because the courts

> have never required Congress to supply a "clearer textual guidance" when the apparent meaning of the Bankruptcy Code's text is itself clear, as it is here. . . . Nor . . . is it appropriate for the Court to look to

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209. *Id.* at 1769 (Souter, J., dissenting). Justice Scalia responded to this point by noting that the dissenting Justices did not answer the question of what a foreclosed property is worth, but instead would leave this determination to the bankruptcy courts. *Id.* at 1766-67.

210. *Id.* at 1767 n.1 (Souter, J., dissenting).

211. *Id.* at 1770 (Souter, J., dissenting).

212. *Id.* at 1771 (Souter, J., dissenting) (citations omitted).

213. *BFP*, 114 S. Ct. at 1774 (Souter, J., dissenting).

"field preemption" cases . . . to support the higher duty of clarity it seeks to impose on Congress."[214]

Perhaps the most critical extra-textual source to which both the majority and dissenting opinion writers resorted in interpreting section 548 of the Bankruptcy Code is their own differing views on the ability of state foreclosure laws to protect the debtor's "equity,"[215] if any, in foreclosed-upon property and the compatibility of such foreclosure laws with "bankruptcy goals" (the dissent's inquiry) or fraudulent conveyance law (the majority's inquiry). Because the majority of the Justices view existing foreclosure laws as protecting the debtor's equity in the foreclosed property in a manner consistent with the historical function of fraudulent conveyance law (i.e., to set aside grossly inadequate sales or sales made with actual intent to defraud), the presumption against preemption applies. The dissenting Justices, however, believe that one can bid a peppercorn for a valuable piece of property at a regularly conducted, noncollusive foreclosure sale, a result that is clearly not harmonious with the bankruptcy goal of maximizing the value of the debtor's estate. Thus, Congress must have intended to preempt state foreclosure laws with the requirement of a fair or reasonable price. If the dissenting Justices' perceptions of foreclosure laws and their incompatibility with bankruptcy goals are flawed, then their rejection of the presumption against preemption is incorrect and, consequently, their interpretation of section 548 is also flawed. The next section of the article will analyze whether, under existing foreclosure laws, the debtor's equity in the foreclosed property is being protected in a manner consistent with bankruptcy objectives.

B. How Well Do Foreclosure Laws Work, and Are They Inherently Incompatible with Bankruptcy Objectives?

State foreclosure laws seek to balance the competing interests of the secured lenders in obtaining a relatively inexpensive and quick process to recover collateral pledged to secure bad debt, the borrowers' interest (and any interest of unsecured creditors or junior lenders of the borrower) in avoiding a forfeiture of equity that a borrower has in pledged property, and the third-party bidders' interest in obtaining clear title to liquidated property. State foreclosure procedures include many protections of borrowers' interests, such as notices to a borrower of default and acceleration of debt; a period of time that must lapse before a foreclosure sale can take place, typically about one

214. *Id.* at 1775, 1777 (Souter, J., dissenting).

215. Contrary to the dissent's approach and consistent with the majority's approach in *BFP*, this author suggests in Part VI.B that the debtors' equity should not be based upon the fair market value of the property, but rather should be based upon the value of the property as affected by the foreclosure process.

year; the equitable right of redemption prior to a sale (i.e., the right to pay the entire amount due on a loan and avoid foreclosure); the right to reinstate a loan (i.e., to cure a default without having to pay off the entire loan); and the statutory right of redemption, notice of the sale, advertising of the sale, and the right to challenge the sale on numerous grounds. All borrowers, not just borrowers who have defaulted, benefit from a foreclosure process that is relatively inexpensive and quick because this process will hold down the lender's initial loan transaction costs. Borrowers as a class also benefit when foreclosure laws reduce the amount of challenges that can be raised to the validity of the foreclosure sales. Reducing the cloud on title should encourage more third parties to bid, and more bidders competing to purchase will lead to higher bidding, thus reducing deficiencies.

Some argue that state legislatures, in creating foreclosure procedures, and the courts, in handling challenges to foreclosure sales, do not adequately balance the competing interests of the participants in real estate finance transactions. Some believe that, under current systems, senior lenders are able to reap windfalls at the expense of borrowers' equity in the property being foreclosed upon.[216] Others, mainly lenders, argue that foreclosure procedures in many states, as well as court rulings in connection with challenges to the validity of foreclosure sales, cause the foreclosure process to be too cumbersome, expensive, and uncertain. These problems reduce the likelihood that lenders will be made whole when an investment goes sour. Those who believe that existing state foreclosure laws inadequately protect the interests of debtors and junior creditors will logically believe that the Supreme Court did not properly balance the competing interests and goals in deciding *BFP*. Rather, they will believe that the decision will lead to even lower bid prices at foreclosure sales, because the sales will no longer require that the bid equal at least some fair percentage of the property's fair market value. On the other hand, those who believe that existing state foreclosure laws do adequately protect the interests of debtors and junior creditors will logically believe that the Supreme Court struck the correct balance in *BFP*. In their view, the decision will lead to greater certainty in title purchased at a foreclosure sale and will not increase foreclosure sale costs. Of course, reasonable arguments can and have been made by both camps regarding the cause of inadequate bidding at foreclosure sales and the appropriate response to the fact that parties do not bid the fair market value for property.

The scant empirical data on foreclosure sales that exist indicate that, on average, it is the secured lenders who suffer when no third parties bid the property's fair market value. According to a study of foreclosure sales in a rural county in New York, when a secured lender took over property at a

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216. *See generally* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 467-577 (3d ed. 1994).

foreclosure sale and resold the property to a third party, the lender lost an average of $14,000 upon resale.[217] Although eighty percent of the foreclosure sales left a deficiency (a total of 94 of the 118 foreclosures studied), the lender sued the borrower to recover the deficiency on only one occasion.[218]

Because the empirical data suggest that, on average, secured lenders are not made whole and almost never sue borrowers for deficiency judgments under current foreclosure laws, any reform of the foreclosure process that adds to the secured lender's losses would not be sound public policy. On the other hand, any reform of the foreclosure process that leads to bid prices that are closer to the fair market value of the property without increasing secured lenders' costs would serve both borrowers' and lenders' best interests and be sound public policy.[219] Interpreting section 548 of the Bankruptcy Code to require a bid of seventy percent of fair market value of foreclosed property, or some other fair price, will not address the real reasons that third parties do not bid at or near the fair market value of property in foreclosure. Such an interpretation could cause secured lenders to incur additional costs and, perhaps, would make it even less likely they will be made whole. The possibility of a sale being set aside within one year based upon the nebulous concept of a fair price under the circumstances is a cloud on title that (1) could depress the number of those willing to bid and the amount that they are willing to bid and (2) could encourage borrowers to file a bankruptcy action to set aside the foreclosure sale, which would force lenders to hire and pay for legal counsel to represent them in defending the validity of the sale.

Generally, there are three basic reasons why properties[220] sold at foreclosure sales do not sell at or anywhere near fair market value. First, borrowers must tender a sizable deposit, often as much as ten percent, and they must be able to pay the full bid shortly after the sale or lose the

217. Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 870 (1985).

218. *Id.* at 878; *see also* Robert J. Aalberts & Douglas S. Bible, *Mortgage Default in Louisiana: An Empirical Study of Recent Foreclosures on Residential Property in Caddo Parish*, 15 S.U. L. REV. 215, 220 (1988) (finding that plaintiffs seek deficiency judgments in only 1.9% of foreclosure suits).

219. *See, e.g.*, Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 VA. L. REV. 959, 961 (1993) (arguing that any reform of the foreclosure process must be done on the basis of maximizing the interest of all parties involved and not by shifting the costs of foreclosure to future borrowers); James G. Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis of Mortgage Foreclosure*, 36 S.C. L. REV. 461, 463-64 (1985) (arguing that because mortgage foreclosures are part of an economic transaction, efficiency should be the primary goal of the foreclosure process).

220. For purposes of simplification, this discussion assumes a residential as opposed to a commercial piece of real estate.

deposit.[221] By comparison, although a voluntary sale typically requires up to a ten-percent deposit at the time that the sales contract is entered into, a buyer usually has up to sixty days to obtain financing. If the buyer is unable to obtain financing during this time, the earnest money deposit will be returned. Second, the usual marketing of a foreclosure sale is limited to two or three advertisements in the legal notice section of newspapers of wide circulation. In a typical voluntary sale, however, a broker is hired to market the property, signs are posted on the property, and the property is advertised in the real estate section of a newspaper. Third, a potential bidder has much more difficulty in investigating the condition, both physical and legal, and the value of the property in an involuntary sale. The property owner in a foreclosure sale is less likely to open the home to inspection than the property owner in a voluntary sale. Furthermore, the time period between the advertising of the property and the foreclosure sale of the property is usually a matter of weeks, making it difficult to get an appraisal or to get title assurances.

One response to these problems is to call for reform of the foreclosure process by making it more "voluntary" to attract more bidders willing to bid at or near fair market value. However, such reforms would invariably lead to large delays in the sale of property and higher transaction costs in accomplishing the sale. One of the primary purposes of the foreclosure process is to terminate the debtor's equitable right of redemption in a relatively inexpensive and expedient process for the lender.[222] If, however, as the empirical data seem to indicate, the property's fair market value does not substantially exceed the secured debt, it is the secured lender who will incur the additional transaction costs not absorbed by a bid in excess of the debt. Secured lenders will then pass along these additional transaction costs by increasing the interest rates or fees they charge on new mortgage-secured loans.[223] Thus, borrowers should not insist on a foreclosure process that focuses exclusively on achieving bids at or near fair market value, because those same borrowers, having received loan proceeds at specified interest rates and fees, benefit from the existence of a foreclosure process that focuses on the secured lenders' interest in recovering the pledged collateral as quickly and inexpensively as possible.[224]

In light of the reasons that a foreclosure sale will not bring the same price as a voluntary sale and the balancing of competing interests each state performs in creating its specific foreclosure process, one can better appreciate Justice Scalia's definition of "worth" as the amount received at a noncollusive

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221. Johnson, *supra* note 220, at 962.
222. *Id.* at 989.
223. *Id.*; Durham, *supra* note 220, at 495.
224. *See* Johnson, *supra* note 220, at 989.

and regularly conducted foreclosure sale. In a similar vein, one could argue that the debtor's equity in the property to be protected in bankruptcy should, in fact, be based upon the value of the property as affected by the foreclosure sale, rather than upon the fair market value of the property. In interpreting section 548 as requiring the receipt of a fair or reasonable price in excess of what state foreclosure laws require, the dissenting Justices failed to recognize the incongruous overlay of a federally determined fair price on state foreclosure sales, where the bid at the sale is affected by the particular foreclosure procedures, and protections adopted by each state's legislature and courts.

Justice Scalia's use in *BFP* of the canon against federal preemption of important state laws absent a clear intent to preempt is also sound because current foreclosure laws are not inherently incompatible with fraudulent conveyance law or even bankruptcy objectives. Historically, to set aside a transfer of property, the party challenging the transfer must show actual intent to defraud or constructive fraud based upon a grossly inadequate price, not a transfer for less than fair market value. Under *BFP*, collusive foreclosure sales or sales for grossly inadequate prices generally can be set aside if such sales could be challenged under existing state foreclosure laws. If one measures a debtor's equity by considering the value of the property as affected by the foreclosure process, then the Court's ruling is completely compatible with the bankruptcy goal of maximizing the debtor's estate. Moreover, the objective of maximizing the debtor's estate for the benefit of the debtor and all the debtor's creditors is limited by the concept that such maximization cannot alter prebankruptcy relative entitlements among creditors.[225] Thus, a finding of congressional intent to preempt existing state law is not compelled by section 548.

VII. IMPLICATIONS AND RECOMMENDATIONS REGARDING FUTURE CONDUCT

Based upon the types of successful challenges that have been made to set aside foreclosure sales under state foreclosure laws, and given the Supreme Court's ruling in *BFP*, certain implications and practice recommendations become clear.

A. Implications to Senior Lenders

First, scrupulous compliance with the procedures of applicable state foreclosure laws is critical. In the absence of some defect or irregularity in the foreclosure process, a party must show a bid price that shocks the judicial

225. Johnson, *supra* note 220, at 1002.

conscience in order to convince most courts to set aside a sale.[226] If, however, a party is able to show some defect or irregularity, the party needs to show only that the defect or irregularity led to a grossly inadequate bid or chilled bidding to the prejudice of a party in interest.[227] Under *BFP*, a foreclosure sale that could be set aside under the state's foreclosure laws loses its presumption of being for "reasonably equivalent value." By scrupulously complying with state foreclosure laws, one can dramatically reduce the likelihood of a successful fraudulent conveyance challenge to the sale under section 548 of the Bankruptcy Code.

Second, a party should order an appraisal of the property prior to the foreclosure sale to ensure that the party bids an adequate amount.[228] As previously discussed, the bid cannot be grossly inadequate (in some cases, a bid for less than fifty percent of the value is considered grossly inadequate); moreover, if there is fraud, deception, or collusion involved that chills bidding, perhaps the only valid defense that a successful bidder could raise is that the bidder nonetheless paid fair value.[229]

Third, a party should be careful in making any preforeclosure sale arrangements regarding bidding. Under the common law, any agreement not to bid was considered to violate public policy.[230] Today, any arrangement designed to prevent the free and fair competition among bidders, which has a chilling affect on the sale and causes the property to be sold for less than market value, will cause the sale to be set aside as collusive.[231] For example, if a foreclosing lender and a third party agree prior to the sale that the lender will bid and that the third party will purchase from the lender after the sale, a court might deem this arrangement collusive if its purpose is to chill bidding and if it leads the borrower to receive less than fair value for the property and the lender to receive more than the amount due on the mortgage.

Fourth, the foreclosing lender and its officers, partners, and agents must not make any inaccurate statements to the borrower or any potential bidder regarding any aspects of the foreclosure sale. Such deception or any form of unfairness can cause a court to set aside the sale.[232]

Fifth, a trustee should be careful in exercising a power of sale. Because a trustee is given more discretion in the procedures for the sale, some courts

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226. *See supra* Part V.B.

227. *See supra* Part V.B.

228. The court in Casey v. NationsBank (*In re* Casey), 173 B.R. 581, 584-85 (Bankr. E.D. Tex. 1994), stated in dicta that a lender can utilize an appraisal of the property in determining the amount it will bid and can even challenge the assumptions underlying an appraisal to convince the appraiser to lower the value reflected in the appraisal.

229. *See supra* Part V.C.

230. *See supra* Part IV.B(1).

231. *See supra* Part IV.A.

232. *See supra* Part V.C.

have imposed a duty on the trustee to exercise that discretion in a manner that will lead to the best bid price possible; failure to meet this duty can lead to the foreclosure sale being set aside.[233]

Sixth, a party should not err in complying with technical requirements that are sometimes overlooked, but that can lead to invalidation of a foreclosure sale, such as failing to give adequate notice of a postponed sale (a common occurrence when the mortgagor is in bankruptcy); failing to deliver notices as required by the foreclosure statute and applicable civil procedure rules; making a nominal bid and expecting to be credited for the amount of senior secured debt without waiving one's right to a deficiency prior to the sale.[234]

Seventh, a party should insist on receiving an insurance policy that does not contain the so-called "creditor's rights" exception (a carve-out of insurance that title insurers added to their policies due to *Durrett* and its progeny), both when obtaining a lender's title insurance policy when a mortgage loan is first made and when obtaining an owner's policy if the successful bidder at the foreclosure sale.

Eighth, in deciding whether to pursue a deed-in-lieu of foreclosure, a party should consider the potential application of *BFP* to this type of arrangement. Although the *BFP* presumption of reasonably equivalent value clearly applies to the sale of property under a judicial sale or a power of sale, it does not appear to apply to a deed-in-lieu, unless the deed-in-lieu is procured pursuant to statutory procedures.[235]

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233. *See supra* Part V.C.

234. Ordinarily, the amount of the borrower's debt is credited to the amount that the lender bid for purposes of determining whether the bid price was grossly inadequate under state law. *See, e.g.*, Polish Nat'l Alliance v. White Eagle Hall Co., 470 N.Y.S.2d 642, 648-49 (App. Div. 1983). At least one court, however, has stated in dicta that, under section 548 of the Bankruptcy Code, in order for a lender to be accorded credit for a deficiency amount due on a debt when the lender has bid less than the amount of the debt, the lender must release its right to a deficiency on or before the foreclosure sale. Gutierrez v. Lomas Mortgage (*In re* Gutierrez), 160 B.R. 788 (Bankr. W.D. Tex. 1993).

235. The holding in *BFP* was confined to whether the amount bid at a regularly conducted and noncollusive real estate foreclosure sale would be conclusively presumed to constitute reasonably equivalent value. Should a deed in lieu of foreclosure, performed in accordance with any state law requirements, also be deemed reasonably equivalent value in light of the reasoning of *BFP*? The problem with applying a presumption of reasonably equivalent value with a deed-in-lieu of foreclosure is that there is no judicial review prior to the conveyance and no notice or advertising of the conveyance. However, some states have enacted statutes that provide for the structure of a deed in lieu of foreclosure. For example, in Illinois, if a borrower agrees to a deed-in-lieu, the borrower is, by statute, released from personal liability on the debt, unless the borrower agrees to remain personally liable on the debt. *See* ILL. COMP. STAT. ch.735, para. 5/15-1401 (Smith-Hurd 1993). Perhaps the judicial deference Justice Scalia displayed towards state foreclosure laws in applying section 548 of the Bankruptcy Code will extend to deed-in-lieu of foreclosure transactions when they are regularly conducted in accordance with state law. Some might argue

B. Implications to Borrowers Or Junior Lenders

Many of the practice points discussed above apply equally to the borrower or other party challenging a foreclosure sale, but from the opposite perspective. However, borrower's and other challengers should keep in mind some particularly important points to increase the likelihood of a successful fraudulent conveyance challenge after *BFP*.

First, borrowers and other parties should bring any challenges, if possible, at the confirmation hearing rather than after the confirmation hearing because the standard for setting aside a foreclosure sale is easier to meet at the confirmation hearing in many jurisdictions.

Second, if a party does not discover the basis for a challenge until after confirmation of the sale, the party should still bring the claim as soon as possible after discovery because failure to bring the claim with due diligence may cause waiver or loss of the claim.

Third, a party should try to find a defect in the foreclosure procedures and try to convince the court that the defect prejudiced the party challenging the sale. Inadequacy of the bid alone will not serve as the basis for setting aside a confirmed sale unless the bid is unconscionable; however, if a prejudicial defect led to a grossly inadequate bid, a court may set aside a confirmed sale.

Fourth, if the foreclosure was through a power of sale, a party may be able to challenge the trustee's or lender's failure to exercise due diligence in obtaining a fair price. Some jurisdictions place a duty on the trustee and the lender to exercise the power of sale in good faith and with due diligence.

VIII. CONCLUSION

Notwithstanding the gasps emanating from the reviewers of *BFP*, the emperor still has clothes. Trustees in bankruptcy will still be able to bring numerous fraudulent conveyance challenges to foreclosure sales under state foreclosure law. Under existing foreclosure laws, foreclosure sales can be set aside not only when there is an unconscionable bid, or a collusive agreement for the purpose of chilling bidding, but also when there is some defect that leads to a grossly inadequate bid. In many jurisdictions, a court can refuse to confirm a sale solely for a grossly inadequate bid. In addition, the dicta in some of the reviewed cases suggests that some courts might find certain presale arrangements to be collusive based upon "badges of fraud," rather than requiring actual intent to chill bidding.

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that the reasoning of *BFP* should not apply to a deed-in-lieu because there is no public sale at which junior lenders could bid. One response is that the junior lender's rights are not cut off by a deed-in-lieu as they are with a judicial sale.

However, the emperor is not overdressed. A defect that occurs in the foreclosure sale procedures and that does not prejudice a party in interest will not serve as the basis for a fraudulent conveyance challenge under a proper reading of *BFP*.

What the emperor should be wearing was a matter of deep division among the Justices of the Supreme Court. The majority and the dissenting Justices disagreed as to the plain or ordinary meaning of section 548 of the Bankruptcy Code. In ascertaining such meaning, both the majority and dissenting opinions utilized extra-textual sources to support their diverging views. Among the extra-textual sources each relied upon were their differing views of the compatibility of foreclosure laws with fraudulent conveyance principles and bankruptcy objectives. The majority opinion correctly concluded that foreclosure laws are compatible with fraudulent conveyance laws because both would set aside transfers for grossly inadequate consideration or for actual intent to defraud. The dissenting opinion incorrectly concluded that state foreclosure laws so inadequately protect the borrower's equity that such laws are clearly incompatible with bankruptcy objectives.

Indeed, when the debtor's equity is accurately defined for purposes of a section 548 challenge, the Court's ruling in *BFP* becomes even more compatible with bankruptcy objectives. As previously discussed, a by-product of the goal of reducing transaction costs associated with foreclosure sales is the difficulty for potential buyers to produce the cash necessary to purchase the property or to perform the typical investigations of, or receive assurances on, items that are usually performed prior to the voluntary closing of a purchase of real estate. As a result, bidders at foreclosure sales do not bid the fair market value, but instead bid fair market value as affected by the foreclosure process. In light of this reality, the borrower's equity in foreclosed property for purposes of section 548 should be defined not as the fair market value of the property, but as the fair market value as affected by the foreclosure process (a process by which the borrower benefitted when the loan was first made). If equity is so defined, *BFP* is completely compatible with the bankruptcy goal of maximizing the debtor's estate (i.e., the debtor's equity in the property foreclosed upon). This being the case, the court in *BFP* correctly applied the presumption against federal preemption because state foreclosure laws are not sufficiently incompatible with bankruptcy goals to justify inferring the intent to preempt.

As previously discussed, empirical data indicate that when third parties fail to bid at or near the fair market value of the property at a foreclosure sale, secured lenders suffers more than debtors. On average, lenders lose more than they gain when they purchase at a foreclosure sale and then resell the property to third parties, yet lenders rarely sue debtors for a deficiency when the amount of the debt exceeds the bid at the foreclosure sale. Thus, any reform of the foreclosure sale process should strive to encourage third parties to bid close to fair market value for the property but not to increase the transaction costs associated with the sale (unless, perhaps, if the fair market value of the property significantly exceeds the outstanding debt on the property), because it is often the lender who will have to absorb those costs and add them to the losses from the bad debt.

To the extent that critics of *BFP* attempt to better protect borrowers' equity in foreclosed property, they should seek to reform on a state-law basis rather than to impose a fair foreclosure price requirement on top of an existing state foreclosure system. They should also consider focusing on the fairness and efficiency of the foreclosure sale process in the context of the entire lending relationship.

Some states, such as Illinois,[236] have enacted legislation that attempts to make the foreclosure process more like a voluntary sale. For example, under the Illinois statute, upon the request of a party, the court can order, among other things, that a broker be hired to market the property with an agreed-upon commission payable from the proceeds of the sale, that signs be posted on the real estate, and that title insurance be provided in a specified form. One way to test the legacy of *BFP* would be to perform an empirical study of foreclosure sales in Illinois and compare the results with the results of empirical studies of foreclosure sales in other jurisdictions that do not contain such special provisions. The study might also gather data as to the amounts bid in foreclosure sales prior to *BFP* and compare them with the amounts bid after the decision to see whether the removal of the federal cloud on title improves bidding or whether the removal of the additional challenges instead causes even lower bidding. This author is currently working on such an empirical study. Perhaps such a study can more definitively establish whether, after *BFP*, the emperor is properly clothed after all.

236. ILL. COMP. STAT. ch. 735, para. 5/1506(f) (Smith-Hurd 1993).