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THE CONTROVERSY OVER SECTION 548 OF THE BANKRUPTCY CODE IN THE MORTGAGE ARENA: MAKING THE CASE FOR A FEDERAL STATUTE REFORMING THE FORECLOSURE PROCESS

Until the 1930's, state law almost exclusively governed real property mortgages.¹ Beginning in the 1930's, the federal government began to take a more active role in the mortgage arena.² This role has increased steadily to dynamic proportions today.³ Despite

1. A mortgage is a conveyance of an interest in land given as security for a debt. *See, e.g.,* R. KRATOVIL, *MODERN MORTGAGE LAW AND PRACTICE* § 1.1 (2d ed. 1981). Mortgages, like other property interests, are created and defined by state law and thus, traditionally have been governed by state law. *See* Lance, *Balancing Public and Private Initiatives in the Mortgage Backed Security Market*, 18 *REAL PROP. PROB. & TR. J.* 426, 429 (1983). *See also* *Butner v. United States*, 440 U.S. 48, 55 (1978) (noting great respect traditionally given to state property law in federal courts).

An estimated thirty percent of all of the outstanding debt in the United States is secured by real property mortgages. G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* § 11.1 (2d ed. 1985). Mortgages secured by one of four family homes account for 68% of the total mortgage debt in the United States. *Id.* Of the remaining mortgage debt in this country, 18% is secured by commercial properties, 8% by multifamily apartment buildings, and 6% by farm properties. *Id.*

2. The term "mortgage arena" will be used throughout this comment to refer in a broad sense to all of the persons and entities—including but not limited to banks, savings and loans, governmental agencies, investors, and mortgage borrowers—that collectively participate in and affect mortgage lending in the United States.

3. Beginning around the Depression of the 1930's, the federal government altered its "hands off" approach to the mortgage arena and became involved in this arena both as a participant and as a regulator. Comment, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 *EMORY L.J.* 971, 975 (1987). Since that time, federal involvement in the mortgage arena has increased dramatically to the point where the federal government's presence pervades all aspects of the mortgage arena today. *See generally* G. NELSON & D. WHITMAN, *supra* note 1, § 11.1. *See also* R. KRATOVIL & R. WERNER, *REAL ESTATE FINANCE LAW* §§ 20.05-.07 (9th ed. 1988); Kratovil, *Mortgage Law Today*, 13 *J. MARSHALL L. REV.* 251 (1980).

The federal government manifests its presence in the mortgage arena in several ways. One manner in which the federal government substantially influences mortgage finance is through its regulation of federally chartered savings and loans (governed by the Federal Home Loan Bank Board ("FHLBB") and the Federal Savings and Loan Insurance Corporation ("FSLIC")), and federally chartered commercial banks (governed by the Federal Deposit Insurance Corporation ("FDIC") and the Federal Reserve Board). G. NELSON & D. WHITMAN, *supra* note 1, § 11.1. Commercial banks and savings and loan associations provide almost half the mortgage loans in the United States. *Id.* Thus, federal regulation of the loan practices of these entities substantially affects the mortgage arena. *Id.*

Another way that the federal government influences the mortgage finance arena is through its widespread provision of mortgage insurance to homebuyers. *See* R. KRATOVIL & R. WERNER, *supra*, § 20.06. The Department of Housing and Urban Development ("HUD"), primarily through the Federal Housing Administration

the strong presence of the federal government in the mortgage arena today, state law continues primarily to govern mortgage foreclosures.⁴ Federal bankruptcy law, however, has had an increasingly

("FHA"), is the largest federal mortgage insurer; the Veteran's Administration ("VA") and the Farmers Home Administration ("FmHA") also extensively provide mortgage insurance to real estate purchasers. *Id.* § 20.41. Under these mortgage insurance programs, the mortgagor makes a down payment for a purchase and receives a loan from a private lending institution; payment of this mortgage loan is guaranteed by the federal government. *Id.* § 20.06. These federally insured mortgage loans are subject to an array of federal regulations that substantially affect mortgage lenders. *See, e.g.*, 24 C.F.R. § 203.1 (HUD regulations for FHA mortgages). For a more complete discussion of these federal insurance programs, see G. NELSON & D. WHITMAN, *supra* note 1, § 11.2. For a discussion of federal loan guarantee programs in general, see Brooks, and Cheever, *The Federal Loan Guarantee Program: A Unified Approach*, 10 J. CORP. LAW. 185 (1984).

Federal involvement in the secondary mortgage market also substantially affects mortgage finance. The modern mortgage arena is divided into two markets: the primary market of original mortgage lenders, such as banks and savings and loans, and the secondary market of investors who purchase the loans from the lenders and hold them in portfolios as long-term investments. R. KRATOVIL & R. WERNER, *supra*, § 20.07. Although private entities play a role in the secondary mortgage market, federal entities are the most prominent participants. Pittman, *Economic and Regulatory Developments Affecting Mortgage Related Securities*, 64 N.D.L. REV. 497, 499-500 (1989). Private participation in the secondary mortgage market has grown in the past few years since Congress passed the Secondary Mortgage Market Enhancement Act (codified at scattered sections of 12 U.S.C. and 15 U.S.C.) to encourage more of such participation in this market. *Id.* at 512-51.

Federal participants in the secondary mortgage market today include the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"). *Id.* These entities purchase large numbers of loans from banks and savings and loans and sell common stock in these loans to the public. G. NELSON & D. WHITMAN, *supra* note 1, § 11.3. These federal entities in the secondary mortgage market pervasively influence the practices of primary mortgage lenders. *See, e.g.*, Creely, *Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts*, 42 VAND. L. REV. 133, 145-49 (1989) (discussing pressures exerted by secondary market on standardizing mortgage documents). *See also* R. KRATOVIL & R. WERNER, *supra*, § 20.14 (noting that almost all mortgage lenders today use the standard FNMA form of mortgage and note). For a general discussion of the intricacies involved with the secondary mortgage market, see Comment, *Secondary Mortgage Market*, *supra*, at 973-91. *See also* Murray and Hadaway, *Mortgage Backed Securities: An Investigation of Legal and Financial Issues*, 11 J. CORP. LAW. 203 (1986) (discussing securities issues surrounding secondary mortgage market); Pittman, *supra*, at 499-512 (discussing various types of mortgage "products" available in secondary mortgage market).

For further discussion of federal regulation of the mortgage arena, see *infra* note 111.

4. The federal government does, however, influence mortgage foreclosures in some ways. For example, the Department of Housing and Urban Development has enacted numerous regulations that may prevent or delay foreclosure of federally insured mortgage loans. *See* 24 C.F.R. § 203.600. *See also* Federal Nat. Mortg. Ass'n v. Moore, 609 F. Supp. 194 (N.D. Ill. 1985) (illustrating the consequences of failure to comply with these requirements). Moreover, in cases where a federal agency forecloses on a federally insured mortgage, federal law may preempt many state foreclosure procedures. *See* Note, *Toward Adoption of the Federal Rule of Decision in Cases Involving Voluntary Federal Creditors*, 73 MINN. L. REV. 171 (1988) (providing good overview of federal preemption in this area). Nevertheless, these provisions have no bearing on the structure of the foreclosure sales.

Congress, however, has enacted a comprehensive statute governing the foreclo-

pervasive impact on mortgage foreclosures in recent years.⁵

Section 548 of the Bankruptcy Code, which pertains to fraudulent transfers, has proven to be the Bankruptcy Code's most controversial provision in the mortgage arena.⁶ Under section 548, a debtor can set aside a transfer of property if, at the time of the transfer: 1) the debtor had an interest in the property transferred; 2) the debtor was insolvent or became insolvent as a result of the transfer; 3) the transfer occurred within one year of the filing of the bankruptcy petition; and 4) the transfer was for less than a "reasonably equivalent value."⁷ In the past decade, federal courts for the first time have

sure of all federally insured mortgages of multi-family (i.e., over four unit) apartment buildings. See 12 U.S.C. § 3701 (1989). This statute governs foreclosure sales as well as pre-foreclosure procedures, but because it applies only to federally insured multi-family mortgages, its impact is very limited.

5. The Bankruptcy Code provision which most often impacts on the mortgage arena is Section 362 of the Bankruptcy Code. 11 U.S.C. § 362 (1982). Under § 362, foreclosure proceedings are stayed automatically when a mortgagor files for bankruptcy before foreclosure is complete. 11 U.S.C. § 326(a) (1982). This provision substantially delays or even prevents foreclosure from occurring if a mortgagor files for bankruptcy prior to completion of the foreclosure proceeding. Nelson, *The Impact of Mortgagor Bankruptcy on the Real Estate Mortgage: Current Problems and Some Suggested Solutions*, 50 MO. L. REV. 217 (1985); W. COLLIER, COLLIER ON BANKRUPTCY § 362 (15th ed. 1979). Although not an easy task, mortgagees can, however, obtain relief from the automatic stay. 11 U.S.C. § 362(d) (1985).

For a good general discussion of the Bankruptcy Code's automatic stay provision, see Johnson and O'Leary, *Automatic Stay Provisions of the Bankruptcy Act of 1978*, 13 N.M.L. REV. 599 (1983). For a discussion of other effects of federal bankruptcy law in the mortgage arena, see Nelson, *supra*.

6. See 11 U.S.C. § 548 (1982). See *infra* notes 84-106 and accompanying text (discussing disagreement among federal courts as to proper application of § 548 in this context).

7. 11 U.S.C. § 548(a) (2) (1982 & Supp. 1988). Section 548 provides, in pertinent part:

- (a) The trustee may avoid any transfer of an interest of the debtor in property . . . that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily -
- (2) (A) received less than a reasonably equivalent value in exchange for such transfer . . . and
- (B) (i) was insolvent on the date that such transfer was made . . . or became insolvent as a result of such transfer. . . .

Id.

Section 548 of the Bankruptcy Code has its origins in the Statute of Fraudulent Conveyances of 13 Elizabeth, which was enacted in England in 1571. Baird and Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985). The Statute of Fraudulent Conveyances was designed to prevent debtors from making transfers with the intent to hinder, delay, or defraud creditors. *Id.* at 829. Because of the difficulty in proving fraudulent intent on the part of debtors, common law courts developed rules, known as "badges of fraud," which treated transfers of property in certain circumstances as fraudulent *per se*. *Id.* at 830. One such rule that developed was that transfers of property by insolvent debtors for less than fair consideration would be treated as fraudulent conveyances. *Id.* Section 548(a) (2) is the Bankruptcy Code's version of this rule.

For an excellent discussion of the evolution of fraudulent conveyance law from its common law origins to its present form, see Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531 (1987). See also Ehrlich, *Avoidance of Foreclosure*

interpreted section 548 as applying to mortgage foreclosure sales.⁸

This application of section 548 is largely due to the fact that the typical foreclosure sale yields far less than the fair market value of the property being sold, thereby giving the purchaser at the sale a windfall at the expense of the mortgagor's unsecured or undersecured creditors.⁹ Applying section 548 to foreclosure sales can provide relief for the mortgagor and his creditors in individual instances where the mortgagor has subsequently filed for bankruptcy by giving the bankruptcy trustee the opportunity to resell the property at a price which presumably will more closely reflect the property's true market value.¹⁰ At the same time, however, applying section 548 in this context destabilizes the certainty of titles transferred at foreclosure sales, and thus is likely to exacerbate the underlying problem of inadequate foreclosure sale prices.¹¹

This comment will explore the various policy issues that are raised by applying section 548 in the mortgage foreclosure sale context. Part I will trace the historical development of current state foreclosure procedures and discuss the failure of these procedures to achieve their intended results. Part II will discuss the federal courts' approaches to section 548 in this context, concluding that all of these approaches are remiss in at least one respect. Part III will conclude that a federal foreclosure reform statute preempting state foreclosure laws is the only satisfactory solution to the above problem, and that Illinois' new foreclosure law should be the model for this federal statute.¹²

Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives, 71 VA. L. REV. 933, 944-53 (1985); Baird & Jackson, *supra*.

8. See *infra* notes 75-83 and accompanying text (discussing policy considerations involved in this new application of § 548).

9. See *infra* notes 77-79 and accompanying text (applying § 548 to foreclosure sales is consistent with section's underlying purpose).

10. Most mortgagors facing foreclosure will have at least some "equity" in the property. See *infra* note 64. Equity in this context is "the amount of value in a property above the total liens or charges . . . thus, an equity of \$5,000 may come about by having fair market value property of \$20,000 with debt of \$15,000." BLACK'S LAW DICTIONARY 484 (5th ed. 1979). By setting aside the foreclosure sale, the bankruptcy trustee can resell the property in the regular real estate market and presumably obtain a price approximating the property's true market value. Thus, in cases where the property's market value exceeds the amount of the mortgage debt, the bankrupt's estate can recoup at least some of the mortgagor's equity for the benefit of the mortgagor's other creditors. Cf. W. Collier, *supra* note 5, § 548.01.

11. See *infra* notes 80-83 and accompanying text (discussing potential harmful effects of applying § 548 to foreclosure sales).

12. This comment will focus on the problems caused by § 548 in the residential mortgage context. Although many of the suggested reforms would be just as applicable in the commercial mortgage context, because commercial mortgagors tend to be much more sophisticated than their residential counterparts, less safeguards are necessary in the commercial context. For a discussion of some of the possible variants in the proposed federal foreclosure reform act for the two types of mortgagors, see *infra* note 138.

I. THE EVOLUTION OF MODERN DAY STATE FORECLOSURE PROCEDURES

A mortgage is a conveyance of an interest in land given as security for the payment of a debt.¹³ American mortgage law has its roots in the English common law.¹⁴ Consequently, to understand the development of American mortgage law, an understanding of the evolution of the common law mortgage is necessary.

A. *The Common Law Mortgage*

While mortgages in some form existed for centuries before,¹⁵ the common law mortgage in fourteenth century England generally is considered to be the ancestor of the modern day American mortgage.¹⁶ The mortgage in fourteenth century England consisted of a borrower ("mortgagor") conveying legal title in a parcel of land to a lender ("mortgagee") to secure a debt between the parties.¹⁷ Such a transaction resulted in the mortgagee receiving all of the incidents of legal title in the parcel of land, including the right to possession.¹⁸ The conveyance of legal title to the mortgagee was subject to one condition: if the mortgagor paid the debt in full on a specified day (commonly referred to as "law day"), the rights of the mortgagee terminated and legal title returned to the mortgagor.¹⁹ However, if the mortgagor failed to pay the debt on law day, the mortgagor's interest in the land was automatically extinguished.²⁰

The common law courts strictly enforced the terms of the mortgage, and a mortgagor was thus faced with the harsh result of being immediately dispossessed of his interests in the property if he failed

13. R. KRATOVIL, *supra* note 1, § 1.1.

14. *Id.* See also G. Nelson & D. Whitman, *supra* note 1, § 1.2 (noting that the common law not only substantially influenced the substance of American mortgage law but is responsible for much of its terminology as well).

15. See G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 104 (discussing the various forms of mortgages in the twelfth and thirteenth centuries).

16. G. NELSON & D. WHITMAN, *supra* note 1, § 1.2; R. KRATOVIL, *supra* note 1, § 1.2.

17. G. OSBORNE, *supra* note 15, § 5.

18. G. NELSON & D. WHITMAN, *supra* note 1, § 1.2. Although the mortgagee had the right to possession of the property during the term of the mortgage, any rents collected by the mortgagee had to be applied to the mortgage debt. R. KRATOVIL, *supra* note 12, § 1.2. Thus, the mortgagee often permitted the mortgagor to remain in possession of the property. *Id.*

19. R. KRATOVIL, *supra* note 1, § 1.2.

20. *Id.* No excuse for late payment was allowed to relieve the mortgagor from automatically losing his rights in the property. See 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, 855-56 (1985).

to fully comply with all terms of the mortgage.²¹ Consequently, the English chancery courts began to intervene to protect mortgagors from these inequitable results.²² By the seventeenth century, the chancery courts routinely allowed a mortgagor to redeem his land from the mortgagee if he tendered the principal and interest due within a reasonable time after law day.²³ The mortgagor's right of late payment became known as the "equity of redemption,"²⁴ and the chancery courts struck down any mortgagee's attempt to limit the mortgagor's right.²⁵

Along with recognizing the mortgagor's equity of redemption, the chancery courts recognized that this right was not perpetual; at some point, a defaulting mortgagor's interest in the property had to terminate to be fair to the mortgagee.²⁶ As a result, the chancery courts created the concept of foreclosure.²⁷ When a mortgagor went into default on payment of a mortgage debt, the mortgagee could bring a suit in equity to terminate, or "foreclose," the mortgagor's equity of redemption.²⁸ The chancery judge then would enter an order allowing the mortgagor additional time, usually between six months and one year, to pay the debt.²⁹ The mortgagor's failure to pay the debt within this time would result in termination of all of the mortgagor's legal rights in the property.³⁰ This common law method of foreclosure is known today as "strict foreclosure."³¹

21. R. KRATOVIL, *supra* note 1, § 1.3; G. NELSON & D. WHITMAN, *supra* note 1, § 1.3; G. OSBORNE, *supra* note 15, § 6.

22. See sources cited *supra* note 21.

23. G. NELSON & D. WHITMAN, *supra* note 1, § 1.3. At first, chancery courts only intervened upon a showing of fraud, accident, oppression or some other usual ground for equity jurisdiction. *Id.* See also G. OSBORNE, *supra* note 15, § 6.

24. G. OSBORNE, *supra* note 15, § 6. The "equity of redemption" soon became an equitable right available to all mortgagors, regardless of whether any of the traditional grounds for equitable relief existed. Wechsler, *supra* note 20, at 856. This recognition by the chancery courts of the "equity of redemption" for all mortgagors marked a significant point in English history toward the increasing shift in power from the common law courts to the chancery courts. G. OSBORNE, *supra* note 15, § 6.

25. R. KRATOVIL, *supra* note 1, § 1.3(a). This prohibition against "clogging" the mortgagor's equitable right of redemption carried over into American law and still survives today in most states in the residential mortgage context. See, e.g., ILL. REV. STAT. ch. 110, para. 15-1601 (Supp. 1990) (commercial mortgagors may waive right of redemption, but in no circumstances may any residential mortgagor waive this right).

26. R. KRATOVIL & R. WERNER, *supra* note 3, § 20.03(a), (b).

27. G. NELSON & D. WHITMAN, *supra* note 1, § 1.3.

28. R. KRATOVIL & R. WERNER, *supra* note 3, § 1.3.

29. *Id.*

30. Failure to comply with the foreclosure decree forever barred the mortgagor's right to redeem. G. NELSON & D. WHITMAN, *supra* note 1, § 1.3.

31. *Id.* This type of foreclosure was not known as "strict foreclosure" in England. See Wechsler, *supra* note 20, at 857 n.44. The term "strict foreclosure" originated in the United States in the early eighteenth century because foreclosure without sale was unduly harsh on mortgagors. *Id.* For a good discussion of the differences between foreclosure without sale in England and early America, see *id.* at 858-59.

B. Foreclosure in the United States

The English concept that the mortgagor possesses an equity of redemption in mortgaged property, and the corresponding requirement of foreclosure to terminate the mortgagor's rights, was carried over into American law.³² However, state courts and legislatures in the United States have developed numerous requirements that were not present at common law for a valid foreclosure of the mortgagor's rights.³³ Most significantly, almost every state now requires a public sale of the mortgaged property as a necessary corollary to a valid foreclosure.³⁴

The practice of requiring a foreclosure sale arose in response to inequities that resulted from common law strict foreclosure.³⁵ Under strict foreclosure, the mortgagee received outright title in the mortgaged property regardless of the property's value compared with the debt it secured.³⁶ Thus, the mortgagee obtained the undeserved benefit of the property's value over the debt amount upon foreclosure.³⁷ The purpose of the public sale requirement was to remedy this inequity.³⁸ Early American reformers believed that by offering the mortgaged property at a public sale, competitive bidding would assure that the property would be sold at a price approximating its true market value.³⁹ Thus, if the property sold for more than the mortgage debt at the sale, the mortgagee would receive payment of his debt in full out of the proceeds of the sale, and the mortgagor would

32. G. OSBORNE, *supra* note 15, § 13.

33. *Id.*

34. G. NELSON & D. WHITMAN, *supra* note 1, § 1.4. *See also infra* note 41 (setting forth statutory foreclosure sale provisions in the United States). A few states, however, still allow for foreclosure without sale in certain circumstances. *See* ALA. CODE. §§ 35-10 to -50 (1975) (mortgagor may transfer deed of property to mortgagee in lieu of foreclosure); CONN. GEN. STAT. ANN. § 49-1 (West Supp. 1989) (strict foreclosure permitted); ILL. REV. STAT. ch. 110, paras. 15-1401 to -1403 (Supp. 1990) (foreclosure without sale when parties consent, deed in lieu of foreclosure permitted, and strict foreclosure permitted in some circumstances); IOWA CODE ANN. § 654.18 (West 1985) (deed in lieu of foreclosure allowed); VT. STAT. ANN. tit. 12, § 4523 (Supp. 1989) (strict foreclosure permitted).

35. Wechsler, *supra* note 20, at 858-59.

36. *See* Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 846-47 (1980).

37. *Id.*

38. Wechsler, *supra* note 20, at 858-59.

39. "During the early development of foreclosure by sale in the United States, the high level of activity in the real estate market justified the conclusion that competitive bidding would assure fair prices." Wechsler, *supra* note 20, at 859. However, modern day foreclosure procedures in America have been ineffective in encouraging competitive bidding, and consequently foreclosure sales typically have yielded far less than the fair market value of the properties sold. *See infra* notes 42-68 and accompanying text for a discussion of the shortcomings of foreclosure sale procedures in the United States today. For a comprehensive analysis of American foreclosure sale practices up until the early twentieth century, see C. WILTSIE, *WILTSIE ON MORTGAGE FORECLOSURE* (Spurr & Rogers 3d ed. 1913).

receive all surplus.⁴⁰ However, if the property sold for less than the amount of the debt, the mortgagee could obtain a personal judgment against the mortgagor for the deficiency.⁴¹

While modern foreclosure sale procedures vary from state to state,⁴² states collectively have done little to encourage competitive

40. R. KRATOVIL, *supra* note 1, § 1.4.

41. Washburn, *supra* note 36, at 846. Under common law strict foreclosure, mortgagees were unable to collect deficiency judgments. G. GLENN, MORTGAGES § 77 (1943). This was primarily because no procedure existed to value the property in relation to the debt and thus fix the amount still due the mortgagee. *Id.* However, under foreclosure by sale, the sale fixes the "value" of the property, and if the amount of the mortgage debt exceeds the foreclosure sale price and the mortgage debt exceeds the foreclosure sale price, the mortgagee can pursue a personal judgment against the mortgagor for the deficiency. *Id.* Many states today, however, limit the mortgagee's right to pursue a deficiency judgment. *See infra* notes 60-64 and accompanying text (discussing the forms and effects of "anti-deficiency legislation").

42. There are two basic types of foreclosure by sale in the United States today. Judicial foreclosure is available in every state, either through express statutory enactment or through the equitable powers of the courts. G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 7.11 (2d ed. 1985). Under judicial foreclosure, a public sale of the property results only after a full judicial proceeding in which all parties with an interest in the property have been joined. *Id.* After the hearing, the court enters a decree of foreclosure specifying the term of the sale in accordance with the governing state statute. *Id.* The public sale is usually conducted by the local sheriff, and becomes final only after judicial confirmation. *Id.*

Judicial foreclosure is the exclusive form of foreclosure in the following fifteen states: CONN. GEN. STAT. ANN. §§ 49-1 to -31 (West Supp. 1990); DEL. CODE ANN. tit. 10 §§ 5061-5094 (1975); FLA. STAT. ANN. §§ 702.01-.09 (West 1969); ILL. REV. STAT. ch. 110, paras. 15-1401 to -1405, 15-1501 to -1512 (Supp. 1990); IND. CODE ANN. §§ 32-8-16-1 to -17-1 (Burns 1980 & Supp. 1986); §§ 34-1-53-1 to -11 (Burns 1986); IOWA CODE ANN. §§ 654-1-654.26 (West Supp. 1990); KAN. STAT. ANN. §§ 58-2314, 58-2326-27 (1983); KY. REV. STAT. ANN. §§ 426.010 to -.990, § 381-190 (Bobbs-Merrill 1972); LA. CODE CIV. PROC. ANN. arts. 2634, 3721-3722 (West 1961); N.J. STAT. ANN. §§ 2A:50-1-52 (West 1987); OHIO REV. CODE ANN. § 23-23.07, § 23-29.17 (Baldwin 1981); PA. STAT. ANN. tit. 42, Rules 1141-50 (Purdon 1987), tit. 21 § 274 (Purdon 1955); S.C. CODE ANN. §§ 29-3-610 to -790, §§ 15-39-610 to -900 (Law. Co-op. 1977 & Supp. 1989); VT. STAT. ANN. tit. 12, §§ 4523-4533 (1973 & Supp. 1989), V.R.C.P. 80.1 (1988); WIS. STAT. ANN. §§ 846.01 to -.72 (West 1977 & Supp. 1989).

The other basic type of foreclosure by sale is "power of sale" foreclosure. Under power of sale foreclosure, after public notice of default and sale is given, the nature of which is determined by statute, the property is sold at a public sale by a public official, the mortgagee, or some other third party. G. NELSON & D. WHITMAN, *supra*, § 7.19. No judicial proceeding is required for power of sale foreclosure, although a mortgagor may subsequently bring a court action attacking the sale's validity. *Id.* Because this method of foreclosure generally is quicker and less costly to the mortgagee, mortgagees prefer power of sale foreclosure. *Id.*

Thirty-five states and the District of Columbia, in addition to providing judicial foreclosure, allow power of sale foreclosure in at least some instances: ALA. CODE §§ 35-10-1 to -10 (1975), § 35-10-11 to -16 (Supp. 1989); ALASKA STAT. §§ 09.45.170 (1983), §§ 34.35.005 to -.045 (1985) (judicial), §§ 34.20.070 to -.135 (1985 & Supp. 1989) (power of sale); ARIZ. REV. STAT. ANN. §§ 33-721 to -730 (judicial), §§ 33-807 to -821 (power of sale) (1990); ARK. STAT. ANN. §§ 18-49-101 to -107 (1987) (judicial), §§ 18-50-101 to -116 (Supp. 1989) (power of sale); CAL. CIV. PROC. CODE §§ 725a-730, CAL. CIV. PROC. CODE §§ 2924a-i (West Supp. 1989); COLO. REV. STAT. §§ 38-37-101 to -140 §, 38-28-101 to -110 (power of sale), §§ 38-39-101 to -119 (judicial) (1982); D.C. CODE ANN. §§ 45-705 to -720 (1986); GA. CODE ANN. § 37-607 (power of sale), § 67-201 to -204 (judicial) (Harrison Supp. 1989); HAW. REV. STAT. §§ 667 (1985); IDAHO CODE §§ 6-

bidding at these sales. In general, state statutes only require minimal amounts of notice of the foreclosure sale to be given by the person or entity conducting the sale.⁴³ Consequently, notice of such sales rarely reaches regular buyers in the real estate market, leaving only the mortgagee, and perhaps a small group of speculators interested in buying at bargain prices, to bid at the sale.⁴⁴

Furthermore, a purchaser at a foreclosure sale usually has no opportunity to view the property prior to the sale,⁴⁵ nor is he assured of receiving clear title in the property if he purchases at the sale.⁴⁶ Finally, a foreclosure sale purchaser virtually always is required to pay his bid in cash either at the sale or within a short time

101 to -108 (judicial), § 45-1502 to -1515 (power of sale) (1977 & Supp. 1989); ME. REV. STAT. ANN. tit. 14, § 6203A (power of sale), §§ 6321-6325 (judicial) (Supp. 1989); MD. REAL PROP. CODE ANN. §§ 7-104 to -105 (1988 & Supp. 1989), Md. Cts. & Jud. PROC. CODE ANN. Rules W70-W81 (1990); MASS. ANN. LAWS ch. 244, §§ 1-40 (Law. Cop. 1986); MICH. COMP. LAWS ANN. §§ 27A.3101-3180 (judicial), §§ 27A.3201-3280 (power of sale) (Callaghan 1988); MINN. STAT. ANN. §§ 580.01-.30 (power of sale), §§ 581.01-.12, § 582.01 (judicial) (West 1988 & Supp. 1989); MISS. CODE ANN. §§ 89-1-43 to -67 (1973); MO. ANN. STAT. §§ 443.190-.280 (judicial), § 443.290 (power of sale) (Vernon 1986); MONT. CODE ANN. §§ 71-1-221 to -235 (1989); NEB. REV. STAT. §§ 25-2137 to -2155 (judicial), §§ 76-1001 to -1018 (power of sale) (1985); NEV. REV. STAT. §§ 40.430-.459 (judicial), §§ 107.020-.100 (power of sale) (Michie 1987); N.H. REV. STAT. ANN. § 477:29, §§ 479:22-29 (1983); N.M. STAT. ANN. §§ 39-5-1 to -23 (judicial), §§ 48-10-10 to -21 (power of sale) (1987); N.Y. REAL PROP. ACTS LAW §§ 1301-1391 (judicial), §§ 1401-1461 (power of sale) (McKinney 1979); N.C. GEN. STAT. §§ 1-339.1 to -.77 (1983 & Supp. 1989) (judicial), §§ 45-4-21.33 (1984 & Supp. 1989) (power of sale); N.D. CENT. CODE §§ 32-19-01 to -40 (1976 & Supp. 1989) (judicial), §§ 35-22-01 to -25 (1980 & Supp. 1989) (power of sale); OKLA. STAT. ANN. tit. 12, § 686 (West 1988) (judicial), tit. 46 § 42-49 (West Supp. 1989) (power of sale); OR. REV. STAT. §§ 86.705-.795 (power of sale), §§ 88.010-.120, §§ 23.410 -.720 (judicial) (1988); R.I. GEN. LAWS §§ 34-27-1 to -4 (1984 & Supp. 1989); S.D. CODIFIED LAWS ANN. §§ 21-47-1 to -25 (1987 & Supp. 1990) (judicial), §§ 44-8-1 to -28 (1983) (power of sale); TENN. CODE ANN. §§ 35-5-101 to -113 (judicial) (1984 & Supp. 1989); TEX. PROP. CODE ANN. § 51.002 (Vernon Supp. 1990); UTAH CODE ANN. §§ 57-1-23 to -36 (1990 & Supp. 1990) (power of sale), §§ 78-37-1 to -9 (1987) (judicial); VA. CODE ANN. §§ 55-58 to -58.2, §§ 55-59 to -59.4 (1986 & Supp. 1989); WASH. REV. CODE ANN. § 61.12.090 (1961), §§ 6.21.010-.130 (judicial), §§ 61.24.020 (power of sale) (Supp. 1989-90); W. VA. CODE §§ 38-1-1 to -15 (1985 & Supp. 1989); WYO. STAT. §§ 1-18-101 to -112 (1988) (judicial), §§ 34-4-101 to -113 (1977) (power of sale).

43. States generally require only that the foreclosure sale be advertised in the legal notices section of a local newspaper and that a sign be placed on the courthouse door and perhaps on the property. Washburn, *supra* note 36, at 848. Moreover, the notice of the sale usually is required to include only a legal description of the property, which gives no meaningful information about the property to potential buyers. See Ehrlich, *supra* note 7, at 961. For an example of a typical foreclosure sale advertisement, see Wechsler, *supra* note 20, at 892 n.236.

44. Washburn, *supra* note 36, at 848. Moreover, the sale usually is held at the local courthouse and often is held concurrently with other foreclosure sales. See Comment, *Avoidance of Foreclosure Sales as Fraudulent Transfers Under Section 548(a) of the Bankruptcy Code: An Impetus to Changing State Foreclosure Procedures*, 66 NEB. L. REV. 383, 409 (1987) (describing in detail the events of a typical foreclosure sale).

45. Wechsler, *supra* note 20, at 891-92.

46. Ehrlich, *supra* note 7, at 961.

afterwards.⁴⁷ The cash bid requirement tends to further discourage regular buyers in the real estate market from bidding at the sale, as few buyers can afford to buy real estate without the assistance of a mortgage lender.⁴⁸ The mortgagee, on the other hand, gains an inherent advantage from the cash bid requirement because he receives a credit toward his bid in the amount of the debt or foreclosure judgment.⁴⁹

In sum, the basic structure of state foreclosure sale procedures favors the mortgagee and discourages truly competitive bidding. Although the forced nature of a foreclosure sale causes prices to be lower than they might be for a sale of real property in the open market,⁵⁰ the lack of competitive bidding at foreclosure sales is a principal reason that prices tend to be well below the market value of the properties being sold.⁵¹ Nevertheless, state legislatures inexplicably have resisted structural reform of the foreclosure sale process.⁵² Instead, states have enacted a variety of measures designed to encourage adequate foreclosure sale prices within the present structure.⁵³

One common state response to inadequate foreclosure sale prices has been the enactment of post-sale redemption statutes, which extend the mortgagor's equity of redemption for a period of

47. Washburn, *supra* note 36, at 849.

48. Ehrlich, *supra* note 7, at 961. Average buyers in the real estate market can purchase high valued properties only with the aid of mortgage financing, which can take as long as two months to procure. Wechsler, *supra* note 20, at 891 n.229. Thus, bidders at foreclosure sales generally are limited to foreclosure specialists with large quantities of readily available cash. Ehrlich, *supra* note 7, at 961.

49. R. KRATOVIL & R. WERNER, *supra* note 3, § 28.14. Because the mortgagee receives a credit for the amount of his bid, and also because foreclosure sales, as currently structured, are unlikely to attract third party bidders, the mortgagee is almost always the successful purchaser at the sale. See Lifton, *Real Estate in Trouble: Lender's Remedies Need an Overhaul*, 31 BUS. LAW. 1927, 1937 (1976) (noting that mortgagee is successful purchaser at 99% of foreclosure sales). See also Wechsler, *supra* note 20, at 871 (study of upstate New York foreclosure sales in 1979 found that mortgagee was purchaser at 77% of sales).

50. See Washburn, *supra* note 36, at 844-55.

51. See *infra* notes 116-34 and accompanying text (noting that foreclosure sales structured like regular sales of realty and meaningfully advertised to normal buyers in real estate market would assure prices approximating fair market value of properties sold).

52. The Uniform Land Transactions Act, adopted in 1975 by the National Conference of Commissioners on State Laws, contains numerous provisions that would reform the structure of foreclosure sales. See UNIFORM LAND TRANSACTIONS ACT §§ 3-508 to -509, 13 U.L.A. 614-17 (1985) [hereinafter U.L.T.A.]. However, the U.L.T.A. has not been adopted in any state, although the New Hampshire Supreme Court has endorsed the concept for nonjudicial power of sale foreclosures in that state. See G. NELSON & D. WHITMAN, *supra* note 1, § 8.8 n.4. For a general discussion of the U.L.T.A., see *Summary of the Uniform Land Transactions Act*, 13 REAL PROP. PROB. & TR. J. 672 (1978). For a further discussion of the U.L.T.A.'s foreclosure provisions, see *infra* note 128.

53. See *infra* notes 54-64 and accompanying text.

time after the foreclosure sale.⁵⁴ Typical redemption statutes permit the mortgagor, or in some states other parties with an interest in the property, to "redeem" the property by paying the foreclosure sale purchaser an amount of money equal to the sale price.⁵⁵ Thus, if the sale price is less than the debt amount and the mortgagor redeems, the mortgagee must pursue a deficiency judgment against the mortgagor to satisfy the remaining debt.⁵⁶

Post-sale redemption statutes arguably may encourage the mortgagee to bid the amount of the debt at foreclosure sales.⁵⁷ However, the prospect that a purchaser's title may be defeated at some later time by a redeeming mortgagor further discourages third parties from purchasing at foreclosure sales and consequently may further depress prices.⁵⁸ As a result, post-sale redemption statutes have become less common in the United States in recent years.⁵⁹

The other major initiative of state legislatures to encourage adequate foreclosure sale prices has been the enactment of statutes that limit the mortgagee's right to a deficiency judgment.⁶⁰ Statutes of this type commonly are called "anti-deficiency legislation."⁶¹ Like post-sale redemption statutes, anti-deficiency statutes may encourage mortgagees to bid the debt amount at foreclosure sales.⁶² At

54. See generally G. NELSON & D. WHITMAN, *supra* note 1, § 8.4. These statutes authorize post-sale redemption rights that last from six months to two years. *Id.*

55. *Id.*

56. *Id.*

57. One purpose of statutory redemption is to economically threaten the mortgagee to bid at least the debt amount. See Washburn, *supra* note 36, at 931. If the sale price is less than the debt amount and the mortgagor then redeems, the lender's only recourse for the remaining debt is to pursue a deficiency judgment against the mortgagor. *Id.* However, mortgagor insolvency or statutory prohibitions may prevent the mortgagee from collecting a deficiency judgment. Thus, under the rationale of statutory post-sale redemption, mortgagees should bid at least the amount of the debt to protect their interests. *Id.*

However, it is questionable whether post-sale redemption statutes genuinely threaten mortgagees. Studies have shown that mortgagors rarely exercise their right to redeem, thus making the "threat" of redemption illusory. See, e.g., Note, *Foreclosure, Redemptions, and Homeowners*, 1975 U. ILL. L. FORUM 335, 351-52 (study showing that less than 1% of mortgagors in Cook County, Illinois, redeemed in 1964 and 1974). See also Prather, *A Realistic Approach to Foreclosure*, 38 BUS. LAW. 132, 135 (1958) (noting that less than 1% of foreclosed properties are ever redeemed). But see Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection Over Credit*, 71 IOWA L. REV. 1, 74-75 (1985) (arguing that statutory redemption may reduce the consequences of price inadequacy).

58. See Washburn, *supra* note 36, at 854 (noting that few people are interested in purchasing property without certainty of obtaining title). But see sources cited *supra* note 57 (concluding that title actually secure).

59. See Bauer, *supra* note 57, at 4-5 (noting that number of states requiring statutory post-sale redemption has dropped from nineteen to eleven in recent years).

60. See generally G. NELSON & D. WHITMAN, *supra* note 1, § 8.3.

61. *Id.* For a detailed discussion of the various types of anti-deficiency statutes enacted in the United States, see Washburn, *supra* note 36, at 901-19, 926-29.

62. G. NELSON & D. WHITMAN, *supra* note 1, § 8.3.

the very least, such statutes protect mortgagors from the potentially disastrous consequences of low foreclosure sale prices.⁶³ However, anti-deficiency statutes do not encourage foreclosure sale prices above the debt amount and, therefore, do not protect the mortgagor's equity in the property.⁶⁴

Thus, state legislative attempts to encourage adequate foreclosure sale prices may succeed in protecting mortgagors from deficiency judgments. However, prices at foreclosure sales routinely have been well below the market value of the properties being sold.⁶⁵ Moreover, mortgagors have little recourse against inadequate foreclosure sale prices from state courts.⁶⁶ In the absence of evidence of actual fraudulent conduct at the sale, state courts will only set aside foreclosure sales where the price received at the sale is "grossly inadequate" or "shocking to the conscience of the court."⁶⁷ While these are somewhat nebulous standards, commentators surveying court decisions in this area have found that property must sell for forty percent or less of the property's market value before a court will set the sale aside.⁶⁸ In sum, foreclosure sales yielding prices far below the market values of the properties being sold are the norm throughout the United States.

II. THE INTRUSION OF BANKRUPTCY LAW

Despite the fact that foreclosure sales have yielded prices far below the market values of the properties being sold for years, until 1980 federal law did not affect whether sales would be set aside.⁶⁹

63. *Id.*

64. Mortgagees have no incentive to bid above the debt amount because their sole purpose in bidding at the sale is to recover the amount of the mortgage debt; mortgagees have little interest in purchasing for investment purposes. *Cf.* Lifton, *supra* note 49, at 1940 (discussing added costs to mortgagee who purchases at sale and subsequently holds property); Wechsler, *supra* note 20, at 880-84 (study finding mortgagees sustained more losses than profits on resale of properties after purchasing at foreclosure sales); Chicago Tribune, Jan. 20, 1990, § 1, at 6, col. 1 (editorial noting large number of devalued properties held by failed savings and loans).

Thus, even with anti-deficiency and post-sale redemption statutes, the mortgagee will only bid the amount of the mortgage debt, and the mortgagor will lose all equity in the property. G. NELSON & D. WHITMAN, *supra* note 1, § 8.8. Furthermore, in most cases the mortgagor should have equity in the property. Mortgage lenders generally lend only 70-80% of the property's market value; the mortgagor usually uses his own funds for the remainder of the purchase price. *See* Washburn, *supra* note 36, at 844-45. Moreover, the mortgagor may have paid off some of the mortgage debt prior to foreclosure. Therefore, unless the market value of the property has fallen substantially, the mortgagor will have equity in the property.

65. *See, e.g.*, Ehrlich, *supra* note 7, at 959 (noting proliferation of anti-deficiency legislation demonstrates that foreclosure sales yield inadequate prices).

66. *See generally* Washburn, *supra* note 36, at 855-901.

67. *Id.* at 862-70.

68. *Id.* at 866. *See also* G. NELSON & D. WHITMAN, *supra* note 1, § 7.16.

69. Federal law, however, could prevent or delay a foreclosure sale from taking

However, in 1980, the decision of the Fifth Circuit Court of Appeals in *Durrett v. Washington National Insurance Company*⁷⁰ dramatically altered this situation.

A. *The Durrett Decision and its Implications*

In *Durrett*, a third party bidder at a foreclosure sale purchased a property valued at \$200,000 for \$115,400.⁷¹ Nine days after the sale, the mortgagor filed a bankruptcy petition and subsequently sought to have the sale set aside.⁷² After initially deciding that a foreclosure sale was a "transfer" within the meaning of section 67(d) of the Bankruptcy Act (section 548's predecessor),⁷³ the *Durrett* court held that the price received at the sale was not a "fair equivalent value" for the property. The court, therefore, ordered the sale set aside.⁷⁴

Durrett marked the first time that a court set aside a regularly conducted, noncollusive foreclosure sale as a fraudulent transfer.⁷⁵ This new application of the Bankruptcy Code's fraudulent transfer

place. See *supra* note 4 (discussing federal regulations pertaining to foreclosure of federally insured mortgages) and note 5 (discussing Bankruptcy Code provisions that may apply prior to foreclosure sale).

70. 621 F.2d 201 (5th Cir. 1980).

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

72. *Id.* at 202-03.

73. Section 67(d) of the Bankruptcy Code provided, in relevant part, that:

(2) Every transfer made and every obligation incurred by a debtor within one year prior to the filing [of a bankruptcy petition] . . . is fraudulent . . . if made or incurred without fair consideration by a debtor who is or will thereby will be rendered insolvent, without regard to actual intent

(1) For the purposes of . . . this subdivision . . . (e) consideration given for the property is fair (1) when in good faith, in exchange and as a fair equivalent therefor, property is transferred

See W. COLLIER, *supra* note 5, § 548.01.

Section 548 of the Bankruptcy Code, adopted in 1978, is derived in large part from former Section 67(d) of the Bankruptcy Act. *Id. Cf.* 11 U.S.C. § 548(a) (2). See *supra* note 7 and accompanying text (setting forth relevant provisions of Section 548(a) (2)). The only significant change in Section 548 is the change from the "fair consideration" standard of Section 67(d) to the "reasonably equivalent value" standard. For purposes of this comment, this change is irrelevant. For a discussion of the reasons for this change in terminology, see Davis & Standiford, *Foreclosure Sale as Fraudulent Transfer Under the Bankruptcy Code: A Reasonable Approach to Reasonably Equivalent Value*, 13 REAL ESTATE L.J. 201, 211 (1984).

74. *Durrett*, 621 F.2d at 203-04.

75. Davis & Standiford, *supra* note 73, at 204. Regularly conducted, noncollusive foreclosure sales never have been considered violative of state fraudulent conveyance laws. *Id.* Indeed, the Uniform Fraudulent Transfer Act of 1984, adopted in twenty states, provides that a person gives reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive sale. See UNIFORM FRAUDULENT TRANSFER ACT § 3(b), 7A U.L.A. 650 (1985) [hereinafter U.F.T.A.]. For a discussion of § 548's relation to the U.F.T.A. and its predecessor, the Uniform Fraudulent Conveyance Act, see W. COLLIER, *supra* note 5, § 548.01.

provision has created a vexing dilemma for the federal courts.⁷⁶ On the one hand, applying Section 548 to foreclosure sales is consistent with that section's underlying purpose, which is to prevent a debtor from injuring his creditors by depleting his estate while he is insolvent.⁷⁷ A foreclosure sale which yields less than the property's fair market value results in the mortgagor losing most, if not all, of his equity in the property.⁷⁸ The value of this lost equity otherwise could have been applied to the mortgagor's other unsecured debts. Thus, inadequate foreclosure sale prices harm the mortgagor's other creditors.⁷⁹

On the other hand, applying section 548 to foreclosure sales may negatively affect the mortgage arena. Applying section 548 in this context creates a de facto right of redemption in the debtor that can last as long as two years.⁸⁰ The resulting uncertainty of the title received at foreclosure sales may further discourage bidding at these sales. As a consequence, it may lead to even lower foreclosure sale prices.⁸¹ At the same time, lenders may find it more difficult to quickly recover on loans in default.⁸² Because the ability to quickly recover on a loan in default is an important concern to mortgage lenders, mortgage money may become less available as a result of applying section 548 to foreclosure sales.⁸³

76. See *infra* notes 77-83 and accompanying text (discussing countervailing concerns involved in applying § 548 to foreclosure sales).

77. Davis & Standiford, *supra* note 73, at 212.

78. See *supra* notes 42-64 and accompanying text (discussing failure of current state foreclosure procedures to protect mortgagor's equity in property).

79. See *supra* note 10 (discussing effect of foreclosure sale on mortgagor's equity).

80. See Nelson, *supra* note 5, at 242. Almost every mortgagor facing foreclosure might file for bankruptcy within one year after the foreclosure sale and subsequently seek to have the sale set aside under § 548. The effect of this "right" of the mortgagor to have the sale set aside under § 548 is the same as the effect of rights conferred upon mortgagors by post-sale redemption statutes: a foreclosure sale purchaser's title potentially will be voidable. See Davis & Standiford, *supra* note 73, at 205. However, unlike under state post-sale redemption statutes, the mortgagor's § 548 "right of redemption" lasts for an indefinite period, possibly as long as two years. Nelson, *supra* note 5, at 212.

81. Davis & Standiford, *supra* note 73, at 205. *But see* Schuchman, *Data on the Durrett Controversy*, 9 CARDOZO L. REV. 605 (1987) (concluding there is no empirical data to support contention that § 548 or state post-sale redemption statutes reduce foreclosure sale prices).

82. See generally Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 CARDOZO L. REV. 581 (1987). See also sources cited *infra* note 112 (discussing factors taken into account by mortgage lenders in making mortgage loans).

83. Davis & Standiford, *supra* note 73, at 205. *But see* Schuchman, *supra* note 81 (statistical data compiled before and after *Durrett* show no effects of decision on availability of mortgage money). However, for a well reasoned criticism of Professor Schuchman's conclusion, see Zinman, *Durrett Data: Shucking the Husks From the Grain*, 9 CARDOZO L. REV. 1013 (1988).

B. Federal Court Approaches to Section 548 After Durrett

Since the Fifth Circuit's decision in *Durrett* raised the issue of applying section 548 to foreclosure sales, the federal courts have taken four basic approaches to resolving the issue. However, an examination of these views demonstrates that none satisfactorily resolves the competing policy concerns involved.

A small minority of courts have concluded that a foreclosure sale is not a "transfer" within the meaning of section 548. Therefore, these courts have held that section 548 does not apply in this context.⁸⁴ The leading case advocating this approach is *In re Madrid*,⁸⁵ decided in 1984 by the Ninth Circuit. The *Madrid* court concluded that the only transfer relevant for the purposes of section 548 occurs when the mortgagee perfects his security interest in the property.⁸⁶ Under this view, the foreclosure sale is nothing more than an involuntary conveyance triggered by a debtor's failure to fulfill an obligation under the mortgage or deed of trust.⁸⁷ The *Madrid* approach thus avoids the section 548 issue altogether.

Although the *Madrid* approach appeals to many commentators because it sidesteps the thorny issues involved in section 548's application in the foreclosure sale context,⁸⁸ this approach finds little support in the Bankruptcy Code. Under the Bankruptcy Code, "transfer" is defined as "every mode . . . voluntary or involuntary . . . of disposing of or parting with property or with an interest in property."⁸⁹ Upon foreclosure, a debtor, although involuntarily, transfers

84. See *In re Madrid*, 725 F.2d 1197 (9th Cir. 1984); *In re Ehring*, 91 Bankr. 897 (Bankr. 9th Cir. 1988); *In re Cardinal Enter.*, 68 Bankr. 460 (Bankr. 9th Cir.), *aff'd*, 844 F.2d 791 (9th Cir. 1988); *In re William*, 39 Bankr. 678 (D. Minn. 1984); *In re Alsop*, 14 Bankr. 982 (Bankr. D. Alaska 1981), *aff'd*, 22 Bankr. 1017 (D. Alaska 1982). See also *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1138 (6th Cir. 1985) (concluding in dicta that foreclosure sale not a transfer within contemplation of § 548).

85. 725 F.2d 1197 (9th Cir. 1984).

86. *Id.* at 1201. The *Madrid* court focused on the definition of transfer contained in § 548(d) (1), which states that "[f]or the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor . . . cannot acquire an interest in such property of the transferee." *Id.* at 1201 (citing 11 U.S.C. § 548(d) (1) (1982)). Once the mortgage is executed, no other person can acquire an interest superior to the mortgagee's. Consequently, the *Madrid* court concluded that the original execution of the mortgage is the only transfer relevant for purposes of § 548. *Madrid*, 725 F.2d at 1201. See *infra* notes 88-90 and accompanying text (criticizing the *Madrid* court's rationale).

87. *Madrid*, 725 F.2d at 1203.

88. See *infra* note 91 (discussing the pros and cons of applying § 548 in the mortgage arena).

89. 11 U.S.C. § 101(48) (1982). Nothing in § 548(d) (1), or in any other part of the Bankruptcy Code, negates the inference that both the execution of the mortgage and the foreclosure sale are "transfers" within the meaning of § 548. Moreover, after the *Madrid* decision, the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(i), amended § 101(48) of the Bankruptcy Code to include "foreclosure of the debtor's equity of redemption" in the definition of trans-

important property interests, including his right to possession, his equitable right of redemption, and often his equity in the property.⁹⁰ Because important property interests are transferred at foreclosure, the *Madrid* view is untenable under the Bankruptcy Code.⁹¹

The second approach that the federal courts have taken regarding section 548 recognizes that a foreclosure sale is a transfer within the meaning of section 548, but nevertheless asserts that the price received at such a sale raises an irrebuttable presumption that the sale price is a "reasonably equivalent value" for purposes of section 548.⁹² While avoiding the logical difficulties of holding a foreclosure sale to not be a transfer, this approach still removes section 548 from the foreclosure arena, and thus does nothing to protect the mortgagor's other creditors.⁹³

Some courts take an alternative view of this approach and grant an irrebuttable presumption of reasonably equivalent value to a foreclosure sale only where a third party was the successful bidder at the sale.⁹⁴ Under this view, it is presumed that if a third party was the purchaser at the sale, competitive bidding necessarily took place, and the sale therefore brought the highest possible price.⁹⁵ However, this conclusion is not necessarily correct. As noted earlier,

fer. See 11 U.S.C. § 101(48) (Supp. 1989). This amendment casts doubt on the *Madrid* court's holding. However, at least two courts have found that the *Madrid* court's holding remains valid in spite of the amendment. See *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1138 (6th Cir. 1985); *In re Ehring*, 91 Bankr. 897 (Bankr. 9th Cir. 1988).

90. See *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 203 (5th Cir. 1980).

91. Nevertheless, many commentators argue that the negative consequences of applying § 548 to foreclosure sales outweigh the benefits to the mortgagor's creditors, and thus conclude that § 548 should not be applied in this context. See, T. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 146-50 (1986). See also LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WIS. L. REV. 311, 352-72 (1982); Baird & Jackson, *supra* note 7, at 843-50; Zinman, *supra* note 82, at 594-603. While removing § 548 from the mortgage arena is a good idea, this step should be taken only in conjunction with reforms in the foreclosure sale process. See *infra* notes 108-38 (discussing suggested reforms in the foreclosure sale process).

92. See *In re Madrid*, 21 Bankr. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir. 1984), *cert. denied*, 469 U.S. 833 (1984); *In re Lindsay*, 98 Bankr. 983 (Bankr. S.D. Cal. 1989); *In re Upham*, 48 Bankr. 695 (Bankr. W.D.N.Y. 1985); *In re White*, 47 Bankr. 98 (Bankr. N.D. Ohio 1985); *In re Strauser*, 40 Bankr. 868 (Bankr. S.D. Tex. 1984). See also *In re Winshall Settlor's Trust*, 758 F.2d 1136, 1139 (6th Cir. 1985) (approving this standard in dicta).

93. Under this approach, as long as a sale would stand up under state law, § 548 would not apply. See *In re Madrid*, 21 Bankr. at 427. Because foreclosure sales that yield far less than the fair market value of the properties sold will be upheld under state law, the mortgagor's creditors receive no protection under this standard. See *supra* notes 67-68 (discussing the almost insurmountable standards for setting aside foreclosure sales under state law).

94. See, e.g., *In re Verna*, 58 Bankr. 246 (Bankr. C.D. Cal. 1986).

95. Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the Durrett Problem*, 38 BUS. LAW. 1605, 1617-20 (1983) [hereinafter *Real Property Foreclosure*].

the only third parties likely to bid at foreclosure sales today are speculators hunting for bargains.⁹⁶ Thus, a successful third party bidder normally will have paid well below market value for the property.⁹⁷ Therefore, granting an irrebuttable presumption of reasonably equivalent value in these cases also is unlikely to benefit the mortgagor's other creditors.

The third approach that the federal courts take to section 548 sets a benchmark of 70 percent of the property's fair market value as reasonably equivalent value under section 548.⁹⁸ Courts following this approach have done so in reliance on dicta in *Durrett*, which stated that the court was unable to locate any decision under section 67(d) of the Bankruptcy Act in which a court approved a transfer of real property for less than 70 percent of the property's market value.⁹⁹ This approach, however, creates the worst of both worlds by subjecting foreclosure sales to a de facto redemption right without providing any substantial relief to the mortgagor's creditors. At best, purchasers at foreclosure sales are encouraged to bid 70 percent of the property's market value, which still will cause the mortgagor to lose his equity in the property in virtually all instances.¹⁰⁰

The final, and most common, approach to section 548 taken by the federal courts mandates that reasonably equivalent value in the foreclosure sale context be determined on a case-by-case basis.¹⁰¹

96. See *supra* notes 43-51 (noting that foreclosure sales do not usually attract regular buyers in the real estate market).

97. Granting an irrebuttable presumption to a third party purchaser at least prevents § 548 from causing further disincentive to bidders at foreclosure sales, and thus prevents § 548 from exacerbating the problem of inadequate foreclosure sale prices. See *Real Property Foreclosure*, *supra* note 95, at 1617-20.

98. See *In re IPI Liberty Village Assoc.*, 92 Bankr. 882 (Bankr. W.D. Mo.), *aff'd*, 82 Bankr. Rep. 507 (1987); *In re Jackson*, 76 Bankr. 597 (Bankr. N.D. Tex. 1987); *In re Park North Partners, Ltd.*, 72 Bankr. 79 (Bankr. N.D. Ga. 1987), *vacated and remanded*, 80 Bankr. 551 (1987); *In re Willis*, 48 Bankr. 295 (S.D.N.Y. 1985); *In re Wheeler*, 34 Bankr. 818 (Bankr. N.D. Ala. 1983); *In re Berge*, 22 Bankr. 642 (Bankr. W.D. Wis. 1983); *In re Perdido Bay Country Club Estates, Inc.*, 23 Bankr. 36 (Bankr. S.D. Fla. 1982); *In re Coleman*, 21 Bankr. 832 (Bankr. S.D. Tex. 1982); *In re Thompson*, 18 Bankr. 67 (Bankr. E.D. Tenn. 1982).

99. *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 203 (5th Cir. 1980).

100. The amount of equity a mortgagor will have in a parcel of property correlates roughly with the likelihood that the mortgagor will face foreclosure. See Comment, *Avoidance of Foreclosure Sales*, *supra* note 44, at 410. In other words, mortgagors with substantial equity in their property are more likely to find means to avoid foreclosure, such as selling the property or obtaining a second mortgage. *Id.* Thus, very few mortgagors with over thirty percent of equity in the property will be facing foreclosure, and, therefore, the 70% benchmark standard will only benefit the mortgagor's creditors in rare instances.

101. See *In re Bundles*, 856 F.2d 815 (7th Cir. 1988); *In re Hulm*, 738 F.2d 323 (8th Cir.), *cert. denied*, 469 U.S. 990 (1984); *In re Lindsay*, 98 Bankr. 983 (Bankr. S.D. Cal. 1989); *Ananko v. Harsany*, 91 Bankr. 231 (D. N.J. 1988); *In re General Industries, Inc.*, 79 Bankr. 124 (Bankr. D. Mass. 1987); *In re Adwar*, 55 Bankr. 111 (Bankr. E.D. N.Y. 1985); *In re Reubeck*, 55 Bankr. 163 (Bankr. D. Mass. 1985); *In re Garrison*, 48 Bankr. 837 (D. Colo. 1985); *In re Richardson*, 23 Bankr. 434 (Bankr. D.

The United States Courts of Appeals for the Seventh and Eighth Circuits, along with numerous lower federal courts, have adopted this approach.¹⁰² Courts that follow the case-by-case approach take into account a number of factors, including: the forced nature of a foreclosure sale; the price actually realized at the sale; whether the property was advertised widely; whether competitive bidding was encouraged, and whether a fair appraisal of the property was made.¹⁰³

The case-by-case approach is the only one of the four approaches that is truly consistent with section 548's underlying purpose of protecting the mortgagor's creditors.¹⁰⁴ This approach allows courts to look at the facts and circumstances surrounding each sale in order to determine whether reasonably equivalent value was received for the property and whether reselling the property would be worthwhile.¹⁰⁵ While this approach is ideal for individual bankruptcies, it is likely to exacerbate the systemic problems that give rise to price inadequacy at foreclosure sales.¹⁰⁶ Under this approach, there is no certainty regarding the circumstances under which a sale might be set aside. Thus, competitive bidding at foreclosure sales is likely to be chilled further, and prices at foreclosure sales may drop even further.

III. A FEDERAL FORECLOSURE STATUTE AS THE SOLUTION TO THE SECTION 548 CONFLICT WITH THE MORTGAGE ARENA

Although applying section 548 to foreclosure sales is likely to be counterproductive, its goal of protecting the creditors of defaulting mortgagors can be achieved in another way. The federal courts' purpose in applying section 548 to foreclosure sales is essentially the same as the purpose for which foreclosure by sale was originally created: to protect the mortgagor's equity in his foreclosed property.¹⁰⁷ Thus, if foreclosure sale procedures were structured to elicit maxi-

Utah 1982); *In re Jones*, 20 Bankr. 988 (Bankr. E.D. Pa. 1982).

102. See *supra* note 101 for a list of federal appellate and district courts that have adopted this *ad hoc* approach.

103. *In re Bundles*, 856 F.2d at 824-25.

104. By focusing on each sale individually, the courts can determine whether the sale brought the highest possible price under the particular circumstances, and consequently can determine whether setting aside the sale will benefit the mortgagor's other creditors. *Id.* at 825.

105. See W. COLLIER, *supra* note 5, § 548.09, at 108 (noting that whether reasonably equivalent value has been received under § 548 is largely a question of fact to be determined from all facts and circumstances surrounding sale).

106. See *supra* note 81 and accompanying text (discussing reasons that foreclosure sale prices are likely to drop further when § 548 applied in this way).

107. See *supra* notes 77-78 and accompanying text (discussing purposes of applying § 548 to foreclosure sales) and notes 35-40 and accompanying text (discussing reasons for requiring foreclosure by sale).

imum sale prices, there would be no need to apply section 548 in this context.¹⁰⁸ Unfortunately, with the exception of Illinois,¹⁰⁹ state legislatures have been unwilling to undertake the necessary structural reforms in the foreclosure sale process to achieve this result.¹¹⁰ Therefore, the only solution lies in a federal foreclosure reform statute that preempts state foreclosure laws.¹¹¹

This federal foreclosure sale statute should be structured to achieve a proper balance between the mortgagee's interest in a quick, low-cost realization of his security, and the interest of the mortgagor and his other creditors in protecting the mortgagor's equity in the property.¹¹² Illinois' recently enacted Mortgage Foreclosure Act ("Illinois Act")¹¹³ is a good model for this new federal statute.¹¹⁴ The Illinois Act has two central features that should be part

108. If foreclosure sales were structured in this fashion, the price received at these sales would be a true indication of the property's fair market value under the circumstances of foreclosure. See Ehrlich, *supra* note 7, at 960.

109. See *infra* notes 115-34 and accompanying text (discussing reforms of foreclosure sale process initiated by Illinois' Mortgage Foreclosure Law).

110. See *supra* note 52 and accompanying text (noting that no state has adopted Uniform Land Transaction Act's foreclosure provisions).

111. Given the increasingly national scope of the mortgage arena (see *supra* notes 2-3 and accompanying text), Congress clearly has the power to enact a preemptive foreclosure statute under the commerce clause of the United States Constitution. U.S. CONST. art. 1, § 8, cl. 3. The Supreme Court has interpreted that clause broadly to give Congress the power to regulate any commercial activity that substantially affects the national economy. See, e.g., *Pennsylvania v. Union Gas Co.*, 109 S. Ct. 2273, 2281-85 (1989) (discussing breadth of commerce power).

Congress already has enacted many statutes that regulate the mortgage arena and preempt state law. See, e.g., 12 U.S.C. § 1735F-7 (1989) (statute preempting state usury laws to extent they apply to first mortgages on residential property); 12 U.S.C. §§ 3801-3806 (1989) (statute preempting most state laws pertaining to alternative mortgage instruments); 12 U.S.C. § 1701j-3 (1989) (statute preempting state laws that regulate "due on sale" clauses). In fact, a federal foreclosure statute that would have applied to all federally insured mortgages previously has been proposed to Congress. See H.R. 10688, 93d. Cong., 1st Sess. (1973); S. 2507, 93d Cong., 1st Sess. (1973). However, the proposed Federal Mortgage Foreclosure Act never was passed. For a discussion of that Act's provisions, see Pedowitz, *Current Developments in Summary Foreclosure*, 9 REAL PROP. PROB. & TR. J. 421, 422-24 (1974); Washburn, *supra* note 36, at 935-36.

112. Protecting the mortgagor's equity in his property cannot be the only concern; if foreclosure is too costly, uncertain and time-consuming for mortgagees, lenders will decrease the amount of funds they are willing to advance in reliance on real property as collateral. Ehrlich, *supra* note 7, at 974. See also Washburn, *supra* note 36, at 844-46 (discussing fact that lender's primary concern is ability to recover amount advanced to borrower); Lifton, *supra* note 49, at 1928-45.

113. ILL. REV. STAT. ch. 110, paras. 15-1101 to -1706 (Supp. 1990).

114. For a good general discussion of the new Illinois Mortgage Foreclosure Act, see generally Freyfogle, *The New Judicial Roles in Illinois Mortgage Foreclosures*, 19 LOY. U. CHI. L.J. 933 (1988) [hereinafter Freyfogle, *New Judicial*]. See also McCormack, *Redemption and Reinstatement Under the Illinois Mortgage Foreclosure Law*, 77 ILL. B.J. 822 (1989) (discussing redemption and reinstatement provisions of Illinois Act); Bernard & Thorpe, *Recent Illinois Mortgage Law Changes Affecting Commercial Mortgage Lending*, 76 ILL. B.J. 606 (1988) (discussing effects of Illinois Act on mortgage lenders); Freyfogle, *Land Trusts and the Decline of Mortgage Law*,

of the new federal statute: structural reform of the foreclosure sale process and allowance for a form of strict foreclosure in some circumstances.¹¹⁵

A. Structural Reform of Sale Process

The Illinois Act includes a variety of provisions designed to make the foreclosure sale more like a sale of real estate in the open market. Unlike traditional foreclosure statutes that require only legal notice of the sale to be given, the Illinois Act requires that notice of the sale be published in a general circulation newspaper in the section where real estate normally is advertised to the public.¹¹⁶ The Illinois Act also requires that a common description of the property, rather than just the property's legal description, be included in the notice of foreclosure sale.¹¹⁷ Furthermore, the notice must include the times when the property is open for inspection prior to the sale.¹¹⁸ Finally, the Illinois Act provides for listing the property with real estate brokers.¹¹⁹ These more extensive advertising requirements ensure that notice of the foreclosure sale will reach regular buyers in the real estate market, and thus should lead to increased bidding at the sale. Therefore, these requirements should be included as part of the new federal statute.

Another important element of the Illinois Act is the abolition of post-sale redemption in virtually all instances.¹²⁰ The elimination of

1988 U. ILL. L. REV. 67 (discussing application of Illinois Act to Illinois land trusts); Liss, *Notices of Foreclosure Sales Under the New Law*, ILL. INST. OF CONT. LEGAL EDUC. ILL. MORTG. FORECLOSURE & PRACTICE § 1-25 (1988) (discussing Illinois Act's more stringent foreclosure sale notice provisions); Lindberg & Bender, *The Illinois Mortgage Foreclosure Law*, 75 ILL. B.J. 800 (1987) (overview of the new Illinois Act); Liss, *Introduction to the Proposed Illinois Mortgage Foreclosure Act*, 9 ILL. FUND CONCEPT 13 (1985) (providing comprehensive discussion of legislative history of Illinois Act); Recent Development, *The New Illinois Mortgage Foreclosure Law and Installment Sales Contracts*, 19 LOY. U. CHI. L.J. 245 (1987) (discussing application of the Illinois Act to installment land contracts).

115. See *infra* notes 116-34 and accompanying text for a discussion of the components of the Illinois Mortgage Foreclosure Law.

116. ILL. REV. STAT. ch. 110, para. 15-1507(c) (1) (I) (2) (i) (B) (Supp. 1990).

117. ILL. REV. STAT. ch. 110, para. 15-1507(c) (1)-(2) (Supp. 1990).

118. ILL. REV. STAT. ch. 110, para. 15-1507(c) (1) (E) (Supp. 1990).

119. ILL. REV. STAT. ch. 110, para. 15-1506 (f) (4) (Supp. 1990). Real estate brokers customarily assist buyers in the real estate market in selecting their desired property. See G. NELSON & D. WHITMAN, *supra* note 1, § 8.8. Brokers, in turn, rely on brokerage listings of properties, gathered and distributed through a nationwide network of brokers, to effectively serve buyers. See Ehrlich, *supra* note 7, at 977. Thus, listing the properties with real estate brokers is the most effective way of assuring that notice of the sale reaches the greatest number of regular buyers in the real estate market.

120. ILL. REV. STAT. ch. 110, paras. 15-1603 to -1604 (Supp. 1990). The Illinois Act also allows mortgagors to reinstate mortgages in default, and thus avert foreclosure, in certain circumstances. See ILL. REV. STAT. ch. 110, para. 15-1602 (Supp. 1990). For a good general discussion of these provisions, see McCormack, *Illinois Mortgage*

post-sale redemption assures final title in the property to a purchaser at a foreclosure sale and thus removes a major disincentive to competitive bidding at the sale.¹²¹ The Illinois Act, however, statutorily extends the mortgagor's equitable right of redemption prior to the sale for as long as seven months.¹²² Because mortgagors virtually never exercise their right of redemption,¹²³ a statutory extension of the mortgagor's right of redemption places an unwarranted burden on mortgagees.¹²⁴ Thus, the federal statute should go one step further than the Illinois Act and abolish statutory redemption in all forms.¹²⁵

Finally, and most importantly, the Illinois Act provides for numerous changes in foreclosure sale procedures.¹²⁶ Under the Illinois Act, a court *may* include, within its discretion, the following provisions in the foreclosure judgment: title insurance for the purchaser at the sale; bids that are contingent on the bidder's ability to obtain mortgage financing; appointment of an independent professional to conduct the sale; and a manner of sale other than by public auction.¹²⁷ If these provisions are included in the judgment, the foreclosure sale is virtually the same as a sale of real estate in the open market.¹²⁸ Buyers at the sale are not obligated to pay the full price in cash and can be assured of clear title in the property.¹²⁹ Moreover, appointing an independent professional to conduct the sale and removing the sale from the public auction setting should further encourage regular buyers in the real estate market to bid on the property.¹³⁰ Maximum prices can be ensured by linking the amount

Foreclosure Law, *supra* note 114.

121. See McCormack, *supra* note 114, at 828.

122. *Id.* at 825-27.

123. See *supra* note 57 (studies noting that less than 1% of mortgagors exercise their redemption rights).

124. *But see* Bauer, *supra* note 57, at 72-81 (arguing that statutory redemption does have material benefits for mortgagors that may outweigh costs to mortgagees).

125. The mortgagor would still retain his equitable right to redemption prior to the foreclosure sale, which should provide him with sufficient protection.

126. See ILL. REV. STAT. ch. 110, para. 15-1506(f) (1)-(14) (Supp. 1990).

127. *Id.*

128. The provisions of the Illinois Act are consistent with the spirit of the Uniform Land Transactions Act, which provides that every aspect of the foreclosure sale must be commercially reasonable, including the method, advertising, time, place and terms. See UNIFORM LAND TRANSACTIONS ACT §§ 3-508 to -509, 13 U.L.A. 614-617 (1985). However, because it specifies in much more detail the various provisions that should be incorporated in the foreclosure sale, the Illinois Act is preferable to the U.L.T.A. as a model for the new federal statute.

129. See *supra* note 127 and accompanying text. Thus, two of the most significant disincentives to competitive bidding that exist under most current state foreclosure procedures—the cash bid requirement and the lack of assurance of clear title in the property—would be removed by enacting these provisions. See *supra* notes 46-49 and accompanying text (discussing problems with current structure of state foreclosure procedures).

130. The independent professional selling the property would stand in the shoes

of compensation the person conducting the sale receives with the price received from the sale.¹³¹

A federal statute that incorporates the above provisions would assure that foreclosure sales yield the highest possible prices, and thus would benefit both the mortgagor and his creditors.¹³² However, unlike under the Illinois Act, where these provisions are included only within the court's discretion, the federal statute should make these provisions mandatory for all sales.¹³³ While such a system would undoubtedly increase the costs of foreclosure to the mortgagee, these increased costs would be offset easily by the higher sale prices that would result.¹³⁴ Therefore, the federal statute should require the aforementioned measure for all foreclosure sales.

of the normal seller of real estate. Cf. G. NELSON & D. WHITMAN, *supra* note 1, § 8.8. Instead of bidding in a public auction setting, buyers would negotiate with this professional, and closings even could be held in the office of a lawyer, bank, or escrow company like most modern real estate conveyances. Ehrlich, *supra* note 7, at 979. When combined with the other reform provisions previously mentioned (*see supra* notes 116-29 and accompanying text), a foreclosure sale in this setting removes the intimidation present in today's typical foreclosure sale and thus will assure more bidding, and higher prices, at these sales.

131. The professional conducting the sale could be paid a modest fixed fee that would increase accordingly as the sale price increases. In this way, the independent professional would have incentive to obtain the highest possible price for the property. For a detailed example of how this system would operate, see G. NELSON & D. WHITMAN, *supra* note 1, § 8.8 n.3.

132. Prices approximating the fair market value of the properties being sold will assure that the mortgagor and his other creditors will realize the benefit of any equity in the property.

133. Making these requirements discretionary places new burdens on judges, who must decide which measures are appropriate in each instance despite the fact that they may not have real estate expertise or time to fully consider each situation. See Freyfogle, *New Judicial*, *supra* note 114, at 956-60. Mortgagees might then subvert the process by exerting undue influence on overburdened courts and unwitting or absent mortgagors. *Id.* Thus, the aforementioned reforms (*see supra* notes 127-31 and accompanying text) should be required for all sales. Only if the independent professional seller is unable to sell the property within a specified period should a sale by public auction be allowed. See G. Nelson & D. Whitman, *supra* note 1, § 8.8. *Id.* Ninety days has been suggested as a reasonable sales period. *Id.* Furthermore, if a property cannot be sold by an independent professional within 90 days, an alternative to an auction procedure would be for the mortgagee to discount the sale price of the property by a specified percentage each month (e.g. five percent per month) until the property is sold. That approach is now being employed by the Resolution Trust Corporation, the agency in charge of the federal government's savings and loan bailout procedure, in order to encourage sales of foreclosure properties that were held by insolvent savings and loan organizations. See Chicago Sun Times, May 11, 1990, at 28, col. 1 (editorial discussing procedures being used by Resolution Trust Corporation to sell vast number of properties held by insolvent savings and loans).

134. Payments to the independent professional salesperson and to a real estate broker add new costs to foreclosure. However, these added costs should almost always result in higher prices which will offset the higher costs. Moreover, abolishing statutory redemption will make foreclosure a much less time-consuming procedure, thereby reducing costs to mortgagees. Provisions for strict foreclosure should also save mortgagees time and money. See *infra* notes 135-38 and accompanying text (discussing suggested provisions for strict foreclosure in the new federal statute).

B. Provision for Strict Foreclosure

Even when foreclosure sale procedures are designed to obtain the highest possible prices, foreclosure by sale is not always appropriate. Where the combined amount of the mortgage debt and the costs of foreclosure exceed the fair market value of the property, a foreclosure sale wastes time and money if the mortgagee is willing to take the property in satisfaction of the mortgagor's debt.¹³⁵ The Illinois Act thus provides for two types of actions that are essentially equivalent to strict foreclosure when all parties to the action consent to such a procedure.¹³⁶

While the Illinois Act's provision for strict foreclosure is laudable, the consent of all parties to the action should not be required for its use.¹³⁷ In all cases where an appraisal of the property shows that the property's market value is less than the amount of the debt and foreclosure costs, strict foreclosure should be available to the mortgagee.¹³⁸ Allowing strict foreclosure in these instances saves the

135. Wechsler, *supra* note 20, at 884-85. Even a foreclosure sale yielding 100% of the property's fair market value would not benefit the mortgagor or his creditors because the mortgagor has no equity in the property which would be realized.

136. See ILL. REV. STAT. ch. 110, para. 15-1401 (Supp. 1990) (consent foreclosure); ILL. REV. STAT. ch. 110, para. 15-1402 (Supp. 1990) (deed in lieu of foreclosure). See also ILL. REV. STAT. ch. 110, para. 15-1403 (Supp. 1990) (common law strict foreclosure where right previously existed in Illinois).

137. Allowing for strict foreclosure only when all parties consent is undesirable for two reasons. First, even where the mortgagor has no equity in the property, he or another party nevertheless may withhold consent and demand a foreclosure sale, which would be patently unfair to the mortgagee. See Freyfogle, *New Judicial*, *supra* note 114, at 949-52. Second, mortgagors may unknowingly or carelessly consent to one of these forms of strict foreclosure when the mortgagor does have equity in the property. For example, an insolvent mortgagor faced with numerous other unsecured debts may not care about strict foreclosure when his equity would only benefit his other creditors rather than himself. Moreover, these other unsecured creditors most likely will not be parties to the action, and thus cannot object until it is too late. Thus, to be consistent with § 548's purpose of protecting the mortgagor's unsecured creditors, and to protect the mortgagee, consent should not be the standard for strict foreclosure under the new federal statute.

138. The mortgagee may prefer to have a foreclosure sale and to pursue a deficiency judgment against the mortgagor if the price yielded is less than the debt amount. Nothing in the new federal statute should limit the right of the mortgagee to pursue such a course if he chooses to do so. See G. NELSON & D. WHITMAN, *supra* note 1, § 8.8. However, if an appraisal shows that the market value of the property is less than the combined amount of the mortgage debt and the costs of a foreclosure sale, the mortgagee should have the option of strict foreclosure.

As noted earlier, the focus of the problems and suggested reforms in this comment is on mortgages in the residential context. However, not all of these proposed reforms should be necessary in the commercial mortgage context. The commercial mortgage market is a much more sophisticated market, with much more sophisticated participants. Thus, participants in the commercial mortgage arena are more likely to be aware of commercial foreclosures, and the need for more extensive advertising of these sales is therefore less important. However, as suggested earlier in this comment in the residential context, the commercial mortgage market would also benefit from sales structured like sales of commercial property in the open market, as opposed to

mortgagee considerable unnecessary expense with no harm to the mortgagor or his other creditors. Thus, the new federal statute should also provide for strict foreclosure.

IV. CONCLUSION

The federal courts have good reasons for applying section 548 in the mortgage arena because foreclosure sales in their current form virtually always yield prices well below the market value of the properties being sold. However, any approach to section 548 in this context that truly achieves the statute's goals is likely to exacerbate the problem of inadequate foreclosure sale prices. A preemptive federal statute reforming the foreclosure process, patterned after the Illinois Act, would achieve the goals of section 548 without the problems associated with applying that section to foreclosure sales. By structuring foreclosure sales like regular sales of real estate, maximum prices would be received at the sales, thereby allowing the mortgagor and his other creditors to receive the benefit of the mortgagor's equity in the property. While this statute will make foreclosure more costly to lenders, abolishing statutory redemption and allowing for strict foreclosure in certain instances would make this new statute attractive to lenders as well.

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auctions to sell these properties. As with residential sales, this would assure the highest possible prices for these properties and would reduce the incidence of banks left holding the properties in satisfaction of the debt. In sum, while the more stringent advertising requirements may not be necessary in the commercial mortgage foreclosure context, the commercial mortgage arena would also benefit from a reform in the structure of the foreclosure sales.