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Recommended Citation
William A. Walsh, In Re Bundles: Finding a New Basis for Determining "Reasonably Equivalent Value" under Section 548 of the Bankruptcy Code, 40 DePaul L. Rev. 175 (1990)
Available at: https://via.library.depaul.edu/law-review/vol40/iss1/5

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IN RE BUNDLES: FINDING A NEW BASIS FOR DETERMINING "REASONABLY EQUIVALENT VALUE" UNDER SECTION 548 OF THE BANKRUPTCY CODE

William A. Walsh*

INTRODUCTION

Young Laertes, an investment banker in New York City, envisioned a life of prosperity. His annual salary was impressive for a young professional and the future seemed to hold only greater promise of advancement. In 1983, ignoring the advice of his father,1 Laertes borrowed $75,000 from Royal Danish Bank to purchase a $160,000 home in Elsinore Heights. His fortunes suffered a dramatic reversal on October 19, 1987, when the stock market plunged.2 One month after the crash, he was fired from his job.3 Three months later, Laertes took out a $25,000 second mortgage on his home in an effort to meet expenses and continue his hunt for new employment. Six months later, unemployed and broke, Laertes missed his first mortgage payment. The Royal Danish Bank immediately declared Laertes in default and initiated foreclosure proceedings against his Elsinore Heights home. Exactly one year after the crash, the house, now worth $325,000, was sold to a third party through a judicial foreclosure for $100,000, an amount equivalent to Laertes outstanding debt. The following morning, Laertes declared bankruptcy.4 That same day Horatio, his bank-


1. Neither a borrower nor a lender be,

For loan oft loses both itself and friend,

And borrowing dulleth edge of husbandry.

W. SHAKESPEARE, HAMLET, Act I, Scene iii, lines 75-78.

2. The Dow Jones industrial average recorded its largest percentage loss on October 19, 1987. The industrial average dropped 508 points to 1,738.74. This 22.6% loss eliminated an "estimated $500 billion in equity value from the nation's stock portfolio," and more than doubled the 12.82% decline recorded on October 28, 1929. N.Y. Times, Oct. 20, 1987, at 1, col. 6. Big Board Chairman, John J. Phelan, Jr., commenting on the loss which involved the trading of over 604 million shares, said, "It's the nearest thing to a meltdown that I ever want to see." Id. at 34, col. 1.


4. The number of bankruptcy petitions filed or pending has increased dramatically over the past ten years. At the close of fiscal year 1975, 254,000 bankruptcy petitions had been filed that year and an additional 202,000 petitions were pending. These figures had more than doubled by the end of fiscal year 1985 with the 365,000 petitions filed and another 609,000 petitions pending. BUREAU OF THE CENSUS, DEPT. OF COM., Statistical Abstract of the United States 511 (1987).
ruptcy trustee, filed suit under section 548 of the Bankruptcy Code ("Code") to have the sale of the Elsinore Heights home set aside. Horatio asserted that the purchaser had not given "reasonably equivalent value" for the property.

Attempts under section 548 to set aside the transfer of property have posed a number of problems for bankruptcy courts. Bankruptcy courts have examined two principal section 548 questions: when the "transfer" occurred, and whether the purchaser has provided "reasonably equivalent value" for the

6. 11 U.S.C. § 548 provides in part:
   (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing or the petition, if the debtor voluntarily or involuntarily—
   (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud . . . or
   (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
   (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation . . . .

Id. (emphasis added).

7. The debtor or trustee must clear four different hurdles before she can have the transfer set aside under § 548. These four requirements are:
   (1) the debtor had an interest in the property transferred; (2) the debtor was insolvent at the time of the transfer 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."

Bundles v. Baker (In re Bundles), 856 F.2d 815, 817 (7th Cir. 1988). Each of these criterion must be met before the court may void the sale for lack of reasonably equivalent value. See id. at 816.

8. The decision in Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), opened the debate over the application of "transfer." In Durrett, the court of appeals determined that "the transfer of title to the real property of the debtor . . . by a trustee on foreclosure of a deed of trust, to a purchaser at the sale constitutes a 'transfer' by debtor . . . ." Id. at 204. This decision found the transfer to have occurred at the time of the foreclosure sale. Id. The Durrett analysis was rejected shortly thereafter inAlsop v. Alaska (In re Alsop), 14 Bankr. 982 (Bankr. D. Alaska 1981), aff'd 22 Bankr. 1017 (D. Alaska 1982). The Alsop court first noted that § 548(d)(1) of the Bankruptcy Code will find that a transfer occurred when it is so far perfected that a bona fide purchaser could not have obtained an interest superior to that of the transferee. 14 Bankr. at 986. The court dated the transfer at issue back to the original execution of the deed of trust, reasoning that no good faith purchaser could have obtained title superior to that of the purchaser at the foreclosure sale. Id. Consequently, the court found that the transfer occurred when the debtor executed the deed of trust, a time more than a year before the bankruptcy petition had been filed, and the conveyance could not be set aside. Id. This latter view was slightly altered in Lawyers Title Ins. Corp. v. Madrid (In re Madrid), 21 Bankr. 424 (Bankr. 9th Cir. 1982), aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984). Here the court of appeals determined that the perfection of the deed of trust was the sole § 548 transfer. 725 F.2d at 1200-01.

The definition of "transfer" under the Bankruptcy Code is very broad. Section 101(50) defines transfer as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ." 11 U.S.C. § 101(50) (1988). The expansive scope of the term has been described as a congressional attempt "to facilitate the use of a single term that would be applicable to the bulk of those sections that the Bankruptcy Act of 1938 adopted . . . ." Zinman, Houle & Weiss, Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits, 39 Bus. Law. 977, 996 (1984).
property. Assessing "reasonably equivalent value" poses substantial difficulty because the Bankruptcy Code fails to provide a definition. The Seventh Circuit most recently attempted to provide a definition of this phrase in *Bundles v. Baker (In re Bundles).* The *Bundles* court did not address the transfer question; instead, it focused on formulating a method for determining reasonably equivalent value. The Seventh Circuit, rejecting both existing legal tests for determining reasonably equivalent value, decided that reasonable equivalence is fact-specific to each case. The *Bundles* court proposed a middle-of-the-road test, but its reasoning has flaws and lacks statutory support. *Bundles* provides little assistance in developing a test for setting the valuation of property and the expected price in a foreclosure sale.

This Article analyzes the history and case law behind the "reasonably equivalent value" requirement and proposes an amendment to section 548 of the Bankruptcy Code.

9. See, e.g., Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980) (setting aside the transfer because payment of 57.7% of property's fair market value was not "reasonably equivalent value" within meaning of Bankruptcy Act); Lawyers Title Ins. Corp. v. Madrid (In re Madrid), 21 Bankr. 424 (Bankr. 9th Cir. 1982) (reversing bankruptcy court's set aside of property transfer under presumption that consideration received at non-collusive, regularly conducted public sale satisfied "reasonably equivalent value" requirement, even though fair market value of property was considerably greater than the price received), aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984).

10. 856 F.2d 815 (7th Cir. 1988).

11. "There is no dispute in this case over whether a foreclosure sale constitutes a 'transfer' for purposes of § 548(a)." Id. at 817 n.2. The court of appeals went on to suggest that this debate has been resolved: "We also note that many courts now consider the transfer issue to have been resolved definitely by the 1984 Amendments to the Bankruptcy Code... in favor of the Durrett approach." Id.; see also Butler v. Lomas Nettleson Co. (In re Butler), 75 Bankr. 528, 531 n.2 (Bankr. E.D. Pa. 1987) (stating that "there is no question... that the 1984 Amendments to the Code... eliminated reliance on the decision of the Ninth Circuit Court of Appeals in Madrid, holding that a foreclosure sale was not a 'transfer'"); Note, Can Mortgage Foreclosure Sales Really Be Fraudulent Conveyances Under § 548(a)(2) of the Bankruptcy Code?, 22 Hous. L. Rev. 1221, 1242 (1985) [hereinafter Note, Mortgage Foreclosure Sales] (stating that the amendments favored Durrett because the application of § 548 to both voluntary and involuntary transfers "invalidated Madrid's most compelling support"). The broad scope of the term's definition justifies the court's conclusion.

This Article will not address the transfer question because it does not exist within this fact scenario, and the author agrees with the view of the Seventh Circuit on the matter.

12. See *In re Bundles*, 856 F.2d at 819-25.

13. The *Bundles* court acknowledged that there were two leading cases in this area of the law. *Id. at 819. The first, Durrett v. Washington Nat'l Ins. Co. (In re Durrett), 621 F.2d 201 (5th Cir. 1980), held that reasonably equivalent value would be based upon a percentage of the property's fair market value. *Id. at 204. The Durrett rule has set a requirement of 70% of the fair market value. See infra notes 37-56 and accompanying text for a discussion of Durrett.*

The second, Lawyers Title Ins. Corp. v. Madrid (In re Madrid), 21 Bankr. 424 (Bankr. 9th Cir. 1982), aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984), rejected the Durrett percentage requirement. *Id. at 426-27. Instead, the Madrid court gave a regularly conducted, noncollusive foreclosure sale a presumption of finality. See infra notes 57-72 and accompanying text for a more detailed examination of Madrid.*

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

15. *Id. at 824.*
the Bankruptcy Code to eliminate the conflicting applications of this term. Part I examines the history and judicial application of section 548. Part II examines the Seventh Circuit's "reasonably equivalent value" test developed in In re Bundles and criticizes its results. Part III proposes an equitable statutory definition describing reasonably equivalent value in terms of the debtor's tax basis in the property, rather than the property's fair market value. The Article concludes that the Bundles court erred in establishing a test that will increase the probability of inconsistent and unpredictable applications of section 548 to foreclosure sales. The Article proposes a model amendment to section 548 that will minimize the occurrence of foreclosure sales without chilling the savings and loan business.

I. FRAUDULENT CONVEYANCES AND REASONABLY EQUIVALENT VALUE

The Anglo-American law for setting aside fraudulent conveyances has its roots in English law dating back as early as 1571. Since adopting the English law, Congress has expanded bankruptcy law to allow debtors and trustees, as well as creditors, to challenge fraudulent transfers in situations where debtors fail to receive "fair consideration." The enactment of the Bankruptcy Code in 1979 changed the meaning of fair consideration by eliminating the element of good faith. However, subsequent interpretations of the Code have arrived at incongruent results. Since the Code's enactment, courts have continued to struggle to find a practical definition of fair consideration.

A. Protecting Lenders' Investments by Prohibiting Fraudulent Conveyances

The initial legal rules against fraudulent conveyances exclusively favored creditors. The Statute of Elizabeth created the foundation for prohibiting fraudulent conveyances and for section 548 of the modern-day Bankruptcy

19. Compare Chandler Act, ch. 575, § 67(d), 52 Stat. 840, 877 (1938) (codified at 11 U.S.C. § 107(d) (1976)) (repealed 1978) (requiring that consideration given for the property or obligation of a debtor be given in "good faith" in order to be considered "fair") with 11 U.S.C. § 548 (a)(2)(A) (1988) (transfer may be set aside if the debtor "received less than a reasonably equivalent value in exchange for the transfer or obligation").
20. Compare Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980) (refusing to uphold transfer where debtor received 57.7% of fair market value for his property because court was unable to locate a single case where a transfer for less than 70% of fair market value was approved) with Lawyers Title Ins. Corp. v. Madrid (In re Madrid), 21 Bankr. 424 (Bankr. 9th Cir. 1982) (upholding transfer by construing the reasonably equivalent value requirement to mean the same consideration as received at a non-collusive and regularly conducted foreclosure sale), aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984).
22. The Statute of Elizabeth is the direct ancestor of current Anglo-American law in this area. Laws against fraudulent conveyances, however, have been traced as far back as the Roman Em-
The Statute of Elizabeth enabled lenders to set aside property conveyances "made by debtors with the specific intent of hindering, delaying, or defrauding creditors." The difficulties inherent in demonstrating specific intent required courts to construct "badges of fraud," factual circumstances that illustrated presumed fraudulent conveyances.

The English law of fraudulent conveyance crossed the Atlantic and found favor with the federal government and various states. From the first codification, every federal bankruptcy act contained provisions prohibiting fraudulent conveyances. Congress specifically incorporated the Statute of Elizabeth in the Bankruptcy Act of 1898. The states also adopted the common law provisions against fraudulent conveyance, although with divergent results. Consequently, the National Conference of Commissioners on Uniform State Law adopted the Uniform Fraudulent Conveyance Act ("UFCA") in 1918. For the most part, the UFCA abandoned the Statute of Elizabeth's subjective test in favor of an objective test for determining constructive fraud. The UFCA
allowed courts to set aside property conveyances as fraudulent without a demonstration of actual intent in certain situations. In particular, under section 4 of the UFCA, a conveyance was presumed fraudulent if the property transfer rendered the individual insolvent, or if it was part of a business transaction.\footnote{Congress adopted the language of section 4 of the UFCA, the insolvency provision, almost verbatim\footnote{when it amended the Bankruptcy Act with the Chandler Act of 1938.\footnote{Congress, however, substituted “transfer” for “conveyance.”}} when it amended the Bankruptcy Act with the Chandler Act of 1938.\footnote{Note, Regularly Conducted Non-Collusive Mortgage Foreclosure Sales: Inapplicability of Section 548(a)(2) of the Bankruptcy Code, 52 FORDHAM L. REV. 261, 267 (1983) [hereinafter Note, Regularly Conducted Foreclosure Sales]; see also Note, Mortgage Foreclosure Sales, supra note 11, at 1238 (stating that, except for a few changes, the amendments were an adoption of the language of section 4 of the UFCA); Henning, supra note 24, at 262 (stating that the Chandler Act of 1938 incorporated concepts derived from § 4 of the UFCA).} Congress, however, substituted “transfer” for “conveyance.”

\footnote{UFCA, supra note 29, § 7, 7A U.L.A. at 509 (emphasis added).}

\footnote{31. § 4. Conveyance by Insolvent

   Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

   \textit{Id.} § 4, 7A U.L.A. at 474 (emphasis added); see also \textit{id.} § 5.

   Fraudulent intent was also presumed under the UFCA if a person in business made the conveyance without fair consideration, such that the business was rendered undercapitalized. \textit{Id.} § 5, 7A U.L.A. at 504 (Conveyances by Persons in Business); see also \textit{id.} § 8, 7A U.L.A. at 576 (Conveyance of Partnership Property); \textit{id.} § 11 7A U.L.A. at 634 (Cases Not Provided For in This Act).

   32. Note, Regularly Conducted Non-Collusive Mortgage Foreclosure Sales: Inapplicability of Section 548(a)(2) of the Bankruptcy Code, 52 FORDHAM L. REV. 261, 267 (1983) [hereinafter Note, Regularly Conducted Foreclosure Sales]; see also Note, Mortgage Foreclosure Sales, supra note 11, at 1238 (stating that, except for a few changes, the amendments were an adoption of the language of section 4 of the UFCA); Henning, supra note 24, at 262 (stating that the Chandler Act of 1938 incorporated concepts derived from § 4 of the UFCA).


   d. (1) For the purposes of, and exclusively applicable to, this subdivision d: (a) “Property” of a debtor shall include only his nonexempt property; (b) “debt” is any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent; (c) “creditor” is a person in whose favor a debt exists; (d) a person is “insolvent” when the present salable value of his property is less than the amount required to pay his debts; and to determine whether a partnership is insolvent, there shall be added to the partnership property the present fair salable value of the separate property of each general partner in excess of the amount required to pay his separate debts, and also the amount realizable on any unpaid subscription to the partnership of each limited partner; and (e) consideration given for the property or obligation of a debtor is “fair” (1) when, in good faith, in exchange and as a fair equivalent thereof, property is transferred or an antecedent debt is satisfied, or (2) when such property or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small as compared with the value of the property or obligation obtained.

   (2) Every transfer made and every obligation incurred by the debtor within one year prior to the filing of a petition initiating a proceeding under this Act by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or (b) as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is unreasonably small capital, without regard to his actual intent; or (c) as to then existing and future creditors, if made or incurred without fair consideration by a debtor who intends or believes he will incur debts}
when it adopted the new Act. Courts could not set aside foreclosure sales under the UFCA, because the UFCA applied only to voluntary conveyances. By rewording the UFCA in the amended Bankruptcy Act, Congress expanded the range of protected transactions by allowing debtors or trustees to challenge involuntary, as well as voluntary, transfers as fraudulent. Accordingly, under section 67(d) of the amended Bankruptcy Act, for-

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34. Compare UFCA § 4 ("Every conveyance made . . . is fraudulent as to creditors . . . if . . . made without consideration.") (emphasis added) with Chandler Act, ch. 575, § 67(d)(2), 52 Stat. 840, 877 (1938) (codified at 11 U.S.C. § 107(d)(2) (1976)) (repealed 1978) ("[e]very transfer made . . .") (emphasis added). See also Note, Regularly Conducted Foreclosure Sales, supra note 32, at 267 ("[O]ne significant change was made by the drafters of the Chandler Act: The word 'conveyance' was replaced with 'transfer.'") (footnote omitted).

35. The UFCA definition of "conveyance" limited, apparently, the application of the Act. See Note, Mortgage Foreclosure Sales, supra note 11, at 1238. "The history of the law of fraudulent conveyances [under the UFCA, earlier state statutes or common law], however, suggests that voluntary action by the debtor is necessary for the conveyance to be voidable." Henning, supra note 24, at 261 n.27. Professor Henning states that "[t]here is little direct authority supporting the view that only voluntary conveyances may be avoided under the UFCA," but notes that the limitation is widely accepted as true. Id. (citing Merriam v. Wimpfheimer, 25 F. Supp. 405 (S.D.N.Y. 1938)).

Transfer shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, or pledge, mortgage, lien, encumbrance, gift, security, or otherwise . . . .
closure sales were potentially voidable as fraudulent transfers. In order to have the conveyance set aside, the trustee had to demonstrate that the debtor did not receive "fair consideration." The Bankruptcy Act's definition of fair consideration created a two-part test: first, the debtor must have received a "fair equivalent," and second, he must have received it in "good faith."

In 1978, Congress passed the Bankruptcy Code to replace the former Bankruptcy Act. The Bankruptcy Code changed the definition of fair consideration by eliminating the good faith requirement. Under section 548 of the current Code, the trustee or debtor may avoid the transfer if the debtor has received less than a "reasonably equivalent value." Since the Code's enactment, courts have grappled with the meaning of "reasonably equivalent value." Not surprisingly, divergent interpretations have resulted.

B. Durrett: Debtor's and Trustee's Right to Equity

The courts first exercised their ability to set aside a foreclosure sale as a fraudulent transfer because of a lack of fair consideration in Durrett v. Washington National Insurance Co. Although Durrett was decided under the predecessor to the current Bankruptcy Code, the case has had a lasting impact on the issue of the meaning of reasonably equivalent value. Durrett established the "Durrett rule." As interpreted, the rule allows either the trustee or the debtor to have a conveyance of property set aside unless the property is sold for at least seventy percent of its fair market value.

37. In re Bundles, 856 F.2d 815 (7th Cir. 1988).
38. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980). Under § 67(d) of the Bankruptcy Act, fair consideration was received:

(1) when, in good faith, in exchange and as a fair equivalent therefor, property is transferred or an antecedent debt is satisfied, or (2) when such property or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small compared with the value of the property or obligation obtained.

42. Id. For the text of the statute, see supra note 6.
43. Simpson, Real Property Foreclosures: The Fallacy of Durrett, 19 REAL PROP. PROB. & TR. J. 73, 73 (1984); see also Henning, supra note 24, at 265 n.50 and accompanying text (noting that although several cases preceded Durrett, it was Durrett that "represented a radical departure from prior law").
44. 621 F.2d 201 (5th Cir. 1980).
45. See id. at 203; see also supra notes 46-56 and accompanying text for a discussion of subsequent law and commentary regarding the Durrett rule.
46. Durrett, 621 F.2d at 203. It is important to note that Durrett did not specifically establish a requirement that the proceeds from a foreclosure sale be no less than 70% of the property's fair market value. The court vacated and remanded after observing that the 57.7% of value received...
REASONABLY EQUIVALENT VALUE

The district court in *Durrett* concluded that a foreclosure sale price of $115,400 had been fair consideration for property with an estimated $200,000 fair market value.\(^4\) In reversing the lower court, the Fifth Circuit applied section 67(d) of the Bankruptcy Act, which defined fair consideration.\(^5\) The circuit court concluded that the debtor had not received "fair equivalent" value for the property.\(^6\) In reaching this conclusion the court noted that it could not locate a single federal case upholding a transaction under section 67(d) where a trustee/debtor received less than seventy percent of the fair market value in consideration.\(^7\)

Although the Fifth Circuit did not specifically hold that courts must void transfers for less than seventy percent of the fair market value of the property, a number of courts have followed the *Durrett* rule, even in the face of a change in the statutory law.\(^8\) The Fifth Circuit reaffirmed *Durrett* one year

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\(^4\) The circumstances of the case arose from Durrett's default on a note which he executed in the amount of $180,000 on April 7, 1969, and secured through a deed of trust on his property. The deed contained a provision for a public sale of the real property in the event of default. Durrett defaulted on the note and the property was posted for a foreclosure sale on December 13, 1976. Only one individual appeared at the sale on January 4, 1977, and he purchased the property with a winning bid of $115,400. This bid matched the "exact amount necessary to liquidate the indebtedness secured by the deed of trust." *Durrett*, 621 F.2d at 203. This amount represented 57.7% of the fair market value of the property. Effectively, the debtor/trustee suffered a loss on the property of more than $84,000. *Id.* at 202-03.

\(^5\) Initially, the court of appeals found that the involuntary disposal of the property at a foreclosure sale constituted a "transfer" within the meaning of the Bankruptcy Act. *Id.* at 204. The court of appeals examined the definition of transfer under the Act, 11 U.S.C. § 1(30), and found:

> The comprehensive character of this definition leads us to conclude that the transfer of title to the real property of the debtor in possession pursuant to an arrangement under Chapter XI of the Act, by a trustee on foreclosure of a deed of trust, to a purchaser at the sale constitutes a "transfer" by debtor in possession within the purview of section 67(d).

*Id.*

Next, the court determined that § 67(d) covered transfers of possession, as well as transfers of title. *Id.* The court acknowledged that the actual transfer of title had been made eight years previously in the deed of trust, but noted that Durrett retain possession of the property until the foreclosure. *Id.* The court reasoned that the Chandler Act contemplated that the surrender of possession was a type of transfer. *Id.* (citing 1 COLLIER ON BANKRUPTCY, § 1.30 at 130.28(2)(3) (14th ed. 1967)).

Finally, the court found that § 67(d) applied, because the foreclosure sale had been a transfer within the past year. *Id.*

\(^6\) *Id.* at 203.

\(^7\) The *Durrett* court stated it was unable "to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the Act, which has approved the transfer for less than 70% of the market value of the property." *Id.*

\(^8\) By the time the court of appeals had reached its decision, § 548(a) of the Bankruptcy Code had already replaced § 67(d) of the Bankruptcy Act. See supra note 33.
later in *Abramson v. Lakewood Bank and Trust Co.*, and bankruptcy courts in other circuits have followed the holding. Most courts adopting the *Durrett* rule have done so without extensive examination of the seventy percent price floor. Courts have considered *Durrett* in nonjudicial foreclosures, judicial foreclosures, execution sales, and strict foreclosures. The most significant

52. 647 F.2d 547 (5th Cir. June 1981). This case, like *Durrett*, was brought under § 67(d) of the Bankruptcy Act. Though the court held that *Durrett* was controlling, almost the entire focus of the opinion was on the transfer question. See id. at 548-49. *Abramson* also contained the first challenge to the *Durrett* rule. In his dissent, Judge Clark argued that the rule clouded the purchaser's title and threatened to further depress foreclosure sale bids. Id. at 549 (Clark, J., dissenting).

53. *E.g.* Coleman v. Home Sav. Ass'n (*In re Coleman*), 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982) (using the 70% benchmark set by *Durrett*, the court determined that where lienor purchased debtor's homestead for slightly more than 28% of market value the amount paid was less than reasonably equivalent value); Wickham v. United Am. Bank (*In re Thompson*), 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982) (determining that where the amount paid for the property represented 80.8% of the fair market value of the subject property, the price paid was a reasonably equivalent value); Madrid v. Del Mar Commerce Co. (*In re Del Mar Commerce Co.*), 10 Bankr. 795, 800 (Bankr. D. Nev. 1981) (concluding that where the purchase price of subject property was 64 to 67% of the market value of the property, purchase price was not the reasonably equivalent value of the market appraisal); see also Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the Durrett Problem*, 38 BUS. LAW. 1605, 1613-16 (1983) (discussing the application of *Durrett's* 70% floor in foreclosure sales).

54. For example, in *In re Butler*, the court merely noted that "[t]he ratio of mortgage balance plus taxes and costs to sale price here is lower than both the high figure in *Jones* and the 57.7 percent figure which the court in *Durrett* found insufficient." *In re Butler*, 75 Bankr. 528, 532 (Bankr. E.D. Pa. 1987) (citing *In re Jones*, 20 Bankr. 988 (Bankr. E.D. Pa. 1982) and *In re Durrett*, 621 F.2d 201 (5th Cir. 1980)).

55. *See, e.g.*, Federal Nat'l Mortgage Ass'n v. Wheeler (*In re Wheeler*), 34 Bankr. 818, 821 (N.D. Ala. 1983) ("[A] nonjudicial foreclosure sale which produces less than 70% of the market value of the foreclosed property is not a reasonably equivalent value in exchange for such transfer and is avoidable under § 548(a)(2)"); Cooper v. Smith (*In re Smith*), 24 Bankr. 19, 23 (Bankr. W.D.N.C. 1982) (holding that the percentage of the amount paid in a nonjudicial foreclosure sale is one factor to be considered in determining reasonably equivalent value); Gillman v. Preston Family Inv. Co. (*In re Richardson*), 23 Bankr. 434, 448 (Bankr. D. Utah 1982) (with respect to a nonjudicial foreclosure sale, the court interpreted *Durrett* to mean that reasonable equivalence will depend on the facts of each case).

56. *See, e.g.*, United Penn Bank v. Dudley (*In re Dudley*), 38 Bankr. 666, 669-70 (Bankr. M.D. Pa. 1984) (agreeing with the conclusion in *Durrett* but refusing to adopt its finding that reasonably equivalent value must be at least 70% of the fair market value); Home Life Ins. Co. v. Jones (*In re Jones*), 20 Bankr. 988 (Bankr. E.D. Pa. 1982) (following the *Durrett* rule, the court concluded that a judicial foreclosure which fails to bring a reasonably equivalent value is voidable).

57. *See, e.g.*, Frank v. Berlin (*In re Frank*), 39 Bankr. 166, 174-75 (Bankr. E.D.N.Y. 1984) (considering the *Durrett* rule as one option in determining whether the debtor received less than reasonably equivalent value for her share of the equity in her home sold at a sheriff's sale where the woman received less than 4% of her equity value in the home); Smith v. American Consumer Fin. Corp. (*In re Smith*), 21 Bankr. 345, 352 (Bankr. M.D. Fla. 1982) (citing to *Durrett* to support the court's holding that the sale of property worth $19,100 for $1212.77 is a fraudulent conveyance).

58. *See, e.g.*, Carr v. Demusis (*In re Carr*), 34 Bankr. 653, 656-57 (Bankr. D. Conn. 1983) (concluding that a sale must be set aside where a debtor received less than 31% of equity remaining in the property after the transfer); Berge v. Sweet (*In re Berge*), 33 Bankr. 642, 649-50
benefit of *Durrett* and its progeny occurs in reorganization cases.60 The protection that the *Durrett* rule provides against a low bid improves a debtor's ability to reorganize successfully and repay her outstanding debts.60

Support for the *Durrett* decision, however, was far from unanimous. Commentators found the sudden shift in the Bankruptcy Act's application disturbing and expressed concern about the ramifications of the ruling.61 Critics argued that *Durrett* created a *de facto* federal right of redemption and suggested that the case would chill foreclosure sale bidding.62 These objections persuaded other courts to reject the seventy percent floor.63

(Click W.D. Wis. 1983) (following *Durrett*, the court concluded that the strict foreclosure was a transfer for less than equivalent consideration and therefore voidable); Perdido Bay Country Club Estates, Inc. v. Equitable Trust Co. (*In re* Perdido Bay Country Club Estates, Inc.), 23 Bankr. 36, 40 (Bankr. S.D. Fla. 1982) (noting that *Durrett* was controlling, the court refused to set aside a transfer where the debtor had received 70% of the fair market value of the property).

59. "The benefits of *Durrett* are most apparent in reorganization cases. If the debtor can regain substantial equity in property sold before he files for bankruptcy, his chances of working out a successful reorganization are increased." *Gillman v. Preston Family Inv. Co.* (*In re* Richardson), 23 Bankr. 434, 447 n.19 (Bankr. D. Utah 1982) (quoting Note, *Nonjudicial Foreclosure Under Deed of Trust May Be a Fraudulent Transfer of Bankrupt's Property*, 47 Mo. L. REV. 345, 352 (1982)).

60. *In re* Richardson, 23 Bankr. at 447 n.19.

61. See, e.g., Coppel & Kahn, *Defanging Durrett: The Established Law of "Transfer,"* 100 BANKING L.J. 676, 677 (1983) (theorizing that *Durrett* and *Abramson* made it impossible to "convey clear and marketable title at foreclosure sales"); *Simpson*, supra note 43, at 73 ("The rule of *Durrett* must have sent shock waves throughout the secured lending community. . . . [T]he effect, if not intent, of *Durrett* has been to jeopardize the security of all titles acquired through foreclosure sales."); *Zinman*, Houle & Weiss, supra note 8, at 978 (concluding that the *Durrett* court "misinterpreted the law of fraudulent transfers and section 67(d)" and indicating that the decision had disrupted the system of real estate financing); see also *In re* Abramson, 647 F.2d at 549 (Clark, J., dissenting) (arguing that *Durrett* is simply wrong in its holding that a foreclosure sale is a transfer within the meaning of § 67(d)); *Alsop v. Alaska* (*In re* Alsop), 22 Bankr. 1017, 1017-18 (D. Alaska 1982) (stating that *Durrett* and *Abramson* are inconsistent with the rationale of the Ninth Circuit's decision in *Evans v. Valley West Shopping Center*, 567 F.2d 358 (9th Cir. 1978)). But see *Gillman v. Preston Family Inv. Co.* (*In re* Richardson), 23 Bankr. 434, 448 (Bankr. D. Utah 1982) (stating that "[w]hile *Durrett* 's application of bankruptcy fraudulent conveyance law to a foreclosure sale may have been unprecedented, there is nothing novel in avoiding transfers under bankruptcy law which are valid under state law").

62. See Note, *Regularly Conducted Foreclosure Sales*, supra note 32, at 278-80. The twin, primary concerns are succinctly described in one paragraph in this Note:

The uncertainty of title caused by *Durrett* may inhibit competitive bidding at foreclosure sales, and as a result, increase the likelihood of deficiency judgments against debtors. In addition, debtors will be less likely to realize any of the equity in their property due to the decreased prices received at foreclosure sales.

"Id. at 278 (citations omitted).

C. Madrid: Giving Presumptive Effect of Innocence to Noncollusive Involuntary Foreclosures

In Lawyers Title Insurance Corp. v. Madrid (In re Madrid), a case decided under the Bankruptcy Code, the Bankruptcy Appellate Panel of the Ninth Circuit specifically rejected the Durrett rule. In Madrid, a third party purchaser at a nonjudicial foreclosure sale paid $80,224 for property purchased sixteen months earlier for $290,000. The Bankruptcy Appellate Panel reversed the lower court, which had followed Durrett, and voided the sale. The panel held that "the consideration received at a non-collusive, regularly conducted public sale satisfies the 'reasonably equivalent value' requirement of section 548(a)(2) of the Bankruptcy Code." The Madrid court distinguished a private transfer from a regularly conducted public sale. Ignoring the language of section 548(a), and relying instead on prior state law decisions, the court stated that inadequacy of price,

64. 21 Bankr. 424 (Bankr. 9th Cir. 1982), aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984) (upholding the sale because the transfer of the home occurred at the time of perfection of the trust deed, not foreclosure).

65. In re Madrid, 21 Bankr. 424, 426-27 (Bankr. 9th Cir. 1982) (declining "to follow Durrett's 70% fair market value rule for the reason that a regularly conducted sale, open to all bidders and all creditors, is itself a safeguard against the evils of private transfers . . .."). aff'd on other grounds, 725 F.2d 1197 (9th Cir. 1984).

66. In re Madrid, 21 Bankr. at 425. Judith Madrid purchased the home in September 1979. She paid the seller $125,000 in cash and a $165,000 one-year note secured by a deed of trust. The cash paid to the seller was gained through a $142,000 note, also secured through a deed of trust, to Del Mar Commerce Company. This second deed had been reduced to $75,300 by June 1980, but Madrid made no further payments. By the time of the foreclosure sale, Madrid owed $175,000 on the first note and $80,224 on the second note. The third party purchaser, Donald Turney, bid the equivalent of the amount due on the second deed of trust and took the property subject to the first deed of trust. Turney's bid was between 64 and 67% of the property's fair market value. Madrid filed a Chapter 11 bankruptcy case one week after the foreclosure sale. Id.

67. Id. at 426-27.

68. Id. at 425.

69. Id. at 426. While such a distinction may well be justified, it does not establish a ground upon which the court could reject Durrett. In Durrett, as in Madrid, the property was sold through a public sale. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 202-03 (5th Cir. 1980). Consequently, Madrid should be considered a sharp break from Durrett, rather than a factually distinguishable case.

70. The language of the Bankruptcy Code provides in part: "the trustee may avoid any transfer of an interest of the debtor in property . . . if the debtor . . . received less than a reasonably equivalent value in exchange for such transfer . . . and . . . was insolvent on the date that such transfer was made or . . . became insolvent as a result of such transfer . . . ." 11 U.S.C. § 548(a) (1988). One of three additional criteria must be met before the trustee can set aside a transfer for lack of reasonably equivalent value: (1) the debtor must be insolvent at the time of the transfer, or (2) be engaged in or about to engage in a business or transaction for which the property retained by the debtor was unreasonably small capital, or (3) the debtor must have intended to or believed that he would incur debts beyond the debtor's ability to satisfy those debts. Id. § 548(a)(2)(B)(i)-(iii) (1988). However, these requirements are merely procedural and the first criterion will be met in all cases involving a foreclosure sale of real property.
alone, was insufficient grounds for avoiding a foreclosure sale. The court added that "there must be in addition proof of some element of fraud, unfairness, or oppression as accounts for and brings about the inadequacy of price."

The Bankruptcy Appellate Panel found that a public, noncollusive sale safeguarded against any of these evils and established an "irrebuttable presumption of reasonableness" for any bid made at such a sale.

The "Madrid presumption" has received legislative and judicial support. The Uniform Fraudulent Transfer Act ("UFTA") specifically adopted Madrid's irrebuttable presumption.

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72. Id. (quoting Oller v. Sonoma County Land Title Co., 137 Cal. App. 2d 633, 635, 290 P.2d 880, 882 (1955)). The Madrid court required "some element of fraud," and thus, reintroduced the good faith requirement that the drafters had abandoned in § 548 of the Bankruptcy Code. The court gave a regularly conducted noncollusive foreclosure a presumption of innocence. Id. According to the Madrid court, a debtor's demonstration of some indication of fraud or "bad faith" is the only way to overcome this presumption and set aside the transfer. Id.

Any good faith requirement is at odds with § 548. The shift in statutory language from "fair consideration" to "reasonably equivalent value" represented congressional movement from a subjective to an objective test. See Chandler Act, ch. 575 § 67(d)(2), 52 Stat. 840, 877 (1938) (codified at 11 U.S.C. § 107(d)(2) (1976)) (repealed 1978). Section 57 of the Bankruptcy Act specifically defined fair consideration in relation to good faith, requiring the latter to find the former. Congress deleted this language in the passage of the Bankruptcy Code and no similar language exists in § 548. For the text of § 548, see supra note 6.

73. Guided by its illusionary distinction between private transfers and regularly conducted public sales, the court stated: "We decline to follow Durrett's 70% fair market value rule for the reason that a regularly conducted sale, open to all bidders and all creditors, is itself a safeguard against the evils of private transfers to relatives and favorites." In re Madrid, 21 Bankr. at 426-27. This focus upon sales to "relatives and favorites" is a throwback to the Elizabethan laws of fraudulent conveyance and fails to recognize the expanded definition of transfer found in the Bankruptcy Code. See supra notes 16-42 and accompanying text.

74. See In re Madrid, 21 Bankr. at 428 (Volinn, J., dissenting). Judge Volinn detailed the risk and error of the majority's opinion:

The majority, however, endows the consideration received at a non-collusive regularly conducted non-judicial foreclosure sale, with a conclusive or irrebuttable presumption of reasonableness. Functionally, the only way to question a fraudulent transfer under § 548 is to examine the adequacy of the consideration. If one is precluded from testing the transaction on the basis of the fraudulent transfer criterion and is deflected to criteria relating to questioning the validity of a deed of trust foreclosure, that is, collusion or irregular conduct, then the majority's logic in applying § 548 as a factor in its decision is illusory.

Id. As the dissent indicates, § 548(a)(2)(A) provides a trustee or debtor the only real means to challenge an involuntary foreclosure sale. See 11 U.S.C. § 548(a)(2)(A) (1988). The majority's argument undermines this subparagraph, and, therefore, the entire section as applied to such cases. The majority opinion creates an unassailable presumption favoring most foreclosure sale prices.

75. Uniform Fraudulent Transfer Act, 7A U.L.A. 639 (1985) [hereinafter UFTA]. Section 3(b) of the UFTA specifically defines the bid at a public sale as a reasonably equivalent value:

[A] person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale.
Durrett's seventy percent rule. Each state that has adopted the UFTA has constructed state law that prohibits a debtor or trustee from challenging the successful bid at a regularly conducted, noncollusive foreclosure sale on a claim of inadequate value. In 1983, Congress introduced legislation to amend section 548 of the Code and to codify the Madrid presumption. The Senate, however, dropped the proposed amendment and never voted on the bill. Although several federal courts have adopted the Madrid presumption, others have expressly rejected the Madrid holding. As the following section dis-

or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

Id. § 3(b).

The section does not completely block the application of Durrett in the states which have adopted the UFTA:

This provision would not affect transfers such as strict foreclosure, the taking of a deed in lieu of foreclosure, or termination of a lease in with the property's value is not tested by sale. Section 8(g) of the UFTA, however, would prevent Durrett's application to lease terminations or non-sale dispositions under the Uniform Commercial Code by specifically providing as a defense that such transfers are not voidable.

Henning, supra note 24, at 258 n.9.


The proposed amendment to § 548 provided:

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


See General Indus., Inc. v. Shea (In re General Indus., Inc.), 79 Bankr. 124, 131 (Bankr. D. Mass. 1987) (rejecting the Madrid presumption because it assumes that state foreclosure procedures are designed to attract bidders and to bring the highest price possible for real property when in reality "[q]uite often the opposite is true"); Gillman v. Preston Family Inv. Co. (In re Richardson), 23 Bankr. 434, 445-48 (Bankr. D. Utah 1982) (rejecting the Madrid presumption
cusses, Madrid's critics have focused upon the decision's conflict with congres-

sional intent and its deference to state law.

D. Initial Rejection of Durrett and Madrid and the Problems With

"Reasonably Equivalent Value"

A number of bankruptcy panels have specifically rejected both the Durrett rule and the Madrid presumption and have adopted an intermediate position requiring a case-by-case application. These courts have rejected Madrid's interpretation of "reasonably equivalent value," but have refused to hold that any single percentage of the fair market value represents reasonably equivalent value for all property. Because section 548 does not define "reasonably equivalent value," some courts have concluded that the amount is a question of fact, specific to each case.

Courts adopting this intermediate position have vehemently rejected Madrid's holding that selling the property at a noncollusive, regularly conducted foreclosure sale, pursuant to state law, ensures that the sale price approximates the reasonably equivalent value of the property. These courts rejected Madrid because they concluded that the presumption contradicts the intent and purpose of the federal statute, and because the federal law addresses different grounds for avoidance than many state statutes. Courts critical of the Madrid presumption also noted that the decision reintroduces a good faith test and places substantial restrictions on the admissibility of evidence rele-

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82. See Gillman v. Preston Family Inv. Co. (In re Richardson), 23 Bankr. 434, 443 (Bankr. D. Utah 1982) ("How much the property was worth at the time of the transfer is a material question of fact because its resolution is an essential predicate to the legal question of reasonable equivalence.").

83. See Bundles v. Baker (In re Bundles), 856 F.2d 815, 821 (7th Cir. 1988). In rejecting the Madrid approach, the Bundles court explained that neither the language of § 548 nor its legislative history supported "an irrebuttable presumption in the case of mortgage foreclosure sales." Id.

84. Unlike a number of state laws, inadequacy of price is a separate ground for setting aside a sale under the federal Bankruptcy Code. "Section 548(a)(2), however, authorizes disturbance of a foreclosure sale, which renders the debtor insolvent, for 'mere inadequacy of price' described by Section 548(a)(2) as 'less than reasonably equivalent value.' " In re Richardson, 23 Bankr. at 447.

In Adwar v. Capgro Leasing Corp. (In re Adwar), 55 Bankr. 111 (Bankr. E.D.N.Y. 1985), the court noted, "11 U.S.C. § 548 by its clear language, allows avoidance of sales for reasons not contemplated by many states' laws." Id. at 114. The court then referred to the more restrictive New York state law, allowing for the avoidance of judicial foreclosures sales only in the cases of fraud, as a demonstration of the variation in scope. Id.

85. See In re Richardson, 23 Bankr. at 447. Congress removed the good faith requirement that had been part of § 548's predecessor. See 11 U.S.C. § 548(a)(2)(A). The deletion indicates that
vant to the question of value given in a foreclosure sale.86

Although many courts have specifically rejected Madrid, these courts have not directly opposed Durrett, choosing instead to redefine that decision. These courts have acknowledged that Durrett did not explicitly establish a seventy percent floor.87 While these courts have agreed that the debtor or trustee must receive some percentage of the fair market value of the property in the foreclosure sale, the courts have rejected the application of a fixed percentage.88 Instead, these courts have favored determining the reasonably equivalent value on a case-by-case basis.89 These courts look beyond the amount paid and consider the transferee's good faith,90 the difference between the amount paid and the fair market value,91 the percentage of the amount paid to the fair market value,92 the difference between a wholesale price and the fair market value,93 and state law considerations.94

Congress considered the test unnecessary when it substituted "reasonably equivalent value" for "fair consideration." See supra notes 38-42 and accompanying text.

86. See In re Richardson, 23 Bankr. at 446 (stating that Madrid limited the evidence on reasonably equivalent value to the amount bid at the foreclosure sale).
87. As noted in In re Richardson: "Although Durrett has been so interpreted, Durrett does not hold that reasonably equivalent value must be 70% or more of fair market value. Durrett held that on the facts of the case, 57.7% of the fair market value was not a fair equivalent." Gillman v. Preston Family Inv. Co. (In re Richardson), 23 Bankr. 434, 448 (Bankr. D. Utah 1982) (citation omitted).
88. Id.
89. "Naturally, reasonable equivalence will depend on the facts of each case. In some cases, no less than 100% of fair market value may be a reasonable price." Id.
90. See, e.g., Cooper v. Smith (In re Smith), 24 Bankr. 19, 23 (Bankr. W.D.N.C. 1982). Arguably, the court should not consider this factor because Congress specifically removed it. See supra note 85.
91. First Fed. Sav. & Loan Ass'n v. Hulm (In re Hulm), 45 Bankr. 523 (Bankr. D.N.D. 1984). The bankruptcy court dismissed the mitigating factors such as the good faith of the purchaser, the relative difference between the amount paid compared to the fair market value, and the percentage of the amount paid that is representative of the fair market value. Id. at 528. The court stated that "there really are no significant factors in most of the cases except the price paid at the [foreclosure] sale and the fair market value of the property at the time." Id. Adopting the case-by-case analysis, the court concluded that reasonably equivalent value for the property would be the full fair market value. Id. at 529.

In reaching its conclusion, the court stated that it was not convinced that, contrary to the opinion of First Federal's experts, market forces alone could not have caused a devaluation from $123,000 to $64,443 in just nine months. Id. at 527. The court determined that, due to the pending foreclosure sale, the property had a fair market value of between $95,000 and $123,000. Id. Consequently, it fixed the sum of $100,000 to be a close approximation of the fair market value of the property as of the date of the foreclosure sale. Id.
92. In re Smith, 24 Bankr. at 23.
94. In re Adwar refers to state-granted redemption periods as a consideration against setting a fixed percentage of the fair market value to represent the reasonably equivalent value. Id. at 113-14. The decision notes that lower foreclosure sale prices generally occur in states with redemption
REASONABLY EQUIVALENT VALUE

The imprecise standards the courts have used in defining fair market value, and the value the purchaser pays at a foreclosure sale underlie the courts' preference for a case-specific analysis. No single definition of fair market value exists and each method of appraisal lacks precision. Furthermore, fair market value might not be appropriate in the foreclosure sale setting. The common legal definition of fair market value is "[t]he amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts." The very nature of a foreclosure sale, however, insures that there is no willing seller and, frequently, that the buyer is reluctant as well. Additionally, the absence of other aspects of a free market make it unlikely that the foreclosure sale price will ever represent a fair market value.

laws, because the purchaser still faces the risk of losing the property during the statutory redemption period. Id. at 113.

95. As this Article has noted, there is no statutory definition of "reasonably equivalent value" and no single judicial definition.

96. The In re Richardson court noted at least five definitions that might be applicable to fair market value:

Even the apparently simple term "market value," . . . has been used by the courts in at least five different senses: (1) the price which the property would actually bring if presently offered for sale, with reasonable time for negotiation, (2) valuation based on current market prices of substantially similar commodities, (3) hypothetical sale price as between a willing buyer and a willing seller, (4) cost of replacement through purchase on the market place, and (5) "justified selling price" or "normal selling price."


97. Four different categories of forces produce fluctuations in the market value of real property. These categories: (i) social ideas and standards; (ii) economic changes and adjustments; (iii) governmental controls and regulations; and (iv) physical and environmental changes, are composed of a number of small components. Each sub-component contributes to the imprecision of a real estate appraisal.

Social forces include population growth and decline, family size, attitude towards education and social activities, utility costs and availability, neighborhood aesthetics and other incalculable aspects of human nature. Economic forces include natural resources, commercial and industrial trends, employment availability, local salary levels, local consumer costs, state and local taxes and other factors that influence purchase power. Zoning laws, building codes, municipal laws (rent control, special use permits, credit controls, etc.), government funded housing and mortgages and other governmental regulations affect appraisals. Local climate and topography, mineral resources, public transportation, availability of community and religious services, flood control, soil conservation and other physical or environmental forces will impact property prices. AM. INST. OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE 3-4 (7th ed. 1978).

98. BLACK'S LAW DICTIONARY, 537 (5th ed. 1979).

99. In most foreclosure sales, the only bidder in attendance will be the creditor, who, if forced to, will bid up to the amount of the outstanding debt so that his security interest is covered. Equally, a third party purchaser seeks to take advantage of the situation and would have a substantially reduced interest in the property if she had to pay the full market value. Henning, supra note 24, at 274.

100. See Note, Regularly Conducted Foreclosure Sales, supra note 32, at 274 (observing that
The problems inherent in determining the value the purchaser pays in relation to the property mirror the difficulty in defining the anticipated fair market value. *Gillman v. Preston Family Investment Co. (In re Richardson)* identified four distinct formulas that different courts have employed to determine the value the purchaser has paid. To determine reasonably equivalent value, courts have compared "the amount of the senior lien plus the bid to the value of the property," "the bid to the value of the property," "the bid to the equity remaining in the property after subtracting the pre-sale liens from the value of the property," and "the bid to the equity remaining in the property after subtracting the post-sale liens from the value of the property." *Richardson,* advocating the fourth formula, reasoned that accounting for prior liens most clearly reflects the equity the purchaser receives in the property.

II. SEEKING A MIDDLE GROUND FOR DETERMINING VALUE

In an effort to correct the inconsistencies of previous tests, the Seventh Circuit formulated the *Bundles* test. The *Bundles* court advocated a case-by-case analysis to determine whether the price received at a foreclosure sale was a reasonable equivalent to the fair market value of the property. However, in formulating this three-part analysis, the *Bundles* court failed to address a number of inherent problems in its implementation.

A. *In re Bundles and a Case-by-Case Analysis*

The Seventh Circuit in *Bundles v. Baker (In re Bundles)* became the first...
federal appellate court to adopt a definition of reasonably equivalent value between the Durrett rule and the Madrid presumption. The Bundles court rejected both a bankruptcy court’s general acceptance of Madrid and a reviewing district court’s subsequent restrictive application of that presumption. Instead, the Seventh Circuit advocated a three part, case-by-case analysis to determine whether the price received at a foreclosure sale was a reasonable equivalent to the fair market value of the property.

The Bundles court’s analysis initially re-emphasized the federal statutory right of review of state court decisions on the question of whether reasonably equivalent value was given. Reading section 548(a)(2)(A) of the Code literally, the court found that all foreclosure sales may receive independent federal review because the statutory language creates no exception for foreclosure sales conducted in accordance with state law. The court further reasoned that state law did not control because Congress had established the federal guidelines for setting aside a foreclosure sale. With respect to the issue of the right of review, the Bundles court concluded that the 1984 amendments to the Bankruptcy Code did not alter these grounds for setting aside a foreclosure sale.

petition under Chapter 13 of the Bankruptcy Code. Id.


111. Bundles v. Baker (In re Bundles), 78 Bankr. 203, 210 (S.D. Ind. 1987) (applying an irrebuttable presumption to a regularly conducted, noncollusive foreclosure where the property was sold to third-party purchaser), rev’d 856 F.2d 815 (7th Cir. 1988).

112. In re Bundles, 856 F.2d at 824.

113. Id. at 821.

114. Id. at 823. The court observed that § 548(a)(2)(A) “makes no distinction between sales that do and sales that do not comply with state law.” Id. at 821. The lack of any limiting language permitted the court to conclude that the reviewing court could make an independent review.

The Seventh Circuit’s argument appears weak and relies upon a loose examination of legislative intent. The court could have strengthened its opinion with a more detailed examination of the Bankruptcy Code. Section 548 will not apply unless the debtor files for bankruptcy under chapter 7, 11, 12, or 13. 11 U.S.C. § 103(a) (1988). Not one of these chapters makes any reference to existing state law in discussing the trustee’s responsibility to represent the interest of the debtor. The absence of a state law reference creates a stronger presumption that the Bankruptcy Code addresses different interests than state law and that the federal law is independent of state law.

115. The circuit court rejected the district court’s application of Butner v. United States, 440 U.S. 48 (1979). In Butner, the Supreme Court held that state law would be applied where the federal government has not exercised its power to establish laws governing bankruptcies. Id. at 54. The Bundles court transformed the right of independent federal review into a federal standard that blocks any deference to state law. Bundles v. Baker (In re Bundles), 856 F.2d 815, 822 (7th Cir. 1988); see supra note 84 for a more detailed explanation of the reasoning behind the federal standard.

116. The court examined the legislative history of the Bankruptcy Amendments and Federal Judgeship Act (“BAFJA”) and proposed amendments addressing the Durrett issue. See supra note 33 for a discussion of BAFJA and the proposed amendments. Because these amendments
In the second portion of its analysis, the Bundles decision strongly rejected the Madrid presumption. In the court’s view, any irrebuttable presumption given to the foreclosure sale conflicts with section 548(a) because that statute fails to provide any exceptions to the trustee’s power of avoidance. Consequently, the court found all judicially formulated exceptions incompatible with the statute. The Seventh Circuit also observed that Madrid, contrary to congressional intent, reintroduced good faith into the foreclosure sale analysis. Finally, the court rejected the Madrid presumption, reasoning that it makes section 548(a)(2) redundant.

Similarly, the Bundles court rejected the Durrett rule in favor of a case-by-case analysis and focused the final portion of its analysis on what constitutes...
The court initially noted the existence of a number of different definitions for "value" and stated that the definition in section 548(d)(2)(A) provided little guidance. The varied definitions of value in the Bankruptcy Code allowed the court to conclude that Congress did not intend to have market value serve as the measure of reasonably equivalent value.

In addition, the Bundles court observed that the federal Bankruptcy Code addresses interests which prohibit full reliance on state law for determining reasonable equivalence. The various interests involved in a foreclosure sale, concluded the court, require the bankruptcy court to examine all the facts in each case. The Bundles court also indicated that bankruptcy courts should consider the Code's interest in preserving the assets of the estate and should examine the foreclosure transaction in its totality. The court, however, concluded that the effect of the foreclosure sale on the fair market value should be the primary factor in determining reasonably equivalent value. The Seventh Circuit added that courts should respect state foreclosure sale proceedings and placed principal importance on the price received at the foreclosure sale.

The Bundles court ultimately concluded that "reasonably equivalent value" was incapable of precise definition. The Seventh Circuit ostensibly came out in favor of a case-by-case analysis of the critical question of whether reasonably equivalent value was given. Nonetheless, the court of appeals concluded that the fact-specific determination should always begin with a presumption in favor of the foreclosure price.

B. No Functional Distinction Exists Between Bundles and Madrid

The Seventh Circuit's decision in In re Bundles contains distinct flaws. Pri-
marily, the new Bundles test will fail to preserve the unique federal interests that underlie elements of the Bankruptcy Code. Bundles conditions the value received through a transfer of property on the circumstances surrounding that transfer and so perpetuates the misapplication of section 548(a)(2)(A).

1. Failure to Preserve the Federal Interests

The federal government has two underlying goals which it seeks to achieve through the Bankruptcy Code. First, bankruptcy proceedings seek to protect the insolvent's estate in order to maximize an equitable distribution of assets.132 Second, this first goal should be met in a swift and economical manner.133 Federal bankruptcy statutes are intentionally more expansive than the state fraudulent transfer laws in order to facilitate these interests.134 For example, section 548 of the Code provides that a trustee may set aside a foreclosure sale for mere inadequacy of price or lack of reasonably equivalent value.135 These reasons are insufficient under state foreclosure laws.136

Despite the Seventh Circuit's recognition of the distinct federal interests under section 548,137 it ignored its own insight and implemented a rule that favors state law. The Bundles court created a rebuttable presumption in favor of the foreclosure price.138 The Bundles conditions for rebutting the presumption favoring the foreclosure price reinforce state law and ignore the federal government's different interests. Most state statutes require proper notice,139 public sales,140 and other procedural protections as conditions for upholding the foreclosure sale. Consequently, when a federal bankruptcy court examines the notice provided and bidding system used, it merely duplicates the analysis under existing state law.

The last inspection that Bundles specifically requires, the appraisal value, offers a criterion so ambiguous that it has no substantive value. Because real
estate appraisal is inexact, courts will consider most ballpark figures to be fair. Despite the Bundles court’s opposition to the Madrid presumption, its alternative test is so deferential both to state law and to the price received at the foreclosure sale that only rarely will a sale be set aside.

Bundles creates a federal test that mimics state law requirements and removes section 548 from the trustee’s arsenal of legal relief. The Bundles test, consequently, eliminates the trustee’s ability to protect the interests of the debtor’s other creditors under section 548. Under Bundles, no substantive difference exists between the state and federal requirements. As a result, the federal goals of distributing the estate equitably and swiftly are forsaken.

2. Failure to Correctly Interpret “Reasonably Equivalent Value”

A trustee may set aside any transfer unless the debtor received “reasonably equivalent value” in exchange for his interest in the property. The value received must be the reasonable equivalent of the debtor’s interest in the property. The Bundles court erred in failing to consider “reasonably equivalent value” independent of the form of transfer. Any attempt to define the value given within terms of the transfer is inconsistent with the plain meaning of section 548(a)(2)(A). Bundles perpetuates the conflict between Durrett and Madrid because the court continues to determine the reasonableness of the value in relation to the circumstances of the transfer.

The Bundles court focused on what value, given that the sale occurs through an involuntary foreclosure sale, would represent a reasonable equivalence. The court concluded that the foreclosure sale price is the only “practical” means

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141. The Seventh Circuit implied that the determination of a fair appraisal price will be left to the bankruptcy judge’s own knowledge. In re Bundles, 856 F.2d at 825 (“[t]he bankruptcy court to draw upon its expertise in evaluating the economic forces at play in a specific case.”). Unless the appraisal shocks the judge’s conscience, the evaluation will likely be upheld.

142. The sales, though regularly conducted, to be avoided under this new test would be those that “shocked the conscience” of the judge. However, such sales can already be set aside under state law. Id. at 822 n.10 (citing Fletcher v. McGill, 110 Ind. 395, 10 N.E. 651, 654 (1887)). Consequently, the effect of Bundles is to make § 548(a)(2)(A) duplicative of § 544(b), which allows a sale to be set aside where state law so permits. See 11 U.S.C. §§ 548(a)(2)(A), 544(b) (1988). This is a result the Bundles court rejected during its examination of Madrid. In re Bundles, 856 F.2d at 823.


144. It is important to note that the statute places this requirement on what was transferred, not on how the transfer was conducted. 11 U.S.C. § 548(a) (1988). Reasonable equivalence must be given for the debtor’s interest in the property. Whether the transfer was voluntary or involuntary does affect the debtor’s interest, nor does it restrict the trustee’s ability to act. Consequently, the fact that the transfer occurred in a foreclosure sale should not affect the determination of reasonably equivalent value.

145. See id.

146. See Bundles v. Baker (In re Bundles), 856 F.2d 815, 824 (7th Cir. 1988) (“[t]he bankruptcy court must focus ultimately on the fair market value as affected by the fact of foreclosure.”).
for determining the effects of the foreclosure on the property's value. The fact that a foreclosure price cannot reflect actual value undermines the apparent simplicity of this analysis. A number of factors significantly diminish the probative value of the foreclosure price. In the vast majority of cases, the single bidder at a foreclosure sale will be the lender. In these cases, the lender generally will bid no higher than the debt owed it and will receive the property for the amount of the unpaid loan. In the event that a third-party appears and bids for the property, the lender will only maintain competitive bidding up to the amount of the loan. Additional factors discourage third-parties from vigorously pursuing the property through higher bids. Typically, foreclosure sales require cash payment. Also, an auctioneer, rather than a qualified broker, conducts the sale. Moreover, the doubt that clouds the title to the property and the possibility that a court might later set aside the sale tend to dampen aggressive bidding.

State law recognizes the weak evidence of value that foreclosure prices provide and will not give presumptive weight to these prices in certain areas of law. These elements indicate that the value paid for the debtor's interest in the property is often significantly depressed and that foreclosure sales do not achieve a fair, let alone a reasonable, price for that interest. Consequently, Bundles posed the wrong question when the court looked solely to the value paid. There is no need to know what effect the foreclosure sale had on the property's value. The statutory question that must be answered before a transfer may be set aside under section 548 is whether the debtor received reasonably equivalent value for his interest in the property.

The direct link between value and interest is inherent in the statute's language, though every court applying the section has failed to see it. Section 548 provides that: "The trustee may avoid any transfer of an interest of the debtor in property... if the debtor voluntarily or involuntarily received less than

147. Id.
148. See supra notes 95-100 and accompanying text.
149. Henning, supra note 24, at 273.
150. Note, Mortgage Foreclosure Sales, supra note 11, at 1247 (citing Lifton, Real Estate in Trouble: Lender's Remedies Need an Overhaul, 31 BUS. LAW. 1927, 1937 (1976) and R. KRAVOTH & R. WERNER, MODERN MORTGAGE LAW AND PRACTICE § 41.02 (2d ed. 1981)); see also Henning, supra note 24, at 273-74 (stating that the procedures governing mortgage foreclosures usually result in the debtor's equity being sacrificed).
151. Henning, supra note 24, at 273.
152. Id. at 274.
153. Id.
154. See id.
156. See supra note 93 and accompanying text; supra notes 141-42 and accompanying text.
158. Id. § 548(a).
REASONABLY EQUIVALENT VALUE

a reasonably equivalent value in exchange for such transfer . . . .159 The broad definition of “transfer” allows courts to read the statute as stating that the trustee may set aside any transfer of an interest of the debtor in property if the debtor did not receive reasonably equivalent value. The statute requires the examination of the value received to be conducted in a vacuum, disregarding the circumstances surrounding the sale.160 The use of “voluntarily or involuntarily” in section 548(a) illustrates that the nature of the transaction is irrelevant.161 The debtor must receive reasonable equivalence for his property interest regardless of how the transfer was initiated or conducted.

The Seventh Circuit erred by relating the foreclosure sale price to reasonable value. Significant factors affect the prices paid at a foreclosure sale. The foreclosure sale price, however, bears no relation to the debtor's interest in the property. In applying section 548(a)(2)(A), the courts must use a definition of reasonably equivalent value that reflects the debtor's interest in the property.

III. A PROPOSED AMENDMENT TO SECTION 548 OF THE BANKRUPTCY CODE

The three different applications of reasonably equivalent value have created substantial confusion and undermined the finality of foreclosure sales. Judicial attempts to satisfy three different interests within an undefined criterion for value have created these difficulties. The secured lender strives to recover as much of its loan as possible. The third-party purchaser seeks to pay the lowest possible price to gain clear title to the property. The debtor/trustee wishes to get the best possible price for the property in order to offset all outstanding debts and rehabilitate the debtor. To maximize the satisfaction of each of these divergent interests and gain continuity within bankruptcy court decisions, Congress should amend section 548 of the Bankruptcy Code to provide a definition of “reasonably equivalent value.”162

The proposed amendment to section 548(d)(2) would shift the emphasis from fair market value to the debtor's basis in the property.163 Bundles provides the rationale for rejecting Madrid.164 Additionally, the inability to achieve a fair market value in the foreclosure on appreciated property necessitates rebuffing the Durrett rule and focusing on the debtor's basis in the

159. Id. § 548(a)(2)(A).
162. The Bankruptcy Code fails to provide a definition for “reasonably equivalent value,” and the legislative history provides no support for a fixed determination. See id. § 548; S. REP. No. 989, 95th Cong., 2d Sess., reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5787.
163. The definition of “basis” is found in 26 U.S.C. § 1012 (1988). The other provisions of the Internal Revenue Code will apply whenever this general definition is not applicable: § 1014 for property acquired from a decedent; § 1015 for property acquired by gifts and transfers or in trust; and § 1016 when changes in the property require the basis to be adjusted.
164. See supra notes 109-22 and accompanying text (discussing the Bundles court’s rejection of Madrid).
A. Proposed Amendment to Section 548(d)(2)

Congress should adopt the following proposed language to amend section 548(d)(2) of the Bankruptcy Code:

(2) In this section—

(D) "reasonably equivalent value" shall be defined as follows for all non-judicial foreclosures, judicial foreclosures, strict foreclosures and execution sales.

(i) Where the value of the real property has appreciated since its original purchase, reasonably equivalent value will be given when the amount given matches or exceeds the individual's "basis" in the property. The determination of basis shall be consistent with the statutory definition in the Internal Revenue Code, 26 U.S.C. § 1012, 1014-16 (1982 & Supp. 1988). An accurate calculation of the individual's basis in the property must be made available at the time of the foreclosure sale.

(ii) Where the value of the real property has depreciated since its original purchase, reasonably equivalent value will be given when the amount given matches or exceeds the property's fair market value. The average of three independent appraisals of the property's value, or a stipulation signed at the time of the transfer by all involved parties, will reflect the fair market value of the property.

B. Advantages of Defining Reasonably Equivalent Value in Terms of Basis

Equity dictates using the debtor's basis in her property to define reasonably equivalent value. The acquisition of the property, plus any improvement to the property, measures every individual's ownership of the property. Initially, the basis offers the best reflection of the debtor's interest in the property. The basis consists of what the individual paid for the property, plus any improvements to the property consistent with section 1016 of the Internal Revenue Code.

Equity demands that the debtor recover what she has paid when a
foreclosure sale occurs. 168

The proposed definition of reasonably equivalent value specifically rejects any consideration of property value appreciation. No actual appreciation in value is realized, and is purely hypothetical and speculative, until the property is sold. This created value is isolated from any cost the property owner incurs, and consequently, the debtor has no equitable interest in the appreciated value of the property. At a foreclosure sale, the debtor should be guaranteed full recovery on what she has paid. 169 The proposed definition establishes a bidding floor that achieves this goal.

Defining reasonably equivalent value in terms of basis fixes a single, predetermined figure for the value. The Internal Revenue Code calculates the individual’s basis in the property at the time of the purchase. 170 This value will not, in the case of real property, undergo any subsequent fluctuations. 171 Linking the debtor’s basis in the property with reasonably equivalent value will guarantee the creditor’s loan up to a pre-existing figure. An example is illustrative of this point. Suppose a debtor owns a house with a fair market value of $150,000. She originally purchased the home for $100,000, and it is listed as collateral for $70,000 in secured loans. Under this scenario, a subsequent lender will know that he may loan up to an additional $30,000 and remain confident that he will recover the money should the borrower default on the loan.

This fixed figure also provides peace of mind to the property’s third-party purchaser. At the time of the foreclosure sale, the purchaser will know or will be informed of the debtor’s basis in the property. 172 So long as the third-party purchaser’s bid exceeds the basis, $100,000 in the example above, the debtor or trustee will be unable to set aside the sale under section 548(a)(2), as amended, and there will be no question regarding the title to the property.

Finally, a direct correlation between basis and the value in the property benefits the debtor. Initially, the figure should serve as a loan ceiling and should help restrict individual debt problems. If the individual limits her borrowing within this figure, she always will be assured of starting from a rela-

Young Laertes has a basis of $160,000 in his Elsinore Heights home. For federal income tax purposes, property appreciation has not affected this basis because Laertes has yet to realize this increase in value. This same argument can be used to anchor Laertes’ interest in the property with his basis rather than allowing it to fluctuate with the real estate market.

168. See Bundles v. Baker (In re Bundles), 856 F.2d 815, 824 (7th Cir. 1988).
169. See supra note 151 (demonstrating how the proposal encourages the early sale of appreciated property).
171. While an individual’s basis in her property might change, it will not be exposed to the wild fluctuations seen in a property’s fair market value. 26 U.S.C. § 1016 details each action that will result in an adjustment of basis. Depreciation or property improvement values can be calculated with relative ease; certainly, in any case, in comparison to land appraisals.
172. If this amendment is adopted, documents certifying the debtor’s basis in the property would have to be available prior to the foreclosure sale. The debtor will bear the responsibility for providing such documentation.
tively clean slate because the foreclosure price will cover secured debts.\textsuperscript{173}

Correlating basis and reasonable equivalence also assists the debtor because it should increase the sale price of her property under any circumstance. The debtor will face three situations: the fair market value will exceed her basis (appreciated property), her basis will exceed the property's fair market value (depreciated property), or the values will be relatively close. The correlation will encourage the debtor to sell either appreciated or depreciated property as soon as possible because allowing foreclosure will result in significant economic loss.\textsuperscript{174} Consequently, foreclosed property should have a fair market value closely equivalent to the basis in the property. This, in turn, produces a foreclosure sale price more equitable to the debtor. In each circumstance, the proposed definition of reasonably equivalent value prompts the debtor towards quick action, resulting in a maximization of return on the sale and allowing

\begin{itemize}
  \item [173] It is inevitable that some individuals will continue to borrow beyond their means. Having a fixed definition, however, should help decrease the number of people who borrow beyond their means. Suppose Laertes, before defaulting on his mortgage, went to Fortinbras at the Norwegian Savings & Loan to borrow $150,000. Laertes would believe himself capable of covering this amount with collateral. After all, he has a home valued at $325,000 and only $100,000 in outstanding debt. Clearly, he believes, he could borrow another $225,000 and cover these loans with his home.

  Fortinbras would then explain the realities of default and foreclosure sales to Laertes. Should Laertes default, he will never be able to recover the full value of his house. Fortinbras, under the proposed amendment, would be able to loan Laertes $60,000 (the difference between Laertes' basis in the property and the amount in loans secured by the home). This figure sets an upward limit for the borrower which he can reach without subjecting himself to any risk other than the loss of his home. If he defaults and the property is sold through a foreclosure sale, the borrower knows that he will be able to meet his debts based upon the sale price. Laertes, under the proposed definition, knows that he is guaranteed $160,000 for his home at a foreclosure sale. The proceeds from the sale will be immediately handed over to his creditors, and he moves his possessions into the moving van and reestablishes himself in a $400 per month apartment in Bayonne. He is free of debt.

  Imagine that the Norwegian Savings & Loan does lend Laertes the $150,000. Both parties know that only $60,000 is guaranteed in a foreclosure. The remaining $90,000 would be a high risk loan. It might be possible to secure this remaining amount through other items Laertes owns. But these other pieces of collateral, such as Laertes' car, also come under Article 9 of the state's Commercial Code and the bank would have to join the line of secured creditors. If the bank has relied solely on its perception of the property's fair market value, it will be forced to bid beyond Laertes' basis in the property. When lenders go beyond the basis in loans, the result will be a slightly more competitive bidding procedure at the foreclosure sale as lenders bid up the price over the basis to insure that they recover on their loans.

  \textsuperscript{174} The predetermined foreclosure floor offers a strong inducement to sell appreciated property early. Imagine that Ophelia purchased a home in Willow Brook in 1968. The property appreciates in value from $40,000 to $200,000 over the subsequent twenty-two years. If Ophelia now faces default and foreclosure, the effects of the proposed amendment strongly promote early sale. She is guaranteed only 20% of the property's value if she postpones acting and foreclosure occurs. Conversely, prompt action insures the best possible recovery for her. Even if the asking price for the house is lowered to speed the sale, the selling price should still exceed any foreclosure sale price.

  Likewise, under the proposed definition, the debtor is encouraged to sell property as soon as possible in the event of depreciation in order to mitigate her losses.
for the payment of debts. This provides the best economic result for the debtor and also, coincidentally, preserves federal interests.\textsuperscript{175}

This amendment also offers advantages over the case-by-case approach. By setting a clear floor for the value received, most foreclosure sales will not require judicial review. This approach directly contrasts with the case-by-case analysis, which is fact specific and could require a full review of each detail of every foreclosure.\textsuperscript{176}

The proposed amendment promotes judicial efficiency; Bundles encourages trustees to assert a section 548 challenge to all foreclosure sales. A consistent definition for reasonably equivalent value substantially diminishes such challenges. Each involved party will know at the time of the sale whether the final sale price constituted reasonable equivalence. This knowledge should eliminate nearly all claims based on section 548(a)(2) in all foreclosure and execution sales.

Economic realities require a two-part definition of reasonably equivalent value. The proposed definition recognizes that the economic realities significantly differ, depending on whether the value of the property has appreciated or depreciated. In contrast to the proposed definition, an absolute recovery of basis rule would prevent the purchase of depreciated property at a foreclosure auction.\textsuperscript{177} The proposed definition acknowledges the rare instances of property value depreciation and attempts to maximize each party's interests. The proposed amendment establishes an acknowledged figure for the property's fair market value at the time of the foreclosure sale. The third-party purchaser, given that she pays this amount, benefits because she takes the property free of a potential section 548 set aside. The proposal also advances the debtor's direct and related interests. The debtor/trustee's right to equitable recovery, complemented by the federal government's interests, mandates this definition of reasonably equivalent value.\textsuperscript{178} The debtor's equitable interest in the property is her basis.\textsuperscript{179} If the property has depreciated in value, a full recovery of the fair market value returns the debtor to the point closest to her basis. This, in turn, maximizes the distribution of her assets to her creditors.\textsuperscript{180}

\textsuperscript{175} See supra notes 126-30 and accompanying text (discussing the federal interest sought to be protected under the Bankruptcy Code).

\textsuperscript{176} See, e.g., Gillman v. Preston Family Inv. Co. (\textit{In re Richardson}), 23 Bankr. 434, 448 (Bankr. D. Utah 1982) (advocating the application of a case-by-case determination by the court of reasonably equivalent value).

\textsuperscript{177} An example demonstrates the problem with such a requirement. The debtor borrowed $2 million to purchase a large ranch outside of Houston, Texas in 1982 for $2.5 million. Six years later the debtor has watched the oil market collapse, his cattle die from disease, and the local real estate market crash. His property is now worth $1 million, and he is broke. No one would match his basis at a foreclosure sale. The property's fair market value is 40\% of his basis.

\textsuperscript{178} See supra notes 126-30 and accompanying text.

\textsuperscript{179} See supra note 167 and accompanying text.

\textsuperscript{180} The single § 548 case involving depreciated property supports the proposal's advocacy of full fair market value recovery. See First Fed. Sav. & Loan Ass'n v. Hulm, (\textit{In re Hulm}), 45 Bankr. 523 (Bankr. D.N.D. 1984) in \textit{In re Hulm}, the court acknowledged that "the best method of determining whether a price constitutes a reasonably equivalent value is simply to compare the
Section (2)(D)(ii) of the proposed amendment places a burden on the lenders, since they may be forced to pay more for the debtor's property than the amount of the loan.\textsuperscript{181} Property depreciation imposes a burden that the lender is best suited to accept. The creditor had the advance opportunity to examine the loan application and determine the appropriateness of the loan. Because the lender has miscalculated the risk, it is rational for it to bear the cost of that error. This application of the proposed definition will be rare.\textsuperscript{182} Additionally, the burden is reasonable because the creditor need only meet the current value of the property.

IV. Conclusion

Though it specifically rejected both \textit{Durrett} and \textit{Madrid}, the \textit{Bundles} court's analytical test does not offer a new solution. The Seventh Circuit recognized the federal right of review independent of state law and carefully illustrated the statutory inconsistencies in the \textit{Madrid} presumption. Unfortunately, the appellate court failed to employ these observations when the court adopted a case-by-case analysis that strongly favors the price received at the foreclosure sale. The \textit{Bundles} test, furthermore, associates the circumstances surrounding the transfer with the received value, and consequently, continues the misapplication of section 548(a)(2)(A).

The inconsistent results in the application of section 548(a)(2)(A) of the Bankruptcy Code come from the perception that the foreclosure sale price must relate to the property's fair market value. This Article suggests that courts should follow a plain meaning application of section 548(a)(2)(A). Further, reasonably equivalent value should be defined in terms of the debtor's basis in real property, as opposed to focusing on the fair market value. These recommendations should help to clarify the meaning of reasonably equivalent purchase price to the fair market value existing at the time of the sale." \textit{Id.} at 529

Admittedly, this is a generous reading of the case because neither the extent of the property's depreciation nor its value in relation to the debtor's basis is known. The debtor's basis in the property is not specified. Nine months before the foreclosure sale, the property was appraised at $123,100, but it was transferred at a bid price of $64,443.64. \textit{Id.} The property was subsequently resold for $95,000. \textit{Id.} at 526. The court, however, indicated that its assessed fair market value of $100,000 was "due to the pending foreclosure sale" and not the decline of property values in the region. \textit{Id.} at 527.

\textsuperscript{181} This burden will be imposed only if the fair market value of the property is greater than the amount of the outstanding mortgage. Under the current definitions of reasonably equivalent value, lenders seek only to recover the amount they are owed. Consequently, lenders normally bid only this amount, even if it is less than the fair market value. In contrast, under the proposed definition the lender cannot tie his bid to the amount owed if it is less than fair market value. The requirement of reasonable equivalence will not be satisfied, and the transfer can be set aside. Lenders are thus forced to bid fair market value even where it exceeds the amount of the loan.

Note that no such burden is imposed on the lender if the mortgage exceeds the fair market value. The lender will bid the amount of the mortgage, thus automatically satisfying the requirement of reasonably equivalent value under the proposed definition.

\textsuperscript{182} See \textit{supra} notes 177 & 180.
value. Ultimately, this should result in a uniform and coherent judicial application of section 548(a)(2)(A).