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Transfer of Real Estate Title May be Avoided as a Preference in Certain Jurisdictions

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Introduction

This article addresses whether a transfer of real estate title may be avoided as a preference under section 547(b) of title 11 of the United States Code (the “Bankruptcy Code”).¹ Section 547 permits avoidance of preferential transfers.² “A preference is a ‘transfer that enables a creditor to receive payment of a greater percentage of his claim against the debtor than he would have received if the transfer had not been made and he had participated in the distribution of assets of the bankrupt estate.’”³ Essentially, a preference allows one creditor to receive more value than other creditors. Preferential transfers violate a central policy of the Bankruptcy code—the equality of distribution among creditors.⁴ Thus, preferential transfers may be avoided if all elements of section 547(b) are satisfied.⁵

Under section 547(b), a “transfer may be voided as preferential if it (1) was made to or for the benefit of a creditor, (2) was made for an antecedent debt, (3) was made while the debtor

¹ 11 U.S.C. § 547(b).

² *Id.*

³ *Barrett Dodge Chrysler Plymouth, Inc. v. Cranshaw (In re Issac Leaseco, Inc.)*, 389 F.3d 1205, 1209 (11th Cir. 2004) (quoting *Union Bank v. Wolas*, 502 U.S. 151, 160–61 (1991)).

⁴ See *In re Hackler & Stelzle-Hackler*, No. 18-1650, 2019 WL 4309510, at *2 (3d Cir. Sept. 12, 2019).

⁵ 11 U.S.C. § 547(b).

was insolvent, (4) was made on or within 90 days before filing for bankruptcy, and (5) enabled the creditor to receive more than it would have received in a Chapter 7 liquidation proceeding.”⁶

However, because title to real estate is governed by state law, which may be at odds with the Bankruptcy Code’s central policy of the equality of distribution among creditors, it is unclear whether a transfer of real estate title may be avoided as a preference under section 547(b) even if all of the elements of that section are satisfied. The confusion originated as a result of the Supreme Court’s decision in *BFP v. Resolution Trust Corp.*,⁷ which interpreted section 548 of the Bankruptcy Code, and held that transfers of real estate title could not be avoided as fraudulent. Section 547(b) is similar to section 548, which also deals with avoidance of transfers. However, where section 547(b) deals with avoidance of transfers as preferential, section 548 deals with avoidance of transfers as fraudulent.⁸ Nevertheless, because transfers of real estate title could not be avoided as fraudulent in *BFP*, lower courts began to wonder if based on *BFP*, transfers of real estate title could not be avoided as preferential as well. While some jurisdictions refused to adopt the reasoning in *BFP* regarding fraudulent transfers to preferential transfers, others willingly extended *BFP* to preference actions.

This article explores the split in three parts. Part I outlines the origin of the split through a discussion of the Supreme Court’s holding in *BFP*. Part II discusses how various jurisdictions refuse to adopt the Supreme Court’s holding in *BFP* regarding section 548 to preference actions under section 547(b) through a plain language approach. Part III, on the other hand, discusses how other jurisdictions extend *BFP* to preference actions based on federalism and policy concerns.

Discussion

⁶ *Id.*

⁷ See *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994).

⁸ 11 U.S.C. § 548.

I. The Supreme Court’s interpretation of section 548 of the Bankruptcy Code in *BFP* creates a split among lower courts over whether a transfer of real estate title may be avoided as a preference.

In *BFP*, the Supreme Court interpreted section 548 of the Bankruptcy Code which governs avoidance of fraudulent transfers.⁹ Under section 548, a transfer may be avoided as fraudulent “if the trustee can establish (1) that the debtor had an interest in property; (2) that a transfer of that interest occurred within one year of the filing of the bankruptcy petition; (3) that the debtor was insolvent at the time of the transfer or became insolvent as a result thereof; and (4) that the debtor received less than a reasonably equivalent value in exchange for such transfer.”¹⁰

Specifically, to determine whether a debtor could avoid a mortgage foreclosure sale as a fraudulent transfer, the Supreme Court interpreted the meaning of “reasonably equivalent value” in section 548.¹¹ Its analysis focused on the plain language of the statute as well as public policy and federalism concerns regarding state interests in securing property titles.

As with all statutory analysis, the starting point is the plain language. The plain language of section 548 includes the term “reasonably equivalent value” not fair market value. Indeed, if Congress wanted “reasonably equivalent value” to mean “fair market value,” it would have drafted the statute accordingly.¹² Thus, by definition, Congress contemplated that reasonably equivalent value is the foreclosure sale price obtained at a regularly conducted mortgage foreclosure sale.¹³ Not, fair market value because “‘fair market value’ presumes market conditions that, by definition, simply do not obtain in the context of a forced sale,” and thus, “[m]arket value cannot be the criterion of equivalence in the foreclosure-sale context.”¹⁴

⁹ *Id.*

¹⁰ 11 U.S.C. § 548; *see BFP*, 511 U.S. at 535.

¹¹ *See BFP*, 511 U.S. at 535.

¹² *See id.*

¹³ *See id.* at 545.

¹⁴ *See id.* at 538.

Further, adopting a different meaning of “reasonably equivalent value” would require “foreclosure sale[s] to yield a certain minimum price beyond what state foreclosure law requires.”¹⁵ Because state foreclosure laws are imperative in securing “titles to real estate” and maintaining “the general welfare of society” within the state,¹⁶ “[t]o displace traditional state regulation . . . the federal statutory purpose must be ‘clear and manifest.’”¹⁷ Importantly, this was not the case regarding section 548 of the Bankruptcy Code.¹⁸ Because the federal statutory purpose in section 548 was not “clear and manifest,” Congress did not intend to displace state law in the foreclosure realm with a definition of “reasonably equivalent value” that would be inconsistent with state law. Accordingly, “‘reasonably equivalent value,’ for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State’s foreclosure law have been complied with.”¹⁹ Given the meaning of “reasonably equivalent value,” a debtor cannot avoid a transfer of real estate title as fraudulent through a regularly conducted mortgage foreclosure sale.²⁰

It is precisely the reasoning employed by the Supreme Court in determining both the meaning of “reasonably equivalent value” in section 548 and refusing to displace state law that sparked the disagreement among lower courts as to whether transfer of real estate title may be avoided as a preference.

II. The Majority View: *BFP* does not apply to preference actions under section 547(b) of the Bankruptcy Code because the plain language of section 547(b) differs from that of section 548.

¹⁵ *See id.* at 542-43.

¹⁶ *See id.* at 544.

¹⁷ *See id.*

¹⁸ *See id.*

¹⁹ *See id.* at 545.

²⁰ *See id.*

Courts, including the United States Court of Appeals for the Third Circuit,²¹ the United States Bankruptcy Court for the Middle District of Pennsylvania,²² and the United States Bankruptcy Court for the Northern District of Texas,²³ have declined to extend *BFP* to preference actions under section 547, holding that transfers of real estate title may be avoided as preferential. These courts distinguished *BFP*'s policy issues and focused instead on the plain language of section 547.

To be a preferential transfer under section 547, the transfer must be (1) made to or for the benefit of a creditor, (2) made for an antecedent debt, (3) made while the debtor was insolvent, (4) made on or within 90 days before filing for bankruptcy, and must (5) enable the creditor to receive more than it would have received in a Chapter 7 liquidation proceeding.²⁴ These elements are distinctly different from those to avoid a fraudulent transfer which include establishing that (1) that the debtor had an interest in property; (2) that a transfer of that interest occurred within one year of the filing of the bankruptcy petition; (3) that the debtor was insolvent at the time of the transfer or became insolvent as a result thereof; and (4) that the debtor received less than a reasonably equivalent value in exchange for such transfer.²⁵ Because these elements do not have any commonalities, the holding in *BFP* is inapplicable and has no precedential value.²⁶ The reasoning employed in *BFP* in determining the meaning of “reasonably equivalent value” cannot extend to section 547 as those terms do not even appear in that section of the

²¹ See *In re Hackler & Stelzle-Hackler*, No. 18-1650, 2019 WL 4309510, (3d Cir. Sept. 12, 2019) (holding that if all of the elements of section 547 are satisfied through a transfer of real estate title, that transfer may be avoided as preferential).

²² See *In re Andrews*, 262 B.R. 299 (Bankr. M.D. Pa. 2001) (holding that *BFP* has “no bearing” on section 547 of the Bankruptcy Code).

²³ See *In re Whittle Development, Inc.*, 463 B.R. 796 (Bankr. N.D. Tex. 2011) (holding that because the term “reasonably equivalent value” does not appear in section 547, *BFP* is inapplicable).

²⁴ 11 U.S.C. § 547(b).

²⁵ 11 U.S.C. § 548.

²⁶ See *In re Hackler*, 2019 WL 4309510, at *4.

statute.²⁷ “No such legal issue presents itself in avoidance actions under section 547(b).”²⁸

Additionally, for the same reason, concerns about displacing state law with a particular definition of “reasonably equivalent value” are unwarranted in the preference context.²⁹ Thus, the meaning of the language in section 548 is inapplicable to section 547.³⁰

Moreover, although section 547’s requirement that a “creditor [] receive more than it would have received in a Chapter 7 liquidation proceeding”³¹ seems similar to section 548’s requirement that “that the debtor received less than a reasonably equivalent value in exchange for such transfer,”³² the two requirements are nevertheless different. The meaning of “reasonably equivalent value” has “no bearing” on whether the creditor received “more” than it would have “without the foreclosure sale and in a liquidation under Chapter 7.”³³ Indeed, “[i]f Congress intended some other result [in § 547(b)(5)], it could have used terms such as ‘reasonably equivalent value’ or adopted a bright line standard such as seventy percent of fair market value. Instead, it chose to use the term ‘more.’”³⁴ Thus, “the only thing that must be shown is that the creditor did, in fact, receive more from the pre-petition transfer than it would have under a Chapter 7 liquidation” proceeding.³⁵ Therefore, by focusing on the specific and unambiguous language of section 547, the United States Court of Appeals for the Third Circuit, the United States Bankruptcy Court for the Middle District of Pennsylvania, and the United States Bankruptcy Court for the Northern District of Texas declined to extend *BFP* to preference actions and held that transfers of real estate title may be voided as preferential.

²⁷ *See id.*

²⁸ *See In re Whittle Development*, 463 B.R. at 801.

²⁹ *See In re Hackler*, 2019 WL 4309510, at *4.

³⁰ *See id.*

³¹ 11 U.S.C. § 547(b)(5).

³² 11 U.S.C. § 548(a)(2)(A).

³³ *See In re Andrews*, 262 B.R. at 304.

³⁴ *See id.* at 306 (citation omitted).

³⁵ *See In re Whittle Development*, 463 B.R. at 800.

III. The Minority View: The federalism and policy concerns outlined by the Supreme Court when interpreting section 548 in *BFP* similarly apply to preference actions under section 547(b).

Conversely, some courts including the United States Bankruptcy Court for the Western District of Pennsylvania³⁶ and the United States Bankruptcy Court for the Eastern District of Michigan,³⁷ extend the Supreme Court's reasoning in *BFP* to section 547(b). Indeed, these courts acknowledge that *BFP* dealt with section 548, but hold that the Supreme Court's rationale in *BFP* applies to section 547(b) in light of the essential federalism and policy concerns present in mortgage foreclosure sales and especially tax foreclosure sales.

States have an important interest in maintaining the finality of foreclosure sales and “enacting laws governing foreclosure of real property.”³⁸ Avoiding transfer of real estate title threatens “the essential sovereign interest in the security and stability of title to land,”³⁹ leading to uncertainty of title ownership. Further, Congress did not intend for the Bankruptcy Code to displace state regulation even in preference actions.⁴⁰ Indeed, the “intent of Congress to displace traditional state regulation . . . must be ‘clear and manifest.’ Otherwise, the Bankruptcy Code must be construed to adopt rather than displace preexisting state law.”⁴¹ Congress did not provide “clear and manifest” intent to override state law when enacting § 547(b).⁴² Thus, even though section 547 does not contain a requirement for “reasonably equivalent value,” and specific concerns about how a different meaning of “reasonably equivalent value” would

³⁶ See *In re Pulcini*, 261 B.R. 836 (Bankr. W.D. Pa. 2001) (finding that the Bankruptcy Code does not override state law governing titles to real estate, and thus, holding that transfer of real estate title may not be avoided as preferential).

³⁷ See *In re RL Mgmt. Grp., LLC*, No. 13-51849, 2014 WL 197692, (Bankr. E.D. Mich. Jan. 10, 2014) (holding that Congress did not intend to displace state law regarding titles to real estate and that avoiding transfers of real estate title would impose significant burdens on state governments).

³⁸ See *In re Pulcini*, 261 B.R. at 844.

³⁹ See *id.*; see also *In re RL*, at *5-*6 (“[T]he general welfare of society is involved in the security of titles to real estate and the power to ensure that security inheres in the very nature of [state] government.”) (citations omitted).

⁴⁰ See *id.*

⁴¹ See *id.*; see also *In re RL*, at *6.

⁴² See *id.* at 844-45.

displace state law does not exist in this context, section 547's unique requirements should also not be read as to override state law. Because, allowing the avoidance of preferential transfers would infringe on state foreclosure regulations, transfers of real estate title cannot be avoided.⁴³

Further, in the tax foreclosure sale context, avoidance would impair state governments from collecting taxes, and thus, from performing their governmental responsibilities, burdening state governments and local municipalities, and leaving an adverse impact on citizens.⁴⁴

Allowing avoidance of tax foreclosures would disrupt the finality of foreclosure judgments and thus, would impair “the financial health and well-being of taxing government units and their citizens.”⁴⁵ Indeed, taxes enable governments to “carry out essential [] functions for the benefit of their citizens.”⁴⁶ Avoidance would “allow properties to fall into disrepair and [] impose on the government unit a substantial period of uncertainty of title” resulting in an increase of abandoned and hazardous properties.⁴⁷ Accordingly, avoidance imposes an “improper burden” on state governments.⁴⁸ Therefore, by realizing the importance of a state's interest in the finality of mortgage and tax foreclosures, the United States Bankruptcy Court for the Western District of Pennsylvania and the United States Bankruptcy Court for the Eastern District of Michigan adopt *BFP* to preference actions under section 547.

Conclusion

Given the Supreme Court's decision in *BFP* where the court held that a transfer of real estate title could not be avoided as fraudulent, the Third Circuit and lower district courts are split as to whether a transfer of real estate title may be avoided as a preference under 11 U.S.C §

⁴³ *See id.* at 844.

⁴⁴ *See In re RL*, at *5-*6.

⁴⁵ *See id.* at *6.

⁴⁶ *See id.*

⁴⁷ *See id.*

⁴⁸ *See id.*

547(b) of the Bankruptcy Code. The Third Circuit and lower district courts decline to extend the Supreme Court's reasoning in *BFP* regarding avoidance of fraudulent transfers under section 548 to preference actions under section 547 because the plain language of section 547 differs from that of section 548, and thus, *BFP* is inapplicable. Accordingly, for real estate title to be avoided as a preference, a debtor need only satisfy all of the elements of section 547(b). However, other district courts extend *BFP* to preference actions and hold that transfer of real estate title cannot be avoided as a preference, because maintaining title to real estate is an essential state interest and Congress did not intend to displace state laws by enacting section 547.