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Bankruptcy Valuation Under Selected Liquidation Provisions

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NOTE

Bankruptcy Valuation Under Selected Liquidation Provisions

I. INTRODUCTION

Chapter 7 of the Bankruptcy Code[1] (the Code) serves a distributive function; it is designed to distribute equitably a debtor's assets from the bankruptcy estate to creditors. All nonexempt assets owned by a debtor at the time of filing a petition for bankruptcy become part of the bankruptcy estate and subsequently are distributed to creditors.[2] Generally, debtor transactions prior to the filing escape the purview of Chapter 7. If, howeve, a debtor distributes assets during the applicable statutory period, giving preference to some creditors[3] or defrauding other creditors,[4] the Code empowers the bankruptcy trustee to avoid those transfers. After filing, a debtor may redeem certain types of property placed under a creditor's lien by paying the creditor's claim.[5] Selected provisions within Chapter 7 describe these basic elements of liquidation that require a valuation of debtor assets. Each provision mentioned may require a valuation under presently vague statutory language, sparse legislative history, and conflicting judicial interpretations.

This Note explores, on an individual basis, certain Bankruptcy Code sections requiring valuation in a bankruptcy liquidation situation. Part II of this Note examines section 522, which exempts certain debtor assets from bankruptcy, but only to a limited value amount. Although section 522 states that "value" means "fair market value,"[6] some courts, because of the liquidation context of section 522, have used the lower "liquidation value" as the applicable standard.[7] Part III discusses section 547, which allows the trustee to avoid preferential transfers to creditors, provided that the

1. 11 U.S.C. §§ 101-09; 301-350; 501-559; 701-766 (1982), *amended by* Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, 98 Stat. 33.

2. 11 U.S.C. § 522 (1982) (exemption provision); *see infra* note 16 (listing exemptions).

3. 11 U.S.C. § 547 (1982) (preferential transfers); *see infra* note 68 (quoting text of § 547).

4. 11 U.S.C. § 548 (1982) (fraudulent transfers); *see infra* note 168 (quoting text of § 548).

5. 11 U.S.C. § 722 (1982) (redemption provision); *see infra* note 246 (quoting text of § 722).

6. 11 U.S.C. § 522 (1982).

7. *See infra* notes 22-35 and accompanying text.

debtor was insolvent and the transfer enabled the creditor to receive a greater amount than would have been received proceeding only on the creditor's secured claim.[8] The valuation of assets to determine solvency has enjoyed numerous, but inconsistent, judicial interpretations; valuation to determine the amount of a secured claim is a more recently evolving issue. Part IV explores section 548, which permits a trustee to avoid certain transfers by a debtor, including involuntary foreclosure sales of the debtor's property, if the debtor does not receive a "reasonably equivalent value" as consideration for the property.[9] Courts are divided sharply over whether "reasonable equivalence" is measured by fair market value or by foreclosure market value. Part V discusses section 722, which allows a debtor to redeem certain property placed under a creditor's lien for the amount of lien, generally measured by the value of the property.[10] Courts have valued encumbered property anywhere from a full fair market value to a lower wholesale or liquidation value. Part VI summarizes the different valuation methods used for each Code section discussed and suggests an appropriate standard that Congress should adopt for each section.

For each Code section discussed, this Note first describes how the mechanics of each section align debtors and creditors in advocating certain methods of valuation. Next, this Note examines judicial responses to each section, emphasizing conflicting theoretical approaches and policies. Finally, this Note suggests valuation standards that will enhance predictability and uniformity within each of the Code sections discussed.

II. SECTION 522 EXEMPTION VALUE

A. *Mechanics Underlying the Valuation Issue*

Section 522[11] of the Code grants debtors the right to exempt portions of certain property from the reach of creditors.[12] Congress has described the purpose behind exemption relief as giving debtors a "fresh start" after bankruptcy by ensuring that debtors re-

8. 11 U.S.C. § 547 (1982).
9. *Id.* § 548.
10. *Id.* § 722.
11. *Id.* § 522.
12. *See* Haines, *Security Interests in Exempt Personalty: Toward Safeguarding Basic Exempt Necessities*, 57 NOTRE DAME L. REV. 215 (1981); Reed, *Over the Hill to the Poor House—The Failure of Section 522 Bankruptcy Exemptions Under the Bankruptcy Reform Act of 1978*, 61 DEN. U.L. REV. 705 (1984); Note, *The Preemption of Bankruptcy—Only Exemptions*, 6 CARDOZO L. REV. 583 (1985).

tain the basic necessities of life.[13] The exemption provision represents an attempt to strike an appropriate balance between debtor survival and creditor rights.[14] The theoretical basis for exemption is that certain debtor necessities outweigh the debtor's obligation to satisfy fully an outstanding debt.[15]

The Code specifically identifies each exemption available and places a dollar amount limitation on each type of asset exempted.[16] Because the dollar amounts for each exemption are limited, a debtor will argue for a valuation low enough to absorb completely a given asset by the exemption amount, or at least low enough to limit the amount of exposure to creditors. For example, section 522 allows an exemption of $1,200 for a debtor's motor vehicle.[17] To protect fully the vehicle by the exemption amount, a debtor will argue that the car's value is equal to or less than $1,200. A creditor can access the car only to the extent that its value exceeds $1,200 and, consequently, will argue for a much higher value for the car.

Debtors and creditors argue not only over dollar amounts, but also over the appropriate standard for determining how an asset should be valued. Many of the Code sections that give rise to a valuation issue require or allow an incorporation of section 506(a), which identifies a valuation system providing guidance in applying the appropriate standard of valuation.[18] Section 506(a) calls for a valuation within the broad guidelines of (1) the purpose of the val-

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13. H.R. Rep. No. 595, 95th Cong., 2d Sess. 126, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6087-88.

14. *See* Haines, *supra* note 12, at 217.

15. *See id.* at 216.

16. Section (d) lists the exemptable items and amounts: (1) debtor's residence, $7,500; (2) motor vehicle, $1,200; (3) household furnishings, $200 per item, $4,000 aggregate; (4) jewelry, $500; (5) debtor's interest in any property, $400, plus up to $3,700 of any unused amount from paragraph (1); (6) tools of trade, $750; (7) any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract; (8) accrued interest, dividends, or loan value of insurance, $4,000; (9) prescribed health aids; (10) rights to receive social security, unemployment compensation, public assistance; veterans' benefits; disability, illness, or unemployment benefits; alimony, support, or separate maintenance; certain stock bonus and profitsharing plans; (11) certain rights to compensation. 11 U.S.C. § 522(d) (1982).

17. *Id.* § 522(d)(2) (stating that "[t]he following property may be exempted under subsection (b)(1) of this section: . . . (2) The debtor's interest, not to exceed $1,200 in value, in one motor vehicle").

18. Section 506(a) values collateral to determine the extent to which a claim is secured. 11 U.S.C. § 506(a) (1982). This Note examines other sections that trigger the use of Section 506(a) valuation. *See infra* notes 115-62, 246-301 and accompanying text (noting that preferential transfers are preferential only to the extent a creditor receives more than his secured debt).

uation, and (2) the proposed use or disposition of the property.[19] Section 522, however, apparently rejects the section 506(a) system and independently defines the word "value."[20] Section 522 offers the seemingly clear statement that "value" means "fair market value as of the date of the filing of the petition."[21] Therefore, the section 522 provision attempts to set forth a much more objective definition than section 506(a).

Courts, however, have offered varied interpretations of the section 522 term "fair market value." Courts have failed to develop a constant or uniform standard because the term "fair market value" merely begs the question of which market is to be used in a valuation determination. Commercial transactions occur in many different types of markets. Liquidation value and ordinary fair market value, for example, connote two very different values for the same item. In the context of section 522, the lower "liquidation value" aids a debtor's fresh start; the higher "ordinary fair market value" may allow a creditor to recoup more of the outstanding debt balance. Arguments supporting each of these two positions are presented below and are followed by a critique suggesting that because "liquidation value" better serves the policy of section 522, Congress should adopt a standard that permits recognition of the liquidation market as the appropriate market for determining "fair market value."

B. Opposing Judicial Responses

1. *Walsh:* Section 522 "Fair Market Value" Means Fair Liquidation Market Value

In 1980 the United States Bankruptcy Court for the District of Columbia, in *In re Walsh*,[22] held that because section 522 functions to determine how much property ultimately is subject to a Chapter 7 liquidation, the "fair market value" contemplated by that section must be equivalent to "liquidation value."[23] The *Walsh* court approached the issue of interpreting fair market value as a statutory construction problem.[24] Initially, the court recognized that section 522 defines value only for section 522 purposes;

19. 11 U.S.C. § 506(a) (1982). See *infra* note 147 for the text and legislative history of section 506(a).
20. 11 U.S.C. § 522(a)(2) (1982).
21. *Id.*
22. 5 Bankr. 239 (Bankr. D.C. 1980).
23. *Id.* at 241.
24. *Id.* at 240.

the language specifically states that "*[i]n this section* value means fair market value."[25] The court, therefore, did not look elsewhere in the Code for interpretive guidance. Furthermore, the court found no relevant legislative history regarding section 522.[26] The court noted that although clear statutory language requires a "plain meaning" interpretation, a statute should be interpreted in a manner that is consistent with all of its provisions and goals.[27] The court then set forth the ordinary meaning of "fair market value" as the "price at which a willing seller and a willing buyer will trade."[28] After stating this normally accepted definition, however, the court found support for the proposition that the definition may "var[y] with the circumstances surrounding a given object and situation to which it is sought to apply."[29] Furthermore, the *Walsh* court noted that a valuation must have a practical purpose in harmony with its context.[30]

This "contextual approach" to interpreting the term "fair market value" was the focus of the court's opinion. To explain how the context of the section 522 exemption leads to a "liquidation value" interpretation of the "fair market value" language in the Code, the court offered the following hypothetical:[31] A debtor owns

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25. 11 U.S.C. § 522(a)(2) (1982) (emphasis added).

26. 5 Bankr. at 240; *see* H.R. REP. No. 595, 95th Cong., 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6316; S. REP. No. 989, 95th Cong., 2nd Sess. 75, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5861.

27. 5 Bankr. at 240-41.

28. *Id.* at 241.

29. *Id.* (quoting McDougall Co. v. Atkins, 201 Tenn. 589, 301 S.W.2d 335, 337 (1957) (holding valuation of air ducts installed in buildings for sales tax purposes not equivalent to scrap value)).

30. The court stated: "The definition is 'not invariable,' but 'varies with the circumstances surrounding the given object and situation to which it is sought to apply to the term.' A valuation is always a stage in some proceeding which has a practical purpose. Thus, the Courts have viewed fair market value in the context in which the valuation question has arisen." 5 Bankr. at 241 (citations omitted); *see* MCCORMICK, THE LAW OF DAMAGES, § 43, 44 at 163-67 (1935).

31. The hypothetical is illustrated as follows:

> A debtor owns an automobile, free and clear of any lien, which, if sold under *ordinary* market conditions—the willing buyer and willing seller approach to the fair market value—would yield $2,000. The debtor, pursuant to 11 U.S.C. 522(d)(2), claims tbe auto as exempt to the extent of $1,200. If the Court deems the asset to be worth $2,000 because of a theoretical fair market value standard and authorizes a sale by the Trustee, the resulting sale, of necessity, in the *actual* forced sale setting, may bring only $1,200—the amount which the debtor is entitled to claim as exempt. Obviously, in this situation, no benefit to the estate is gained because the only amount realized is subject to the debtor's claim of exemption. Accordingly, the only conclusion that can be logically drawn is that fair market value, as defined in 522(a), is subject to bankruptcy market conditions.

an automobile that could bring a price of $2,000 under ordinary market conditions. Pursuant to section 522(d)(2), the debtor claims the automobile to be exempt to the extent of $1,200. If the court chooses to value the automobile at a "theoretical fair market value" standard and authorizes a sale by the trustee under forced liquidation-type procedures, that sale may bring only $1,200—the debtor's exemption amount. Thus, the estate does not benefit because the full proceeds of the actual sale would fall within the debtor's exempt amount.

Although the *Walsh* court exhibits a well developed and logical analysis in interpreting the section 522 "fair market value" standard, the majority of courts have held that "fair market value" under section 522 contemplates the more traditional market in which a willing buyer and a willing seller would trade.[32] Even though many other jurisdictions do not accept *Walsh*, a recent decision, *In re* Ricks,[33] indicates that *Walsh* remains the applicable law in the District of Columbia. The *Ricks* court, however, was not forced to confront facts that would cause the method of valuation to be outcome determinative because the property would have been fully exempt even if valued at ordinary fair market value.[34] The court did note that the value could have been determined by liquidation value pursuant to *Walsh*.[35]

2. *Nellis*: Section 522 "Fair Market Value" Means Traditional Fair Market Value

Shortly after the *Walsh* opinion the United States Bankruptcy Court for the District of Connecticut, in *In re Nellis*,[36] carefully considered the *Walsh* holding, but decided that "liquidation value" does not satisfy the section 522 fair market value requirement.[37] Although the *Nellis* court used the same statutory construction analysis as the *Walsh* court, the *Nellis* court found that Congress clearly had precluded the use of liquidation value when it

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5 Bankr. at 241 n.3.

32. *See, e.g., In re* Moore, 30 Bankr. 197 (Bankr. D. Md. 1983); *In re* Parenteau, 23 Bankr. 289 (Bankr. 1st Cir. 1982); *In re* Henderson, 33 Bankr. 1419 (Bankr. D. N.M. 1982); *In re* Holyst, 19 Bankr. 14 (Bankr. D. Conn. 1982); *In re* Shuttleworth, 12 Bankr. 27 (Bankr. W.D. Pa. 1981); *In re* Nellis, 12 Bankr. 770 (Bankr. D. Conn. 1982). *But see In re* Ricks, 40 Bankr. 507 (Bankr. D.C. 1984) (following the *Walsh* view).

33. *In re* Ricks, 40 Bankr. 507, 509 (Bankr. D.C. 1984).

34. *Id.* at 509.

35. *Id.*

36. 12 Bankr. 770 (Bankr. D. Conn. 1981).

37. *Id.* at 772.

defined section 522 value as "fair market value."[38] The *Nellis* court analogized from section 101(26) of the Code, which uses the phrase "at a fair valuation" to describe the value of an insolvent's property.[39] The court rested its conclusion solely on Professor Collier's interpretation of section 101(26), which describes the appropriate market as that between willing buyers and sellers under ordinary conditions.[40]

Since the *Nellis* decision, most bankruptcy courts have followed its "ordinary market" approach rather than *Walsh*'s "liquidation market" approach.[41] At least one court has noted that valuation under section 506(a) is much more flexible than a section 522 valuation because section 506(a) asks for an examination of the circumstances, whereas section 522 does not.[42] Some post-*Nellis* decisions, including a recent opinion by the United States Court of Appeals for the Fourth Circuit, simply have stated, without analysis or justification, that "fair market value" contemplates the ordinary market place value negotiated between willing buyers and sellers.[43]

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38. *Id.*

39. *Id.*

40. The court stated:

> In § 101(26) of the Bankruptcy Code, Congress, in defining "insolvent" uses the phrase "at a fair evaluation" to determine the amount of an entity's property. 2 *Collier on Bankruptcy* (15th ed.) ¶ 101.26[4] in discussing "fair valuation" claims that such valuation is not arrived at "by reliance upon the sum which would he realized at a foreclosure, execution or receivership sale . . . nor . . . the price which the debtor could obtain if he were forced to *instantly* dispose of the assets in question" (emphasis in original at 101-55). Fair valuation is "what can be realized out of the assets within a reasonable time either through collection or sale at the regular market value, conceiving the latter as the amount which could be obtained for the property in question within such period by a 'capable and diligent businessman' from an interested buyer 'who is willing to purchase under the ordinary selling conditions.'"

12 Bankr. at 772 (citation omitted).

41. *See, e.g., In re* Parenteau, 23 Bankr. 289 (Bankr. 1st Cir. 1982); *In re* Moore, 30 Bankr. 197 (Bankr. D. Md. 1983); *In re* Holyst, 19 Bankr. 14 (Bankr. D. Conn. 1982); *In re* Henderson, 33 Bankr. 149 (Bankr. D. N.M. 1982); *In re* Shuttleworth, 12 Bankr. 27 (Bankr. W.D. Pa. 1981). *But see In re* Ricks, 40 Bankr. 507 (Bankr. D.C. 1984).

42. *In re* Henderson, 33 Bankr. 149, 150 (Bankr. D. N.M. 1982). The *Henderson* court examined both *Walsh* and *Nellis* and decided to follow *Nellis'* ordinary fair market value approach. Later, the court makes a classic error, concluding that the standard for appraisal should be fair market value. The term fair market value, however, is exactly how section 522 defines value, and that definition is exactly what *Walsh* interpreted to mean fair "liquidation market value." Courts should be more careful with terminology; the *Henderson* court should bave concluded by stating which "market" it thought Congress intended to refer to when it used the phrase "fair market value." For this reason, the *Walsh* court offered sound analysis because it endeavored to determine the appropriate "market" intended by the phrase "fair market value."

43. *See In re* Fitzgerald, 729 F.2d 306 (4th Cir. 1984); *In re* Rehbein, 49 Bankr. 250 (Bankr. D. Mass. 1985); *In re* Allen, 44 Bankr. 38 (Bankr. D. N.M. 1984); *In re* Rappaport,

In further support of this view, even pre-Code bankruptcy exemption cases valued the exempt property with a standard in accord with the *Nellis* approach.[44]

The next question confronted under the *Nellis* approach is how to value property at the fair market value standard. Thus far, the analysis only has attached a label to the appropriate standard. In applying that standard to procure the correct result, many courts do not get beyond mere generalities.[45] One court has stated affirmatively, however, that "[a]n appraisal of a property is not the result of a scientific analysis."[46] Another court has recognized the subjective nature of "value" and, consequently, has suggested that a court should not become fixed on a particular figure, but should take guidance from all factors.[47] Despite the vagueness surrounding the "value" concept, certain guidelines established by the courts in section 522 proceedings merit attention. Generally, appraisals of a property's selling price are determined "exclusive of reductions for expenses or costs which might be incurred in [that theoretical] sale."[48] Appraisals often are the only criteria on which

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19 Bankr. 971 (Bankr. E.D. Pa. 1982).

44. *In re* Aranoff & Son, 1 F. Supp. 708 (N.D. Ga. 1931).

45. *See In re* Moore, 30 Bankr. 197 (Bankr. D. Md. 1983). One Bankruptcy Appellate Panel, however, has articulated guidelines for interpreting "ordinary fair market value." *See In re* Parenteau, 23 Bankr. 289 (Bankr. 1st Cir. 1982) (citing *Nellis* with approval). The *Moore* court stated:

> Fair market value has been defined as: 1. The highest price in terms of money which a property will bring in a competitive and open market under the conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus. 2. The price at which a willing seller would sell and a willing buyer would buy, neither being under abnormal pressure. 3. The price expectable if a reasonable time is allowed to find a purchaser and if both seller and prospective buyer are fully informed. . . . AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE 23 (7th Ed. 1978). Implicit in this definition is the consummation of a sale as of a specified date in the passing whereby: 1. Buyer and seller are typically motivated. 2. Both parties are well informed, are well advised, and each acting in what he considers his own best interest. 3. A reasonable time is allowed for exposure in the open market. 4. Payment is made in cash or its equivalent. 5. Financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale. 6. The price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

30 Bankr. at 198-99 (citing AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE 23 (7th ed. 1978)).

46. *In re* Development, Inc., 36 Bankr. 998, 1004 (Bankr. D. Haw. 1984).

47. *In re* Rehbein; 49 Bankr. 250, 253 (Bankr. D. Mass. 1985).

48. *Id.*; *see also In re* Nellis, 12 Bankr. 770, 773 (Bankr. D. Conn. 1981). At least one court has held that fair market value does not include hypothetical broker fees, even if clearly ascertainable. *In re* Shuttleworth, 12 Bankr. 27, 29 (Bankr. W.D. Pa. 1981).

courts base their conclusions. Courts closely scrutinize the merits and foundations of appraisals offered by the parties.[49] When actual sales of other property are used to reflect the hypothetical sale price of the property in question, courts examine both the comparability of the property sold and the date of the sale.[50] Section 522 sets a clear time for the valuation: "as of the date of the filing of the peititon."[51] Postpetition appreciation, therefore, inures to the benefit of the debtor,[52] thereby supporting the policy of encouraging a debtor's postbankruptcy efforts to recover and start afresh.[53] After the filing date, however, if the debtor consummates a sale for greater than the declared value at the time of filing, and the court finds no proof that the property has changed in value since the filing, the court will adopt the sale price as the proper value of the property.[54]

C. *Analysis: Value Resulting from an Actual Sale*

The essential dispute between *Walsh* and *Nellis* adherents focuses on whether Congress made a "clear expression"[55] when it defined "value" under section 522 as "fair market value."[56] Neither the Code language nor its legislative history reveals a clear congressional intent.[57] Indeed, the deeper question is whether Congress had a specific intent at all when it defined value. Congress likely contemplated the common usage of the term "fair market value" without considering that a different fair value may exist under different markets. Opposing interpretations of "fair market value" emerged, therefore, because a literal interpretation of the term "fair market value" leaves open the question of which market is to be considered. Section 522 itself does not stipulate which "market" is contemplated. The *Walsh* court resorted to a valuation method similar to that prescribed under section 506(a): the court looked to the circumstances and context of the valuation.[58] The court recognized that "[t]he only market on the day a bank-

49. *See, e.g., In re* Rappaport, 19 Bankr. 971, 973 (Bankr. E.D. Pa. 1982).
50. *See id.*
51. 11 U.S.C. § 522(a)(2) (1982).
52. *In re* Rappaport, 19 Bankr. 971, 973 (Bankr. E.D. Pa. 1982).
53. *Id.*
54. *See, e.g., In re* Fitzgerald, 729 F.2d 306 (4th Cir. 1984).
55. *See supra* note 38 and accompanying text.
56. *See supra* note 26 and accompanying text.
57. *See supra* notes 40-42 and accompanying text.
58. 5 Bankr. at 240-41.

ruptcy petition is filed, is, invariably a bankruptcy sale."[59] This concept supports the adoption of "liquidation value." The *Walsh* court, however, wisely did not rely on or mention section 506(a) and, consequently, perhaps saved itself from attack under a statutory construction argument.

Congress drafted section 506(a) to identify the extent to which a claim is secured, an analysis that requires a valuation of the collateral.[60] Many sections require the bifurcation of claims into secured and unsecured portions and incorporate section 506(a) for guidance in valuing the collateral.[61] Congress seemingly was aware that section 506(a) would be used in both a liquidation and reorganization context and, accordingly, drafted broad guidelines aimed at the context of the valuation.[62] Although section 522 generally does not govern secured claims, Congress could have directed a section 522 inquiry to consult section 506(a) for guidance, a directive that would have justified the *Walsh* result because of the liquidation context of section 522. Instead, Congress drafted a specific definition for section 522 and, therefore, likely intended the ordinary meaning of "fair market value" to be determined in the market between a willing buyer and seller. Congress, however, likely did not intend the use of ordinary fair market value when a market between a willing buyer and seller actually does not exist.

Congress should adopt the *Walsh* analysis and identify the liquidation market, when the facts allow, as the proper market. Congress should recognize that the *Walsh* view further supports the policy of providing a postbankrupt debtor with the necessities of life for two reasons. First, property valued under the lower liquidation value is absorbed more easily by the exemptions' dollar limitations. Second, property valued at ordinary fair market value may produce, upon actual sale, only a liquidation value. For example, under the hypothetical offered by the *Walsh* court,[63] not only did the estate fail to benefit—because the sale resulted in a depressed liquidation value equaling the exemption amount—but the debtor also lost an automobile that might have been a necessity. Thus, the debtor would have been forced to purchase an auto for $1,200 in the higher used car market to replace a $2,000 car. The result is that the debtor gets a lower value car, the bankruptcy es-

59. *Id.* at 241.
60. 11 U.S.C. § 506(a) (1982).
61. *See, e.g., id.* §§ 547, 722, 1125.
62. *See infra* note 147.
63. *See supra* note 31 and accompanying text.

tate is not increased, and the estate even may have to pay the costs of the sale.

The choice of valuation method, therefore, presents policy questions perhaps not considered by Congress. Congress may have intended, without express statement, ordinary fair market value to be the standard; arguably, the exemption itself is a release from a legal obligation and is a sufficient device to give debtors a fresh start. The unfortunate, and perhaps unforeseen, result under the ordinary fair market value approach, however, may be a sale that deprives a debtor of a necessity and, instead of benefiting the bankruptcy estate, burdens the estate with the cost of the sale. Accordingly, Congress should adopt a valuation standard for section 522 that will allow liquidation value when the facts do not suggest that an actual sale would yield ordinary fair market value.

III. Section 547 Preferential Transfers

A. *Mechanics Underlying the Valuation Issue*

Section 547[64] of the Code allows the trustee, or in certain circumstances the debtor,[65] to set aside, as "preferential," certain transfers of,[66] or liens upon,[67] the debtor's property when these transfers or liens occur during the statutory period. To set aside a transfer as preferential, the debtor or trustee must prove that the transfer was made (1) to benefit a creditor, (2) to satisfy a debt existing prior to the transfer, (3) while the debtor was insolvent, (4) on or within 90 days before the debtor filed a petition for bankruptcy, and (5) to cause a creditor to receive an amount greater than it would have received if it had waited to satisfy its claim during a Chapter 7 liquidation.[68] Section 547's three principal pol-

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64. 11 U.S.C. § 547 (1982).

65. Section 1107(a) gives a debtor in possession substantially the same rights as a trustee:

> Subject to any limitations on a trustee under this chapter and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right of compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

11 U.S.C. § 1107(a) (1982); *see In re* Earth Servs., 25 Bankr. 399, 400 (Bankr. D. Vt. 1982) (holding debtor action to avoid the attachment of a judgment lien to be a preferential transfer).

66. *See In re* Schick Oil & Gas, 35 Bankr. 282, 284 (Bankr. W.D. Okla. 1983) (concerning trustee action to avoid debtor's transfer of a security interest).

67. *See Earth Servs.*, 25 Bankr. at 399.

68. 11 U.S.C. § 547(b) (1982). Section 547(b) sets forth the following conditions required to classify a transfer as preferential:

icy objectives are (1) to discourage creditors from forcing debtors to file petitions,[69] (2) to prevent an unequal distribution of debtor assets to similarly situated creditors, and (3) to lessen the creditor scramble for an advantage on the eve of bankruptcy.[70] Unequal distribution, the real thrust behind section 547, occurs when a creditor receives a greater amount than it would have received absent the transfer under a Chapter 7 liquidation.[71] Although a claimant must prove each of the five elements listed above to avoid a transfer,[72] a valuation issue arises only under the third ("insolvency") and fifth ("greater amount received") requirements.

The "insolvency" requirement prompts a trustee or debtor seeking to avoid a transfer to argue for a low total asset value, relative to total liabilities, in order to support a claim that the debtor was insolvent at the time of the transfer.[73] Conversely, the transferee-creditor must argue for a high asset value in an effort to prove that the debtor was solvent at the time of the transfer. The

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(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—

(i) was an insider; and

(ii) had reasonable cause to believe the dehtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (1982).

69. *See In re* Thomas Farm Sys., Inc., 18 Bankr. 541, 542 (Bankr. E.D. Pa. 1982); *In re* Vecco Const. Ind., 9 Bankr. 866, 867 (Bankr. E.D. Va. 1981); Farmers Bank v. Julian, 383 F.2d. 314, 327 (8th Cir. 1967).

70. H.R. REP. No. 595, 95th Cong., 2d Sess. 178, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6138-39; *see* Barash v. Public Fin. Corp., 658 F.2d 504, 508 (7th Cir. 1981); *see also* Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 726 (1985).

71. *See Barash*, 658 F. 2d. at 507; *see also infra* notes 141-44 and accompanying text.

72. *See Thomas Farm Sys., Inc.*, 18 Bankr. at 541.

73. 11 U.S.C. § 101(29) (1982) defines insolvency as a condition where the debtor's liabilities exceed his assets. In addition, the debtor is presumed to be insolvent during the 90 day period prior to the filing of a bankruptcy petition. *Id.* § 547(f).

"greater amount received" requirement demands the more difficult determination of what the transferee-creditor would have received under a Chapter 7 liquidation.[74] Section 506(a) governs the extent to which a creditor is secured and, thus, the amount available in Chapter 7 liquidation.[75] For example, if the value of the collateral exceeds the amount of the claim, it would be impossible for the creditor to receive more from a transfer during the preference period than the creditor would receive under liquidation because, upon liquidation, the collateral would cover fully the creditor's claim.[76] The "greater amount received" issue, therefore, also motivates debtors and trustees to prove a low value and creditors to argue for a high, fully secured value.

Although the result of a singular vein of policy objectives,[77] section 547 nevertheless creates two separate valuation opportunities. Both the "insolvency" and the "greater amount received" preference requirements lead to a valuation of debtor assets for the same purpose, yet appear to operate through different statutory mandates. Theoretically, these two requirements should use the same valuation standard because both attempt to determine whether a creditor is receiving preferential treatment from a debtor on the eve of bankruptcy. Courts, however, have applied different standards to the "insolvency" and the "greater amount received" requirements. A discussion of how the courts have approached separately the valuation issue within each of these requirements is presented below, followed by a brief section on uniformity.

B. *Section 547's "Insolvency" Requirement: "Fair Valuation" in a Hypothetical Market*

The two most common situations giving rise to the insolvency issue are when a debtor attempts to avoid a judgment lien[78] and when a trustee attempts to avoid a transfer made by a debtor to a

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74. *See infra* notes 115-52 and accompanying text.

75. 11 U.S.C. §506(a) (1982). The creditor is secured only to the extent of the collateral. To the extent money is available from the estate after the secured creditors are paid, unsecured creditors receive payments on an equitable percentage basis. *See In re* Utility Stationery Stores, Inc., 12 Bankr. 170, 179 (Bankr. N.D. Ill. 1981). For the pertinent text of § 506(a), see *infra* note 147.

76. *See, e.g., In re* Conn, 9 Bankr. 431, 434 (Bankr. N.D. Ohio 1981). If the collateral value did not equal or exceed the amount of the claim, payments to the creditor above collateral value would be preferential.

77. *See* Countryman, *supra* note 70, at 726.

78. *See supra* note 66.

creditor.[79] Although section 547 normally only reaches transfers made 90 days before the debtor's filing of a bankruptcy petition, if the transferee is an "insider," as defined in Code section 101(28), the reach extends back to one year before the filing. These time periods are termed the "preference periods."[80]

Recognizing that reasonable minds can differ on the valuation issue, Congress placed a heavy burden on a transferee-creditor attempting to prove that the debtor was solvent at the time of the transfer. Section 547 contains a provision[81] which states that "the debtor is presumed to have been insolvent on and during the 90 days immediately proceeding the date of the filing of the petition."[82] In valuation terms, this means that the value of debtor liabilities is presumed to exceed debtor assets during the preference period.[83] This presumption, however, provides little guidance on the proper valuation standard for purposes of the insolvency requirement.

Congress drafted the 90 day insolvency presumption to reduce litigation and to promote equality because there was a perceived rarity of debtor solvency during the preference period.[84] Courts do not hesitate to end quickly a case by applying this presumption against a transferee that fails to come forward with evidence bearing on the debtor's solvency.[85] Although the trustee or debtor carries the overall burden of proof on the value issue, the creditor must rebut the presumption of insolvency to avoid summary judgment.[86] Some courts, however, are lenient on the issue of how much evidence a creditor must present to overcome the presumption of insolvency.[87] Once rebutted, however, the presumption ar-

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79. *See In re* National Buy-Rite, Inc., 7 Bankr. 407 (Bankr. N.D. Ga. 1980).

80. 11 U.S.C. § 547(b)(4)(B) (1982); *see supra* note 68.

81. 11 U.S.C. § 553(c) (1982) contains a similar provision.

82. The full text reads as follows: "(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of tbe filing of the petition." 11 U.S.C. § 547(f) (1982).

83. *See* 11 U.S.C. § 101(26) (1982) (defining insolvency in the balance sheet sense).

84. *See* Countryman, *supra* note 70, at 727.

85. *See Earth Servs.*, 25 Bankr. at 400. In *Earth Servs.* the court found that the presumption requires the party against whom it is directed to come forward with some evidence to rebut the presumption, but the burden of proof remains on the party in whose favor the presumption exists. In the instant case the defendant failed to introduce any testimony bearing on insolvency, as defined in the Code, tbat would require the plaintiff to come forward with rebutting evidence. *Id.*; *see also* Countryman, *supra* note 70, at 730 n.109 and cases cited therein.

86. *See In re* National Buy-Rite, Inc., 7 Bankr. 407. (Bankr. N.D. Ga. 1980)

87. *See Thomas Farm Sys., Inc.*, 18 Bankr. at 542 (holding letter from the debtor to the creditor in which the debtor indicated doubts regarding its solvency sufficient to over-

guably should not interfere with the valuation standards described below.

Although the insolvency presumption may preempt some litigation, the presumption remains a weak attempt to clarify the standard by which property should be valued under section 547. Section 101(29) of the Code defines insolvency as a "financial condition such that the sum of [an entity's] debts is greater than all of such entity's property, at a fair valuation."[88] Based on the Code's formal definition of insolvency, the properly phrased issue becomes whether an entity's assets, at a "fair valuation," were less than the entity's obligations at the time of the transfer.[89] This comparison of assets and liabilities commonly is termed the "balance sheet" test.[90]

In a 1940 case that later would gain wide acceptance the United States Court of Appeals for the Second Circuit, in *Syracuse*

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come the presumption).

88. Section 101(29) provides:

"insolvent" means—

(A) with reference to any entity other than a partnership, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of—

(i) property transferred, concealed, or removed with intent to hinder, delay or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title; and

(B) with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation—

(i) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph; and

(ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (a) of this paragraph, over such partner's nonpartnership debts.

11 U.S.C. § 101(29) (1982). This definition is substantially similar to the former Act's § 1(19) definition, which stated that "[a] person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property . . . shall not at a fair valuation be sufficient in amount to pay his debts." *See In re* Purbeck & Assoc., Ltd., 27 Bankr. 953, 954 (Bankr. D. Conn. 1983). The common and most crucial element of both definitions is the phrase "at fair valuation." Furthermore, the former Act's definition of insolvency was triggered by the former Act's equivalent of section 547, a provision that also avoided a transfer prior to filing if the debtor was insolvent. *See, e.g.*, Darby v. Shawnee Southwest, Inc., 399 F. Supp. 587, 589 (W.D. Okla. 1975); *In re* Hunter Press, Inc., 420 F. Supp. 338 (D. Conn. 1976). Because of the similarities between the present Code and the former Act, courts uniformly accept cases interpreting equivalent provisions of the former Act as precedent. *See Purbeck & Assoc.*, 27 Bankr. at 954 (stating that due to the similarity in the definition of insolvency, "cases which illuminate the old law" are useful in this proceeding).

89. *See Schick Oil & Gas*, 35 Bankr. at 285.

90. *Hunter Press*, 420 F. Supp. at 341.

Engineering Co. v. Haight,[91] articulated an interpretation of "fair valuation" under the former Act's equivalent to section 547.[92] The *Syracuse* court determined that the interests of both debtor and creditor are best served by using a standard based on the fair market value that would result from a sale, within a reasonable period of time, between a willing buyer and a willing seller.[93] This definition apparently avoids section 522's problem of identifying the appropriate market; the benchmark here is the price between a willing buyer and a willing seller in *whatever* market they may transact. In adopting this interpretation of "fair value," the court also specifically dismissed any possibility that a distress or forced sale value would serve as the applicable standard.[94]

In attempting to comport with the above valuation standard, at least one court astutely has recognized that although book value does not necessarily prove fair market value, "book value is not precluded as evidence of fair market value."[95] Courts generally will examine balance sheets and other financial statements, appraisals, expert testimony, and any other evidence relevant to determining the appropriate value.[96] In contrast to the rigid formula for value found in section 522, the *Syracuse* interpretation of fair value tolerates values that may fall below full fair market value. The *Syracuse* requirement that the sale must occur within a reasonable pe-

91. 110 F.2d 468 (2nd Cir. 1940).

92. *See supra* note 88.

93. The court stated:

> Fair valuation of an estate such as this might conceivably be based on forced sale prices, or on fair market prices, or on so-called intrinsic values, irrespective of sale. A proper regard for the interests of the bankrupt, as well as the interests of his creditors, compels the conclusion that fair market price is the most equitable standard . . . . It involves a value that can be made available for payment of debts within a reasonable period of time . . . . And fair market value implies not only a "willing buyer", but a "willing seller."

110 F.2d at 471.

94. *Id.* In accordance with *Syracuse*, Professor Collier has stated that fair value "signifies the reasonable estimate of what can be realized from the assets by converting them into, or reducing them to, cash under carefully guarded, if not idealized, conditions." 1 COLLIER ON BANKRUPTCY ¶ 1.19, at 121 (14th ed. 1974).

95. Inter-State Nat'l Bank v. Luther, 221 F.2d 382 (10th Cir. 1955). The court stated, "It is true that book value does not necessarily prove fair market value . . . [b]ut, book value is not inadmissible evidence of fair market value." *Id.* at 391.

96. Courts are aware of the technical nature of certain financial information and may shy away from reliance on such information without testimony from an accountant explaining the use of accounting practices and certain terms contained in the reports. *See, e.g., Purbeck & Assoc.*, 27 Bankr. at 955; *In re* Windor Indus. Inc. 459 F. Supp. 270, 276 (N.D. Tex. 1978). *But see Schick Oil & Gas*, 35 Bankr. at 285 (giving weight to unaudited financial statements without accompanying testimony).

riod of time, however, creates two problems.[97] First, the *Syracuse* approach seems to admit that a debtor's assets ordinarily may not have a traditional fair market value during the preference period. Second, the envisioned sale is purely hypothetical and, therefore, does not contemplate any market at all.

When a creditor has secured a judgment lien upon, attached, and sold or established a selling price for a debtor's assets, the fair valuation standard also applies to the *actual* sale.[98] The question in this context becomes to what extent the sale price should serve as a measure for "fair valuation." Although the *Syracuse* decision suggests that a creditor's distressed or forced sale price would fall short of the fair valuation standard, some courts have found no difficulty in equating this sale price to "fair valuation."[99] In attempting to obtain this result, a trustee seeking to prove a debtor's insolvency may argue that the debtor's business status does not warrant full retail value, even if given a reasonable period of time in which to execute a retail sale.[100] If a creditor chooses to foreclose and later sells to a dealer at wholesale, the trustee can argue that the sale also represented the debtor's only option and, accordingly, acurately reflected the fair value of the property at that time. A creditor's sale for a depressed amount, perhaps the amount of the loan, therefore, actually may boost a trustee's argument for insolvency and aid his case for avoiding the transfer. Thus, in contrast to the limitation developed in *Syracuse*, the fair valuation standard tolerates even an actual sale, regardless of whether the sale produces a depressed liquidation value.

To reduce the valuation further, trustees may argue for a reduction in the sale price to cover selling costs incurred by the creditor.[101] Courts, however, hold that because the price theoretically represents a fair valuation, and because the only available fair

97. Professor Collier's definition, discussed *supra* note 94, is limited similarly. The limitation in Collier's definition is that the sale must be "under carefully guarded, if not idealized, conditions," suggesting that the sale ordinarily would not occur in that manner.

98. *See, e.g., Windor Indus. Inc.*, 459 F. Supp. at 270; *In re* Hunter Press, Inc., 420 F. Supp. 338 (D. Conn. 1976); Darby v. Shawnee Southwest, Inc., 399 F. Supp. 507 (W.D. Okla. 1975).

99. *See supra* note 94.

100. For example, in *Darby* the debtor abandoned a business consisting primarily of carpet inventory. The creditor, seeking to prove that debtor's assets exceeded liabilities, argued for increasing the debtor's historical cost by the industry retail markup. The trustee, however, successfully proved that because of the debtor's prior markups, lack of customers, and dealer unwillingness to pay more than factory cost, the only possible sale within a reasonable time would be to a dealer at factory cost. 399 F. Supp. at 591.

101. *See, e.g., Darby*, 399 F. Supp. at 592; *Hunter Press*, 420 F. Supp. at 341.

market may be that in which the creditor actually sold, selling costs should not reduce the sale price because those costs do not affect the sale price negotiated between willing buyers and sellers in ordinary transactions.[102] This position, however, does not prevent all costs incurred by the creditor from reducing the sale price.[103] If, for example, the creditor incurred costs in making an asset marketable or in finishing work in process, courts will allow a reduction in the sale price.[104] Therefore, costs that add value and enhance marketability should be distinguished from those incident to executing a sale.[105] In summary, although the *Syracuse* standard of valuation initially may suggest traditional fair market value, later courts have held the *Syracuse* standard to be satisfied hy foreclosure and sale for an amount just sufficient to satisfy the debt. This amount perhaps can be reduced further by subtracting certain costs incident to the sale.

Creditors, on the other hand, when arguing for a high asset value to prove that the debtor was solvent at the time of the transfer, often urge courts to value a company's assets by using a "going concern" valuation standard.[106] At least one court has rejected the "going concern" standard as incompatible with the balance sheet concept required by the Code's definition of insolvency — liabili-

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102. *Hunter Press*, 420 F. Supp. at 341. In *Hunter Press* the court stated:

> In determining what such a willing buyer might pay a willing seller, I conclude that one should not take into account the auction costs of selling the property. The balance sheet approach calls upon the court to compare the value of the assets and the amount of liabilities of the bankrupt at the time of the attachment. The value of these assets is . . . [tbeir] fair market price, what a willing buyer would pay for these assets under ordinary selling conditions. Clearly that market price would not include any of the costs of sale. An auction sale to liquidate property is moreover not generally a normal selling condition. To deduct from the market price the costs of such a liquidating auction would be inconsistent with the balance sheet approach and unfairly decrease the value of the debtor's assets.

Id.

103. *Id.*

104. *See, e.g., id.* at 342. In *In re* Schindler, 223 F. Supp. 512 (E.D. Mo. 1963), *rev'd on other grounds sub nom.* American Nat'l Bank & Trust Co. v. Bone, 333 F.2d 984 (8th Cir. 1964), the court allowed a deduction for the costs of preparing crops and livestock for the market, but did not discuss the attorney fees, auction fees, or negotiation costs of the actual sales.

105. *Hunter Press*, 420 F. Supp. at 341-42. To illustrate further, when accounts receivable are discounted, the discount represents the "risks and costs" of collection and reflects the market value, not the costs, of a sale. *Id.*

106. *See In re* Utility Stationery Stores, 12 Bankr. 170, 177 (N.D. Ill. 1981); *In re* Windor Indus., 459 F. Supp. 270, 276 (N.D. Tex. 1978); *In re* Perdue Housing Indus., Inc., 437 F. Supp. 36, 37 (W.D. Okla. 1977).

ties exceeding assets at a fair value.[107] The going concern standard also does not fit within the meaning of "fair value," judicially understood to mean the value resulting from a sale of an entity's individual assets, not the continuing viability of that entity.[108] Other courts have stated that going concern value is inappropriate only when the company is merely "nominally in existence" or "on its death bed"[109]—a condition perhaps easily proven by the trustee's showing, for example, unpaid debtor liabilities.[110] Finally, even when a court examines going concern value, many assets eventually are discounted to reflect the true position of the company, the company's inventory is reduced to recognize obsolescence, and accounts receivable are adjusted to reflect collectibility.[111]

Regardless of the method used, the statute clearly requires an insolvency determination to be conducted by assigning a "fair valuation" to the debtor's assets.[112] The judiciary initially interpreted fair valuation to mean the value obtainable in a market between a willing seller, given a reasonable time to sell, and a willing buyer.[113] This market, however, exists only in theory. First, any sale is theoretical because the debtor, at the time of the transfer, has not filed a petition for bankruptcy and, therefore, may not have contemplated selling assets in any market. Second, if the debtor desired to sell its enterprise, the debtor likely would sell the entire entity for the maximum going concern value achievable, including good will. Furthermore, absent bankruptcy, the debtor would have more than a reasonable time to sell the entity or a particular asset. Thus, the *Syracuse* fair valuation standard is a purely hypothetical arrangement because it appears to command less than what ordinary business operations would yield, yet greater than what a forced liquidation sale would produce. Case law illustrates that the hypothetical nature of judicial interpretations of fair valuation causes quantification difficulties and litigation uncertainty.

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107. *See Perdue Housing*, 437 F. Supp. at 38.

108. *See id.*

109. *See, e.g., Windor Indus.*, 459 F. Supp. at 276. The court noted:

> The [creditor] argu[es] that the business should bave been valued at its "going concern" value. The fact that a company is nominally in existence is not persuasive in valuing the company at a "going concern" valuation . . . and where the company is on its deathbed, the "going concern" value does not apply.

Id. (citations omitted).

110. *Id.* In *Windor Indus.* substantial amounts of payables were overdue by 60 days and approximately $1.5 million was owed to nearly 200 creditors. *Id.*

111. *See Utility Stationery Stores,* 12 Bankr. at 176-77.

112. *See supra* note 88 and accompanying text.

113. *See supra* note 93 and accompanying text.

Despite diverse judicial interpretations, examining the various policy considerations may aid in discerning what Congress intended by the term "fair valuation." The initial task is to determine who benefits from the use of a given standard. A valuation standard placing a high value on assets, such as the *Syracuse* fair market value standard, is more likely to result in a solvency conclusion and, thus, benefit a particular transferee-creditor. A forced sale or liquidation valuation standard, however, places a low value on property and is more likely to lead to an insolvency conclusion. As a result, *all* creditors will benefit because the transfer will be avoided as a preference and the assets will be included in the bankruptcy estate.

Perhaps the statutory presumption of insolvency during the preference period, although easily rebutted, should imply that Congress recognized that debtors may not be fairly classified as operating in ordinary fair market conditions during this period. Judicial decisions upholding the price obtained from an attachment and forced sale as satisfying the "fair valuation" requirement further support this proposition.[114] The statutory language of "fair valuation," however, does not, and perhaps should not, limit itself to one particular method. A valuation could be fair for one type of asset and unfair for another. Equity considerations inhere in the definition by the use of the word "fair." A "fair valuation" seemingly should consider the nature of the debtor, the type of asset involved, and the condition of the market place—the same standards articulated under section 506(a). Although the term "fair valuation" may comport with section 547's policy objectives by favoring neither creditor nor debtor, the term creates confusion because judicial interpretations have created a hypothetical market.

A less confusing definition of fair valuation would be the highest realizable value existing at the time of the transfer, considering the totality of circumstances surrounding the debtor. This construction of fair valuation retains flexibility, but directs all inquiries into individual asset valuations toward the same considerations. For example, a debtor's inventory may have become obsolete due to market conditions and, consequently, be worthy only of scrap value; other inventory or assets may have appreciated highly. Furthermore, the impetus that subsequently caused the bankruptcy may have been completely unforeseen and, therefore, should not affect the value of the asset at the time of transfer. Under a high-

114. *See supra* notes 98-100 and accompanying text.

est realizable value standard all factors relevant to the appropriate value could be examined and the value will reflect reality. The highest realizable value is fully consistent with a secured creditor's expectation interest because if a debtor voluntarily decided to sell assets to pay debts, the debtor would attempt to obtain the highest price achievable. Although this standard may contemplate a sale that in fact does not occur, the standard does not contemplate a hypothetical market because it recognizes that, under the proper circumstances, certain assets may not have a willing buyer, or, under other circumstances, these assets may not attract a buyer willing to pay a premium.

C. Section 547's "Greater Amount Received" Requirement: Section 506(a) "Facts and Circumstances" Value

The second valuation issue contained within the preferential transfer requirements is whether the transferee-creditor received a greater amount than it otherwise would have received under the distributive provisions of the Code.[115] Essentially, this requirement is intended to prevent one creditor from improving, by means of a prefiling transfer, its position with respect to other similarly situated creditors.[116] The requirement further supports section 547's policy of ensuring an equal distribution among creditors[117] by comparing what the transferee-creditor receives from a transfer with what other creditors would have received absent that transfer.[118] Section 506(a) bifurcates a creditor's claim into a secured and an unsecured portion,[119] stating that a claim is secured only to the extent of the collateral's value.[120] Generally, a prefiling transfer to a fully secured claimant does not affect the bankruptcy estate and will not provide the transferee-creditor with a greater amount than at liquidation.[121] A claim is fully secured when the value of the collateral securing the debt is at least equal to the amount of the debt.[122] On some occasions a court will assume, in the absence of proof bearing on value, that the collateral is equal to the amount of

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115. 11 U.S.C. § 547(b)(5) (1982). See *supra* note 68 for text of the section.

116. H.R. REP. No. 595, 95th Cong., 2d Sess. 178, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6138-39.

117. *Id.*; *see* Barash v. Public Fin. Corp., 658 F.2d. 504, 508 (7th Cir. 1981).

118. *Barash*, 658 F.2d at 508.

119. 11 U.S.C. § 506(a)(1982); *Barash*, 658 F.2d at 507.

120. 11 U.S.C. § 506(a) (1982); *Barash*, 658 F.2d at 511.

121. *See id.*; *In re* Conn, 9 Bankr. 431, 434 (Bankr. N.D. Ohio 1981); *In re* Windor Indus., 459 F. Supp. 270, 278 (N.D. Tex. 1978).

122. 11 U.S.C. § 506(a)(1982).

the claim.[123] Generally, however, the party arguing that a transfer was not preferential must carry the burden of proving a collateral value sufficient to absorb the full claim.[124] A secured creditor, therefore, will argue for a high valuation of the asset in which the creditor has security in order to prove that its claim was fully secured and would have been satisfied in full even upon liquidation.

The converse of a fully secured creditor is an entirely unsecured creditor. An unsecured creditor is termed a general creditor; a general creditor must subordinate its Chapter 7 claims to those of secured creditors.[125] Upon liquidation unsecured creditors are paid a certain percentage of their claim.[126] The percentages are calculated by scheduling the assorted general creditor claims against any assets remaining after secured creditors have been paid.[127] An unsecured creditor that receives a transfer during the preference period faces virtually insurmountable difficulty in proving that the transfer was not preferential. For example, if a debtor's assets are insufficient to satisfy all secured claims, an unsecured claim will receive nothing and, thus, have a distribution percentage of zero. In that situation any prior transfer automatically will place the creditor in receipt of more than it would receive at liquidation.[128] Thus, only assets valued in a manner sufficient to create a 100% liquidation ratio allow an unsecured creditor to show that it received a nonpreferential transfer,[129] an unlikely event, however, because if a debtor could pay off all its creditors, the debtor presumably would not be in bankruptcy.

Even when an unsecured creditor is scheduled to receive some percentage of its claim upon liquidation, a payment in the 90 day period still may result in the receipt of a greater amount.[130] In *Palmer City Products Co. v. Browns*[131] Justice Brandeis offered an example of a creditor with a $10,000 claim, a 50% liquidation ratio, and in receipt of a $1,000 payment during the preference period. Because of the transfer, this creditor eventually will receive $5,500 ($1,000 plus 50% of the remaining $9,000 claim); other creditors with identical claims, but without a similar transfer, will receive

123. *See, e.g., Conn*, 9 Bankr. at 434.
124. *See id.*
125. *In re* Utility Stationery Stores, 12 Bankr. 170, 179 (N.D. Ill. Bankr. 1981).
126. *See id.*
127. *See id.*
128. *See id.*
129. *Id.*
130. *Id.*
131. 297 U.S. 227, 229 (1936).

only $5,000.[132] Justice Brandeis' example emphasizes that a proper analysis must focus both on the amount of the transfer, which may be below the distribution percentage, and on any forthcoming receipt upon liquidation.[133] Thus, an unsecured or partially secured creditor with any liquidation percentage below 100% risks having its prefiling transfer classified as preferential.[134]

At least one court, however, has noted that a creditor with a distribution percentage below 100 may not always face an insurmountable challenge in denying that its transfer was preferential. The recent United States Court of Appeals for the Ninth Circuit decision in *In re Shurtleff*[135] justified that position by distinguishing its facts from the facts in *Palmer City Products*. In *Shurtleff* the creditor received a prefiling payment in full satisfaction of a claim, whereas in *Palmer City Products* the creditor received a payment "on account" and was forced to seek further satisfaction upon liquidation.[136] The *Shurtleff* court held that because the transferees would have a claim for breach of contract if the transfer were avoided and no claim if the transfer remained intact, the value of the transferred items should be compared to possible damages resulting from a breach of contract.[137] The court remanded the case for a finding of value, holding that the transfer would be avoided as a preference only if the value of the transferred items was greater than the resulting possible damages for breach.[138] Thus, in light of *Shurtleff*, a transfer to an unsecured creditor with a distribution percentage of less than 100% may not necessarily result in a preferential transfer.

Valuation is perhaps most significant when a creditor is partially secured. Under section 506(a) a valuation of collateral determines the extent to which a creditor's claim is secured.[139] As noted above, a fully secured creditor can defend a preference attack,[140] but a partially secured creditor is in a different position. A partially secured creditor may receive more from a transfer during the preference period than it would receive at liquidation. In *Barash v.*

132. *Id.*
133. *See Barash*, 658 F.2d at 509.
134. *See Utility Stationery Stores*, 12 Bankr. at 179.
135. 778 F.2d 416, 1422 (9th Cir. 1985).
136. *Id.*
137. *Id.*
138. *Id.*
139. 11 U.S.C. § 506(a)(1982). See *infra* note 147 for text of § 506(a).
140. *See supra* note 121 and accompanying text.

Public Finance[141] the United States Court of Appeals for the Seventh Circuit held that transfers to a partially secured creditor are charged first to the unsecured portion of the debt.[142] Thus, because *Barash* allocates transfers during the preference period to the unsecured portion of a claim, the transfer amount plus the amount received at liquidation from the secured claim may result in the creditor receiving more than its share.[143] *Barash*'s allocation of a partially secured creditor's transfer causes that creditor to enjoy a better position than similarly situated creditors not in receipt of a transfer.[144] *Barash*, therefore, motivates secured creditors to prove a collateral value at least sufficient to absorb both the secured and unsecured portions of the claim.

Although both the *Barash* and *Shurtleff* courts clearly identified when and how a valuation issue arises under section 547,[145]

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141. 658 F.2d 504 (7th Cir. 1981).

142. *Id.* at 508-09.

143. The *Barash* court described the results of a transfer to a partially secured creditor as follows:

> [I]f upon liquidation unsecured creditors would be paid 20% of their claims (based on remaining assets and scheduled claims after secured creditors are paid), to defeat a trustee's avoidance rights a creditor would have to show only that the payments received during the 90-day period do not exceed 20% of the creditor's unsecured claim. This sole comparison, however, does not account for what happens thereafter. If the payments made were less than 20%, there would be no preference and the creditor would keep the payments and later also receive a pro-rata share of the balance of his claim. In the final analysis, this would violate the fundamental principle of equal distribution among a class of claims.
>
> Section 547(b)(5) is directed at transfers which *enable* creditors to receive more than they would have received had the estate been liquidated and the disputed transfer not been made. As long as the transfers diminish the bankrupt's estate available for distribution, creditors who are allowed to keep transfers would be enabled to receive more than their share. The creditors in the instant case must account for the payments they received during the 90 days preceding the bankruptcy filing, or they will ultimately receive a larger share of their *unsecured* claims than other unsecured creditors. Of course, they will still receive the full benefit of their collateral as to their secured claims.

Id. (emphasis in original).

144. *Id.* See also *Windor Indus.*, 459 F. Supp. at 278, for a parallel analysis reaching the same conclusion as *Barash* three years prior to *Barash*. Neither the *Barash* court nor later courts, however, have relied on *Windor*.

145. The *Barash* court stated: "Section 506(a) provides that a debt is secured only to the extent of the value of the collateral. Any remaining amount is an unsecured claim. Valuation of collateral is thus crucial to determining the amount of the preferences." 658 F.2d at 511. The *Shurtleff* court stated:

> [W]e are unsure whether the bankruptcy court should have deducted the transaction costs of a sale in computing the value of the property transferred. Section 547(b) itself does not address the method by which transferred property should be appraised. Nor does the Code appear to authorize a uniform method for valuation. For example, in assessing the extent of a creditor's secured status, courts are to determine the value of

neither court resolved the issue.[146] Both courts recognized that section 506(a) should control in a value determination,[147] but neither court applied that section or refined that section's general principles. Recently, however, the United States Court of Appeals for the Eleventh Circuit, in *In re Lacklow Brothers*,[148] considered whether the bankruptcy court applied the appropriate method of valuation.[149] The issue arose in a context similar to that found in *Barash*: the trustee argued that the collateral value was insufficient to absorb the creditor's partially secured claim and that the transfer should be avoided.[150] Ultimately, the Eleventh Circuit held that the collateral value was sufficient to cover the creditor's claim at

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collateral "in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a) (1982).

778 F.2d. at 1422.

146. The *Barash* court declined to reach a conclusion on the valuation issue, stating:

> We hold that regular installment payments on consumer debts, made within 90 days preceding the filing of a bankruptcy petition, may be avoided as preferential transfers to the extent the payments are credited to unsecured claims. The bankruptcy court must determine the value of collateral on a case-by-case basis to ascertain the extent of the preferences, in keeping with the bifurcation of debts into secured and unsecured claims under 11 U.S.C. § 506(a).

658 F.2d at 512.

The *Shurtleff* court also declined to reach a conclusion on the valuation issue:

> If the bankruptcy court was correct in finding that the apartments had a net value of $27,500, the transfer was preferential, to repeat, only as to Broadway.
>
> This would justify a reversal of the district court's judgment with a remand to make it conform with the conclusion. We are, however, reluctant to do so. This is because we are unsure whether the bankruptcy court erred in calculating the net value of the apartments, and thus in applying 11 U.S.C. § 547(b)(5).

778 F.2d at 1423.

147. Section 506(a) states that "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." 11 U.S.C. § 506(a) (1982).

The legislative history confirms that the valuation standard was intended to be left open ended. "While courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property." H.R. REP. No. 595, 95th Cong., 2d Sess. 356, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6312. " 'Value' does not necessarily contemplate the forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." S. REP. No. 989, 95th Cong., 2d Sess. 68, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5854.

148. 752 F.2d 1529 (11th Cir. 1985).

149. *Id.* at 1531. The court noted, "The sole issue we must resolve is whether the district court was clearly erroneous in applying the 'ongoing concern' value in determining [that the] Creditor had not received preferential payments under section 547(b) . . . ." *Id.*

150. *Id.* at 1530-31.

the time of the transfer.[151] After citing section 506(a) for the guiding principles, the court found that because the only evidence bearing on value at the appropriate time reflected "ongoing concern" value, ongoing concern value "is not only more appropriate, but is even mandatory."[152]

Although one court has characterized the *Lacklow Brothers* holding as resulting solely from "a failure of proof,"[153] the opinion does provide some guidance into valuation determination. While the *Barash* and *Shurtleff* courts addressed valuation only to recognize that the issue should be resolved by the lower courts,[154] the *Lacklow Brothers* court addressed the question of whether the lower court applied the appropriate standard.[155] The Eleventh Circuit affirmed the lower court's view that a valuation of property for purposes of a different Code section should not control valuation of that property for purposes of section 547.[156] Thus, the *Lacklow Brothers* court firmly established the section-by-section factual analysis[157] that *Barash*[158] and *Shurtleff*[159] also adopted for a section 506(a) valuation under section 547. The *Lacklow Brothers* court also considered statements from Professor Collier[160] that suggested applying a "liquidation" value for a Chapter 7 liquidation and a "going concern" value for a Chapter 11 reorganization.[161] Professor Collier's treatise, however, also recognized the flexibility intended under section 506(a). In light of Professor Collier's statements, the *Lacklow Brothers* court was justified in affirming "going concern value" as the appropriate standard, even within the liquidation context of section 547.[162]

In a section 547 valuation for purposes of the "greater amount received" requirement, when a transferee-creditor is partially se-

151. *Id.* at 1532.

152. *Id.* By "ongoing concern" value, the court was referring to certain computerized accounting reports prepared by the debtor and used by the creditor as a basis for extending credit. Although the trustee challenged the validity of the reports, the trustee presented no other evidence showing value at the time of transfer. The trustee only presented the value that the creditor actually received upon liquidation six months after the filing for bankruptcy.

153. *See In re* Olympic Foundry, 51 Bankr. 428, 431 (Bankr. W.D. Wash. 1985).

154. *See supra* notes 145-46 and accompanying text.

155. *See supra* note 149 and accompanying text.

156. *Lacklow Bros.*, 752 F.2d at 1530 n.3.

157. *Id.* at 1532.

158. 658 F.2d at 512.

159. 778 F.2d at 1422.

160. 4 COLLIER ON BANKRUPTCY ¶ 547.41, at 129 (15th ed. 1984).

161. *Lacklow Bros.*, 752 F.2d at 1532.

162. *Id.*

cured the valuation should follow the section 506(a) method of valuation.[163] Under circumstances similar to the unsecured creditor situation in *Shurtleff*, however, section 506(a) is not incorporated directly because section 506(a) applies only to a secured claim. Although the *Shurtleff* court did not address specifically the valuation issue,[164] the standard should be similar to that articulated in section 506(a). Regardless of whether a creditor has a right, due to the creditor's secured status or the creditor's distribution percentage, to payment, a transfer may be preferential if it causes a creditor to receive more than what the creditor has a right to receive at liquidation. In both instances the valuation determines the amount that the creditor has a right to receive.

D. *Uniformity Between Section 506(a) and "Fair Valuation"*

Unfortunately, the section 506(a) test still awaits sufficient application under section 547 for a trend to develop. A trend, however, may never emerge because of the broad guidelines established by section 506(a)'s statutory language and legislative history.[165] Nevertheless, the valuation standard should be the same for both the "insolvency" and "greater amount received" requirements of section 547 for proving a preferential transfer. Valuation under the insolvency requirement has spanned from approaching traditional fair market value to the value resulting from property that has been foreclosed and sold, a result perhaps justified by the word "fair" in the "fair valuation" requirement.[166] The results, if not the methods, approach those contemplated by section 506(a). The insolvency requirement also operates to determine the appropriate amount that a creditor has a right to receive. If the debtor is insolvent during the preference period, the debtor effectively is bankrupt at that time and should be unable to transfer property to allow a creditor to receive more than the creditor has a right to receive. Essentially, general bankruptcy distribution principles effectively relate back to the preference period in the event that the debtor is deemed insolvent. The result is twofold: (1) insolvency valuation cases should open up more fully to a "facts and circumstances" analysis similar to that of section 506(a); and (2) greater amount received cases may look to insolvency cases for help in

163. *See supra* note 147 and accompanying text.

164. *See supra* notes 145-46 and accompanying text; *see also* text accompanying note 155.

165. *See supra* note 147 and accompanying text.

166. *See* text following note 115.

treating identical cases similarly.

IV. Section 548 Fraudulent Transfers

A. *Mechanics Underlying the Valuation Issue*

Section 548[167] of the Code parallels section 547 in empowering a trustee to avoid certain transfers of items in which the debtor had an interest. The trustee's power to avoid transfers is triggered either if the transfer is fraudulent or if the debtor fails to receive a reasonably equivalent value for the transferred property or interest.[168] The goal of section 548 is to prevent the debtor from fraudulently excluding property from the bankruptcy estate.[169] The underlying policy is that creditors are entitled to benefit from the debtor's full equity in property that may affect the bankruptcy estate.[170] Any transfer or obligation incurred by the debtor within one year before filing for bankruptcy falls within the scrutiny of section 548.[171]

Section 548 empowers a trustee to avoid a transfer on two grounds. First, the trustee may avoid a transfer that the debtor executed with "actual intent to hinder, delay, or defraud" any present or subsequent creditor.[172] Second, the trustee may avoid the transfer: (1) if the debtor "received less than a reasonably equivalent value"[173] for the property transferred, thus creating a

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167. 11 U.S.C. § 548 (1982).

168. *Id.* § 548 (a). The entire section states as follows:

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

Id.

169. H.R. Rep. No. 595, 95th Cong., 2d Sess. 375, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6331.

170. *See* Baird & Jackson, *Fraudulent Conveyance Law and It's Proper Domain,* 38 Vand. L. Rev. 829 (1985).

171. 11 U.S.C. § 548(a) (1982).

172. *Id.* § 548(a)(1).

173. *Id.* § 548(a)(2)(A).

valuation issue; and (2) if in making the transfer the debtor was or became insolvent, was left with unreasonably small capital for a business, or intended to incur debts beyond its ability to pay.[174]

One court treated the reasonably equivalent value requirement as if Congress "created an irrebuttable presumption of fraud in certain cases of insufficient consideration received for a transferred item."[175] Defendants in section 548 cases are usually the transferees, who argue that they paid a "reasonably equivalent value" for what they acquired.[176] Plaintiffs and trustees, and sometimes even debtors,[177] argue that the consideration fell below a "reasonably equivalent value" of the interest transferred. If successful, the plaintiff either may have the transfer avoided or may recover any deficiency in consideration.[178]

Section 548 defines value as "property, or satisfaction or security of a present or antecedent debt of the debtor, but does not include an unperformed promise."[179] That definition, however, identifies only the items classified as having "value," not the standard by which to measure a "reasonably equivalent value" for the item transferred. The legislative history is equally unhelpful in providing guidance on the issue.[180]

One of the most difficult applications of section 548 concerns the foreclosure sale. Bankruptcy trustees and debtors often employ section 548 to avoid transfers of property sold pursuant to a foreclosure sale.[181] Foreclosure sales commonly conclude with the judg-

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174. *Id.* § 548(a)(2)(B).

175. *In re* Madrid, 725 F.2d 1197, 1203 (9th Cir.) (Farris, J., concurring), *cert. denied sub nom.* Madrid v. Lawyers Title Ins. Corp., 469 U.S. 833 (1984).

176. *See, e.g., In re* Jackson, 48 Bankr. 497 (Bankr. D. Minn. 1985); *In re* Dudley, 38 Bankr. 666 (Bankr. M.D. Penn. 1984).

177. *See In re* Dudley, 38 Bankr. at 668.

178. 11 U.S.C. § 550(a) (1982).

179. *Id.* § 548(d)(2)(A).

180. *See* H.R. REP. No. 595, 95th Cong., 2d. Sess. 375, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6331.

The record states:

> This section is derived in large part from section 67d of the Bankruptcy Act. It permits the trustee to avoid transfers by the debtor in fraud of his creditors. Its history dates from the statute of 13 Eliz. c. 5 (1570). The trustee may avoid fraudulent transfers or obligations if made with actual intent to hinder, delay, or defraud a past or future creditor. Transfers made for less than a reasonably equivalent consideration are also vulnerable if the debtor was or thereby became insolvent, was engaged in business with an unreasonably small capital, or intended to incur debts that would be beyond his ability to repay.

Id.

181. *See, e.g., In re* Hulm, 738 F.2d 323 (8th Cir. 1983), *cert. denied sub nom.* First Federal Sav. & Loan Ass'n v. Hulm, 469 U.S. 990 (1984); Abramsom v. Lakewood Bank, 647

ment creditor extending the only bid and purchasing the property for the amount of the debt, usually a substantial percentage below what would be considered traditional fair market value.[182] This fact pattern prompts trustees to assert that the property was sold for less than a reasonably equivalent value because the price fell below a "reasonable equivalent" to fair market value. The crucial question becomes to what standard of value must the sale price be reasonably equivalent.[183]

Most courts seem to accept, without comment, that the appropriate standard is fair market value.[184] This phenomenon, however, results in the conceptually confusing comparison of a foreclosure sale price to a fair market value price. One court found this comparison unrealistic because it ignores the "realities of the foreclosure market."[185] Foreclosure sales typically yield a much lower selling price than a regular sale on the open market.[186]

In establishing the "reasonably equivalent value" requirement, Congress could have intended two interpretations. Congress could have intended that the selling price be reasonably equivalent to the price that could be obtained from a voluntary sale on the open market, or that it be reasonably equivalent to the price that could be obtained from a properly conducted foreclosure sale. Although courts do not frame the conflict in the above terms, they are split precisely in that manner.[187]

F.2d 547, 548 (5th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982); Durrett v. Washington Nat'l Bank, 621 F.2d 201, 204 (5th Cir. 1981); *see also In re* Frank, 39 Bankr. 166, 169-70 (Bankr. E.D. N.Y. 1984) (giving a summary of the various transfers falling under section 547). An issue parallel to the proper meaning of "reasonable equivalence" is whether a foreclosure sale even constitutes a transfer within the meaning of section 548. *See* Erlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933 (1985); Baird & Jackson, *supra* note 170, at 829, 843-50; Alden, Gross & Borowitz, *Real Property Foreclosure as a Fraudulent Conveyance: Proposals for Solving the* Durrett *Problem*, 38 BUS. LAW. 1605 (1983). For a recent case outlining the split among the circuit courts, see Lower Downtown Assoc. v. Barzosbanc Sav. Ass'n, 52 Bankr. 662 (Bankr. D. Colo. 1985).

182. *See In re* Richardson, 23 Bankr. 434, 446 (Bankr. D. Utah 1982).

183. Both the Code language and the legislative history left open this question. *See supra* note 181 and accompanying text.

184. *See, e.g., In re* Willis, 48 Bankr. 295, 301 (Bankr. S.D. Tex. 1985).

185. *In re* Upham, 48 Bankr. 695, 697 (Bankr. W.D. N.Y. 1985). The court stated, "In a foreclosure sale situation, such as this, the standard that reasonably equivalent value must be a comparison between the foreclosure sale price and the appraised market value is not realistic. Such a standard would neglect to take into consideration the realities of the foreclosure market." *Id.*

186. *See Richardson*, 23 Bankr. at 446.

187. Many courts frame the issue as whether they should follow Durrett v. Washington National Ins. Co., 621 F.2d 201 (5th Cir. 1980), or *In re* Madrid, 21 Bankr. 424 (Bankr.

B. *Opposing Judicial Responses*

1. *Durrett*: Reasonably Equivalent to Fair Market Value

The Fifth Circuit's *Durret v. Washington National Insurance Co.*[188] decision is the landmark opinion holding that section 548 requires a foreclosure sale price to be reasonably equivalent to fair market value. Although *Durrett* was decided under the old Bankruptcy Act,[189] the decision has been accepted as the majority view under the new Code.[190] In spite of *Durrett*'s wide acceptance, the court's holding was predicated more on the facts of the case than on an analysis of the Code.[191] The court calculated the foreclosure sale price as a percentage of the property's fair market value (57.7%) and, because no other court had allowed a percentage below 70%, held that the price was not reasonably equivalent to fair market value.[192] Thus, the court did not specifically hold that 70% of fair market value is the minimum requirement for reasonable equivalence.[193] The court also did not articulate a rationale for holding that the price should be reasonably equivalent to fair market value and not to foreclosure market value.[194] Later courts, however, have extrapolated *Durrett* to support these principles.

Many courts initially extended *Durrett* to an extreme by stating that *Durrett* stands for the proposition that 70% of fair mar-

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9th Cir. 1982), *aff'd*, 725 F.2d. 1197 (9th Cir.), *cert. denied sub nom.* Madrid v. Lawyers Title Ins. Corp., 469 U.S. 833 (1984). *See, e.g., In re* Dudley, 38 Bankr. 666, 669 (Bankr. M.D. Pa. 1984); *In re* Frank, 39 Bankr. 166, 170 (Bankr. E.D. N.Y. 1984); *In re* Richardson, 23 Bankr. 434, 444 (Bankr. D. Utah 1982).

188. 621 F.2d 201 (5th Cir. 1980).

189. *Durrett* was decided under section 67(d) of the former Act. That section provided in pertinent part: "(1) For the purposes of, and exclusively applicable to this subdivision: . . . (e) consideration given for the property or obligation of a debtor is "fair" (1) when, in good faith, in exchange and as a fair equivalent therefore, property is transferred." 621 F.2d at 202 n.2 (quoting 11 U.S.C. § 107(d) (1976)).

190. Courts following *Durrett* fall into two categories: one treats 70% of the fair market value as the standard for avoiding foreclosure sales, *see, e.g., In re* Jacobson, 48 Bankr. 497 (Bankr. D. Minn. 1985); *In re* Wheeler, 34 Bankr. 818 (Bankr. N.D. Ala. 1983); *In re* Berge, 33 Bankr. 642 (Bankr. W.D. Wis. 1983); *In re* Jones, 20 Bankr. 988 (Bankr. E.D. Pa. 1982), the other declines to follow an absolute percentage, but agrees that a sale can be avoided for lack of reasonably equivalent value even if state foreclosure law is not violated, *In re* Hulm, 45 Bankr. 523 (Bankr. D.N.D. 1984); *In re* Frank, 39 Bankr. 166 (Bankr. E.D. N.Y. 1984); *In re* Dudley, 38 Bankr. 666 (Bankr. M.D. Pa. 1984); *In re* Carr, 34 Bankr. 653 (Bankr. D. Conn. 1983); *In re* Richardson, 23 Bankr. 434 (Bankr. D. Utah 1982).

191. *Accord In re* Hulm, 45 Bankr. 523, 527 (Bankr. D.N.D. 1984).

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

193. Later courts, however, recognized what is known as the *Durrett* rule of 70%. *See In re* Jacobson, 48 Bankr. 497, 499 n.2 (Bankr. D. Minn. 1985).

194. For an excellent discussion of this distinction, see *In re* Richardson, 23 Bankr. 434 (Bankr. D. Utah 1982).

ket value is the absolute minimum for reasonably equivalent value.[195] Later decisions have recognized, however, that *Durrett* does not stand for this proposition.[196] These decisions suggest that a percentage below fair market value that still is reasonably equivalent should receive a section 506(a)-type analysis, which considers the circumstances of each case, the nature of the parties, and the property in question.[197] Courts adopting a section 506(a)-type analysis avoid many computational difficulties by not adhering to a strict percentage.[198] For example, a foreclosure sale may be intertwined with various other mortgages and liens.[199] Thus, in computing reasonable equivalence the fair market value, inclusive of the debtor's equity, should be compared to what the purchaser paid, giving full consideration to any liabilities assumed.[200] In short, these decisions hold that each transaction should be evaluated to determine the exact values given up and received. One court recently stated that "[w]here the price paid in view of all the attended factors in a particular case is so grossly inadequate as to shock the court's conscience, then the price may be said to be less than reasonably equivalent."[201] Although confusion arose over the 70% standard that developed from *Durrett*, the primary reason for *Durrett*'s following appears to lie in its willingness to avoid a foreclosure sale if it fails to produce a price reasonably equivalent to the property's fair market value, even when the sale fully comports with state foreclosure law.

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195. *See, e.g., In re* Jacobson, 48 Bankr. 497 (Bankr. D. Minn. 1985); *In re* Coleman, 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982); *cf. In re* Richardson, 23 Bankr. 434, 448 n.21 (Bankr. D. Utah 1982).

196. *See, e.g., In re* Fargo Biltmore Hotel Corp., 49 Bankr. 782, 788 (Bankr. D.N.D. 1985); *In re* Frank, 39 Bankr. 166, 176 (Bankr. E.D. N.Y. 1984); *In re* Richardson, 23 Bankr. 434, 448 (Bankr. D. Utah 1982); *In re* Jones, 20 Bankr. 988 (Bankr. E.D. Pa. 1982).

197. The *Richardson* court stated:

> Naturally, reasonable equivalence will depend on the facts of each case. In some cases, no less than 100 percent of fair market value may be a reasonable price. In all cases, facts such as "the bargaining position of the parties . . . and the marketability of the property transferred" will he relevant.

23 Bankr. at 448 (quoting Cook, *Fraudulent Transfer Liability Under the Bankruptcy Code*, 17 Hous. L. Rev. 263, 278 (1980)); *see also Hulm*, 45 Bankr. at 528.

198. *See Fargo Biltmore Hotel*, 49 Bankr. at 788-89.

199. *See, e.g., Richardson*, 23 Bankr. at 445; *Fargo Biltmore Hotel*, 49 Bankr. at 788.

200. *Fargo Biltmore Hotel*, 49 Bankr. at 788-89.

201. *Id.* at 789.

2. *Madrid*: Reasonably Equivalent to Foreclosure Market Value

Following the *Durrett* opinion the Bankruptcy Appellate Panel for the Ninth Circuit, in *In re Madrid*,[202] held that "the consideration received at a non-collusive, regularly conducted public [foreclosure] sale satisfies the reasonably equivalent value requirement."[203] By holding that a properly conducted foreclosure sale conclusively produces a reasonably equivalent value, the *Madrid* court avoided the conceptual discomfort of comparing fair market value to foreclosure market value.[204] The *Durrett* court had avoided that discomfort by indexing fair market value by 70% to equate fair market value with its reasonable equivalent in the foreclosure market.[205]

Although the sale price in *Madrid* was only a very small margin below the *Durrett* 70% standard,[206] the *Madrid* holding represents a very different conceptual analysis. The *Madrid* court did not hold that 70% is an inappropriate index for fair market value, but held that fair market value simply is not the value to which the sale must be reasonably equivalent.[207] The *Madrid* court acknowledged that a section 548 valuation is unavoidably immersed in the realities of a foreclosure sale. The *Madrid* court acknowledged that general foreclosure law requires some element of fraud, unfairness, or oppression actually to cause an inadequate price before the foreclosure price becomes subject to avoidance as a

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202. 21 Bankr. 424, 425 (Bankr. 9th Cir. 1982), *aff'd*, 725 F.2d 1197 (9th Cir.), *cert. denied sub nom.* Madrid v. Lawyers Title Ins. Corp., 469 U.S. 833 (1984).

203. *Id.* at 425.

204. *See supra* note 185 and accompanying text.

205. *See supra* note 192 and accompanying text.

206. *See supra* note 183.

207. Although the *Madrid* approach is conceptually different from *Durrett*, the *Madrid* court did examine the foundation for the 70% rule. The *Madrid* court noted that *Durrett*, in support of its 70% standard, cited only one case in which the sale was voluntary, and that sale was to the "mother of the principal stockholder of the debtor corporation." *Madrid*, 21 Bankr. at 426. The *Madrid* court then concluded by factual analogy that the *Durrett* 70% rule has a tainted foundation because it includes voluntary private transfers. *See id.*

The court went on to object to the *Durrett* rule on theoretical grounds:

> However valid it may be to hold that less than 70% of fair market value is not a fair equivalent for a private transfer to an insider, application of that standard to regularly conducted public sales is questionable. 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 safe-guard against the evils of private transfers to relatives and favorites.

Id. at 426-27.

fradulent transfer.[208] Thus, the *Madrid* court sought compatability with foreclosure principles by holding that a foreclosure sale must have some defect before it is avoidable as a fraudulent conveyance.[209] In addition, the court was reluctant to adopt a standard that empowers a bankruptcy trustee to set aside a foreclosure sale conducted in full compliance with state law.[210]

For a variety of reasons, the *Madrid* holding has not gained the acceptance of a majority of courts.[211] The *Madrid* decision, however, recently received additional support from the United States Court of Appeals for the Sixth Circuit. In *In re Winshall Settlers' Trust*[212] the Sixth Circuit adopted the *Madrid* view without providing additional analysis.[213] In another recent decision, which mentioned neither *Madrid* nor *Winshall Settlers' Trust*, the United States Bankruptcy Court for the Western District of New York refused to upset a properly conducted foreclosure sale on grounds that the sale price lacked reasonable equivalence in value to the property sold.[214]

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208. The *Madrid* court made the following statements with respect to foreclosure law:

> If we consider the question of price adequacy in the context of foreclosure law we find, not suprisingly, that mere inadequacy will not upset a foreclosure sale. "[T]here must be in addition proof of some element of fraud, unfairness, or oppression as accounts for and brings about the inadequacy of price." . . . The trial court's construction of 548 would radically alter these rules. Any foreclosure sale which failed to bring 70% of the property's market value could be set aside by a bankruptcy trustee or a debtor-in-possession for a period of one year.

Id. at 427 (citations omitted). One must question whether the Code itself was meant to alter the above rules because the thrust of section 548(a)(2) is that an inadequate price alone can render a transfer fraudulent.

209. *Id.*

210. The court felt that state foreclosure law should blend with, not be changed by, fraudulent conveyance law. Thus, the only compatible standard would be to interpret "reasonably equivalent" as the value received at a sale without "defects," as defined under state law. *Id.*

211. *See supra* note 190 and accompanying text.

212. 758 F.2d 1136 (6th Cir. 1985).

213. The court first held that the foreclosure sale did not constitute a transfer and then stated:

> Even if the sale in question were a transfer subject to § 548, the better view is that reasonable equivalence for the purposes of a foreclosure sale under § 548(a)(2)(A) should be consonant with the state law of fraudulent conveyances. The Bankruptcy Appellate Panel in *In re Madrid*, noting the well-nigh universal rule that mere inadequacy of price alone does not justify setting aside an execution sale and that generally there must be in addition proof of some element of fraud, unfairness, or oppression accounting for the inadequacy in price, concluded that following the *Durrett* holding would radically alter these rules (citation omittcd).

Id. at 1139.

214. *In re* Upham, 48 Bankr. 695 (Bankr. W.D. N.Y. 1985). The court concluded that "[t]he highest bid received in a properly conducted foreclosure action, where there has been

Under these cases, therefore, securing an affirmation of the foreclosure sale price lies in stressing the incompatability of requiring a price to be reasonably equivalent to fair market value when no state law requirements have been violated.[215] Thus, the lower courts are faced with choosing between the clear holding of *Durrett* in the Fifth Circuit and the tacit holding of *Madrid* in the Ninth Circuit.[216] *Durrett* has emerged the clear winner, with the lower courts providing the missing rebuttal to *Madrid*.[217]

C. Analysis: Comparison of Durrett *and* Madrid

Subsequent decisions have recognized that the *Madrid* holding essentially created an irrebuttable presumption that when state foreclosure sale law is followed, selling prices will be deemed to be reasonably equivalent to the value of the property sold.[218] Courts following *Durrett* have noted that this presumption conflicts with the trustee's power to prove that a sale falls below the section 548 reasonable equivalence standard set by Congress.[219] The problem in interpreting and applying section 548 is that Congress did not set a standard by which to measure reasonable equivalence. Courts following *Durrett* justify their interpretation of reasonable equivalence by promoting it as a method to combat circumstances in which no buyers bid on the property and the creditor simply sells the property to itself for the amount of the debt.[220] Even when buyers appear, often they do not bid more than the debt amount because they are aware that creditors merely wish to satisfy their outstanding obligation.[221] Because of these circumstances, *Durrett*

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no complaint of foul play or improper process, is the reasonably equivalent value of that property." *Id.* at 697.

215. *Id.*; *see supra* note 208 and accompanying text.

216. *See supra* note 187 and accompanying text.

217. *See supra* note 190 and accompanying text. At least one court, however, felt tbat following *Madrid* was obligatory, but did so only under protest. *See In re* Coleman, 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982). The *Coleman* court stated its dislike for *Durrett* as follows:

> [T]he court will state at this time that the holding of *Durrett* and cases following thereafter cast a cloud upon mortgages and trust deeds. . . . [G]enerally foreclosure sales "do not bring the best price, but most states, including Texas, mandate public sales when foreclosure is the creditor's remedy." If this court were free to do so it would [not] follow [*Durrett*].

Id. at 834.

218. *Richardson*, 23 Bankr. at 446; *accord In re* New Yorketown Assocs., 40 Bankr. 701, 706 (Bankr. E.D. Pa. 1984).

219. *Hulm*, 45 Bankr. at 526; *New Yorketown Assoc.*, 40 Bankr. at 706.

220. *See, e.g., Hulm*, 45 Bankr. at 528; *Richardson*, 23 Bankr. at 446.

221. *See Richardson*, 23 Bankr. at 446.

proponents argue, the foreclosure sale price may not merit an irrebuttable presumption of reasonable equivalence in value.[222] Furthermore, as the *Madrid* dissent recognized, allowing a rebuttal to the presumption of reasonable equivalence is meritorious.[223]

A statutory construction argument also favors allowing a trustee to avoid a properly conducted foreclosure sale that does not produce a reasonably equivalent value. Under *Madrid* a trustee may attack a foreclosure sale only by alleging bad faith, fraud, or collusion in the sale.[224] When Congress enacted section 548 of the Code, however, Congress intentionally discarded[225] the former Act's good faith element[226] in favor of the perceived more objective standard of reasonable equivalence in value.[227] At least one court has recognized that to adopt *Madrid* essentially would require the trustee to read good faith back into section 548, an element Congress intended to discard.[228]

Perhaps the strongest argument levied against *Durrett* focuses on the decision's disruptive effect on state foreclosure law and foreclosure markets.[229] Those effects allegedly cast a "cloud upon mortgages and trust deeds" by allowing sales consummated one year before the debtor's filing to be avoided for lack of reasonably equivalent value.[230] *Durrett* opponents view the "cloud" as having the spiral effect of reducing the number of bidders at foreclosure sales, which in turn further decreases prices obtained at those sales and creates an even greater suspicion of a lack of reasonably equivalent value being achieved.[231]

Durrett supporters respond with a number of arguments. They note that many state laws do not allow the disruption of a foreclosure sale solely because the sale obtained an inadequate price.[232] Thus, to the extent the reasonable equivalence standard conflicts with a state law, that state law should not deter or control

222. *Id.*

223. *Madrid*, 21 Bankr. at 427, 429 (Volinn, J., dissenting).

224. *See Frank*, 39 Bankr. at 175; *Richardson*, 23 Bankr. at 447.

225. See *Richardson*, 23 Bankr. at 447, for support of the proposition that Congress intentionally discarded the good faith requirement.

226. Bankruptcy Act § 67 incorporated fraud and collusion, in addition to bad faith, as causes of action available to the trustee.

227. *See* Erlich, *supra* note 170, at 945.

228. *Richardson*, 23 Bankr. at 447.

229. *See* Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982).

230. *Id.*

231. *See id.*; Baird & Jackson, *supra* note 181, at 846.

232. *Richardson*, 23 Bankr. at 447.

the application of the federal standard.[233] The primary goal of section 548 is to promote the equal distribution of a debtors' assets, a goal not nurtured by state foreclosure law.[234] Although some Code provisions were designed to function under a concurrent application of state law,[235] section 548 omits any reference to examining state foreclosure law for a determination of reasonably equivalent value. Furthermore, the argument that *Durrett* causes an unprecedented interference with state law is refuted by reference to other provisions allowing the trustee to avoid certain transfers—for example, section 547 preferential transfers and section 545 statutory liens.[236] Moreover, *Durrett* followers acknowledge the policy concerns expressed with respect to the detrimental effect on foreclosure markets, but feel that those concerns are better directed to Congress because Congress created the provisions causing the disruptive effect.[237]

To bring these competing views back into the valuation context, *Durrett* suggests an interpretation of reasonably equivalent value that allows a trustee to avoid a sale falling below some percentage of fair market value.[238] *Madrid*, on the other hand, suggests that reasonable equivalence is a measure unavoidably confined within foreclosure market realities and allows the trustee to avoid a sale only if it falls outside the requirements of state foreclosure law.[239] *Madrid* adherents insist that the realities of the foreclosure market should not allow a comparison of foreclosure sale value to fair market value. These proponents argue that the price received in a proper foreclosure sale represents the value most reasonably equivalent to the property's worth at the time of the sale and most reasonably equivalent to the property's worth within the market comprised of foreclosure sale buyers.[240]

The issue properly stated, therefore, is to what standard must the sale price be reasonably equivalent, fair market value or foreclosure market value. Neither statutory language nor legislative history addresses the question.[241] One congressional indication favoring the *Durret* standard may lie in the 1984 amendment to

233. *Id.*
234. *Frank*, 39 Bankr. at 179.
235. *Id. See, e.g.*, 11 U.S.C. §§ 522(b), 544(b), 547(e)(1)-(2), 548(d)(1) (1982).
236. *Richardson*, 23 Bankr. at 448.
237. *Id.*
238. *See supra* note 192 and accompanying text.
239. *See supra* notes 208-10 and accompanying text.
240. *Id.*
241. *See supra* note 187.

section 548, which defines "transfer" to include both voluntary and involuntary sales.[242] By including the word "involuntary," some commentators believe that Congress sought to settle the debate over whether foreclosure sales even constitute a "transfer" under section 548.[243] The amendment supports the *Durrett* approach because under the *Durrett* analysis a court first must find that a foreclosure sale is a transfer before it can avoid the sale; therefore, because the Circuit Courts of Appeal are split on the transfer issue, the amendment appears to support the trustee's power to avoid a foreclosure sale. The amendment, however, still does not articulate which standard a court should use to measure reasonable equivalence. Congress, however, must have been aware of the *Durrett* approach of avoiding sales for falling below a certain percentage of fair market value and, thus, could have calmed the effect of *Durrett* by drafting a presumption in support of the foreclosure sale price. Congressional silence, however, is dubious support.

One commentator has suggested that although *Durrett* and *Madrid* seem mutually exclusive, the two cases can be reconciled into a more cohesive analysis.[244] A reconciliation of the two views requires identifying the cause of the problem that the *Durrett* view seeks to solve: inadequate prices from foreclosure sales. The cause may be the procedures employed for those sales. One commentator has suggested the following as some of the factors creating low foreclosure sale prices: (1) the sale lacks appropriate notice mechanisms to properly inform a full range of investors; (2) the requirement of an all cash purchase excludes purchasers without financing; and (3) the rapid sale mechanism does not allow a proper inquiry into the soundness of the title or the availability of insurance.[245] Thus, under an idealized state foreclosure law system that more closely approaches the normal retail market, the sale could receive a *Madrid* presumption of reasonable equivalence. Absent a

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242. 11 U.S.C.A. § 548 (Supp. 1986).

243. *See* Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 780 n.175 (1984); *see also* Lower Downtown Assoc. v. Barzosbanc Sav. Ass'n., 52 Bankr. 662 (Bankr. D. Colo. 1985). The *Lower Downtown Assoc.* court noted, without citation, that a sponsor of the amendment failed to amend further the statute to provide that "if a purchaser at a noncollusive foreclosure sale bid at least the full amount of the debt secured by the property, the bid would conclusively constitute reasonable equivalent value for the property." *Lower Downtown Assoc.*, 52 Bankr. at 664-65. *But see In re* Winshall Settlor's Trust, 758 F.2d 1136, 1138-39 n.3 (6th Cir. 1985) (adopting the view that a foreclosure sale is not a transfer, even in the face of the new amendment, and claiming that there is no reference to the amendment in the legislative history).

244. *See* Erlich, *supra* note 181, at 979-80.

245. *Id.* at 974-80.

more appropriate system, however, foreclosure sale prices should be measured by the *Durrett* standard of reasonable equivalence and compared to the price an ideal system would have produced.

V. Section 722 Redemption Value

A. *Mechanics Underlying the Valuation Issue*

Section 722 of the Code allows debtors to redeem certain property from a lien securing a dischargeable consumer debt.[246] The redeemable property must be tangible personalty held for personal, family, or household use, and the property is redeemable only if exempted under section 522[247] or abandoned under section 544.[248] The legislative history describes redemption as a "right of first refusal for the debtor in consumer goods that might otherwise be repossessed."[249] The right of redemption, by giving the debtor a fresh start after declaring bankruptcy and surrendering property, supports the same policy as the exemption provision.[250] A debtor can use postpetition earnings or exemption proceeds to purchase, for the amount of the claim, any necessary items held by the lienholder and, thus, avoid a possible high replacement cost.[251] From a creditor's perspective, section 722 merely places the creditor in the same position as if the creditor had repossessed and sold the property.[252]

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246. Section 722 provides:

> An individual debtor may . . . redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

11 U.S.C. § 722 (1982).

247. *Id.*; *see supra* notes 6-13 and accompanying text (describing exempt items and the mechanics of § 522). Section 722 redemptions do not overlap Section 522 exemptions because under § 522 a debtor may exempt only non-possessory, nonpurchase money security interests, whereas under § 722 a debtor may redeem from a purchase money security interest as well as a nonpurchase money security interest. *See* 4 Collier on Bankruptcy ¶ 722.01, at 722-3 (15th ed. 1985).

248. 11 U.S.C. § 722 (1982). Section 554 allows abandonment when the property is inconsequential or burdensome to the estate. *Id.* § 554(a)-(b). Property also is abandoned by operation of law if it is not administered by the closing of the case. *Id.* § 554(c).

249. H. R. Rep. No. 595, 95th Cong., 2d. Sess. 380-81, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6336-37.

250. *See* Traer v. Clews, 115 U.S. 528, 541 (1885).

251. *See id.*; H. R. Rep. No. 595, 95th Cong., 2d. Sess. 380-81, *reprinted in* 1978 U.S. Code Cong. & Anmin. News 5963, 6336-37; 4 Collier on Bankruptcy ¶ 722.01, at 722-2 (15th ed. 1985).

252. *See In re* Pierce, 5 Bankr. 346, 347 (Bankr. D. Neb. 1980).

Valuation becomes an issue under section 722 because a debtor may redeem property from a creditor's lien by paying the creditor the value of the property upon which the creditor has an allowed, secured claim.[253] Section 506(a) provides that an allowed claim is a claim secured to the extent of the value of the creditor's collateral.[254] Theoretically, a debtor could redeem property for less than the original obligation[255] because the secured portion of the claim is limited to the value of the property. Therefore, debtors will argue for a low value, which allows them to redeem their property more easily, while creditors will argue for a high value, which allows them to recoup a larger portion of the original obligation.[256]

Section 722 contains no language offering guidance on the appropriate standard or method of valuation.[257] Section 506(a), however, addresses the valuation issue with the purpose of determining the extent to which a claim is secured. Section 506(a) and its legislative history permit an examination into the purpose of the valuation or the proposed use or disposition of the property and indicate that valuations can vary with the circumstances from case to case.[258] Section 722 does not state expressly that section 506(a) should control the valuation issue; section 506(a), however, is necessary to determine the extent to which a claim is secured for purposes of section 722.[259]

Section 722's legislative history addresses value only to indicate that when a debtor deliberately allows the property to decline in value, the debtor must pay the full fair market value of the property or the amount of the claim, whichever is less.[260] The legislative history, however, offers no method for determining fair market value and does not indicate when fair market value should be determined, although presumably this determination will occur sometime prior to when the debtor allowed the depreciation in value. Thus, the relevant Code language and legislative history seemingly indicate that when the debtor does not deliberately per-

253. *See supra* note 246.

254. 11 U.S.C. § 506(a) (1982).

255. *See In re* Cruseturner, 8 Bankr. 581, 588 (Bankr. D. Utah 1981).

256. *See, e.g., In re* Clark, 10 Bankr. 605 (Bankr. C.D. Ill. 1981); *In re* Pierce, 5 Bankr. 346 (Bankr. D. Neb. 1980).

257. *See supra* note 246.

258. *See supra* note 147 and accompanying text (providing text and legislative history of § 506(a)).

259. *See In re* Seigler, 5 Bankr. 12, 13 (Bankr. D. Minn. 1980).

260. S. REP. No. 989, 95th Cong., 2nd Sess. 95, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5881.

mit a decline in value, a court may accept something less than fair market value as the redemption value.

B. Inconsistent Judicial Terminology and Approaches

Judicial response to section 722 valuation lacks consistency, with courts adopting a number of different valuation labels, ranging from lien redemption value,[261] wholesale value,[262] replacement value,[263] and fair market value[264] to open market value.[265] Unfortunately, the lack of consistency in terminology also leads to inconsistent conceptual approaches. Different courts have applied completely different methods and theories of valuation to almost identical fact patterns.

In *In re Siegler*[266] the United States Bankruptcy Court for the District of Minnesota identified the appropriate value as "lien redemption value" and noted two separate definitions that, according to the court, would lead to identical valuations.[267] The first definition identifies the appropriate value as the amount the creditor could apply to the debt after a deliberate sale of the debtor's property, reduced by costs incident to that sale.[268] This valuation method recognizes that the sale price reflects creditors' different abilities to invest time and effort in a sale.[269] The second definition of "lien redemption value" is the amount that the debtor would have to pay a willing seller who is in a position similar to that of the creditor.[270] The court found the two definitions to be identical and, without explanation, stated that the definitions recognize the reasonable expectations of the parties.[271]

After receiving testimony on liquidation value, loan value,

261. *In re* Seigler, 5 Bankr. 12 (Bankr. D. Minn. 1980).

262. *In re* Pierce, 5 Bankr. 346 (Bankr. D. Neb. 1980).

263. *In re* McQuinn, 6 Bankr. 899 (Bankr. D. Neb. 1980).

264. *In re* Kinser, 17 Bankr. 468 (Bankr. N.D. Ga. 1981).

265. *In re* Klien, 20 Bankr. 493 (N.D. Ill. 1982).

266. 5 Bankr. 12 (Bankr. D. Minn. 1980).

267. *Id.* at 13-14.

268. *Id.* at 13. Costs incident to a final sale include foreclosure expenses and any repair expenses necessary to improve the property for sale. *Id.*

269. *Id.* Some creditors will sell on the retail market, while others will sell on the wholesale market. *Id.* In *Siegler* the court felt that the creditor was in a position to put more time, money, and patience into the sale and, thus, reap a higher price than most secured creditors such as banks or finance companies. *Id.*

270. *Id.* at 13-14.

271. *Id.* at 14. The court stated, "[T]hese two values are identical. They are not loan, retail, wholesale, liquidation, fair market or even replacement values. They do recognize the reasonable expectancies of debtors and creditors under 11 U.S.C.]§ 50]6 and 722. They may therefore be termed together as the lien redemption value." *Id.*

trade-in value, and retail value, the court conceded that its final determination necessarily would be speculative because the result would be a "prediction of the final sale without benefit of a final sale actually happening."[272] The court finally determined the appropriate value to be the loan value plus two-thirds of the difference between loan value and retail value.[273] The court erred in equating the amount a creditor could realize with the amount a debtor would have to pay because a creditor may not always sell in the same market from which a debtor buys. Because redeemable property is personal in nature, the debtor likely will purchase in a retail market, yet, unless the creditor happens to be a retailer, the creditor likely will sell in a market resembling wholesale.

Other courts make strong arguments for allowing the debtor to redeem its property at wholesale value.[274] Wholesale valuation applies to a creditor who cannot expect to receive more than a wholesale price upon foreclosure of the lien and sale of the property.[275] A creditor cannot expect more than a wholesale price in two circumstances. First, when a creditor is not in the business of selling the type of property in question on the retail market, the creditor either must sell to a dealer at wholesale or auction the property for perhaps even less.[276] Second, when the property sought to be redeemed is of a nature such that a retail market does not exist for that property, wholesale value also is appropriate.[277] From a debtor's perspective, wholesale value provides a less formidable redemption price and supports the section 722 policy of allowing the debtor to redeem its essential household items.[278] Wholesale value also comports with the creditor's expectation interest because if

272. *Id.*

273. The court chose two-thirds rather than the normal percentage of one-half because of the nature of the creditor. *Id.*

274. *See, e.g., In re* Redding, 34 Bankr. 971 (Bankr. M.D. Pa. 1983); *In re* Clark, 10 Bankr. 605 (Bankr. C.D. Ill. 1981); *In re* Pierce, 5 Bankr. 346 (Bankr. D. Neb. 1980).

275. *See, e.g., Redding,* 34 Bankr. at 973; *Pierce,* 5 Bankr. at 347.

276. *See Redding,* 34 Bankr. at 973. The *Redding* court stated:

> In this case, we think that all SCDC can hope to recover is the wholesale value of the debtors' motor vehicle. As a practical matter, SCDC is not in the business of selling used cars. If the debtors' vehicle was returned to SCDC, its most likely disposition of the vehicle would be at auction or through resale by a dealer. While the value of the vehicle to the debtors undoubtedly exceeds its forced sale value, we find that the fair market value of the debtors' vehicle to be the wholesale value of $1,900. The equities are well balanced by this determination because SCDC receives the value it could best hope to achieve and the debtors' fresh start is facilitated by the lower valuation.

Id.

277. *See Pierce,* 5 Bankr. at 347.

278. *See Redding,* 34 Bankr. at 973.

the property lacks retail value, the creditor could hope to receive no more than wholesale value.[279] Creditors, however, are not always limited to a wholesale market and, thus, under the contextual approach of section 506(a), creditors should be allowed to argue that they have access to a retail market.

At least one court has attempted to utilize the term "replacement value" as the proper standard under section 722.[280] The United States Bankruptcy Court for the District of Nebraska, in *In re McQuinn*, recognized section 506(a) as controlling[281] and then determined that because section 722 "amounts to a right of first refusal," the debtor should be forced to pay the replacement value of the collateral—the retail price.[282] Finally, the court decided that the retail value should be reduced by the amount of dealer overhead, salesman's commissions, and dealer profit.[283] These last adjustments essentially converted replacement value into wholesale value.[284]

McQuinn represents a poor analysis for two reasons. First, the proper focus should be on the amount recoverable by the creditor upon exercise of the lien and sale of the property, not upon the amount the debtor would have to pay elsewhere absent the redemption right. The court did not explore in what market the creditor might sell. If the debtor is required to pay the same price regardless of whether the property is acquired by redemption from the creditor or by purchase from a dealer, section 722 would offer no benefit to the debtor. To solve this conceptual problem, the court reduced the price for certain dealer costs. Second, the court assumes that the retail market is the debtor's proper replacement market. Considering the debtor's postbankruptcy position, the debtor likely would explore the second-hand market, not the retail market, for a replacement.

Some courts have required the debtor to pay full fair market value regardless of whether the creditor is a retailer[285] or a nonretailer.[286] These decisions are mostly conclusory, lacking developed reasoning or justification for using fair market value instead of

279. *Id.*
280. *In re* McQuinn, 6 Bankr. 899 (Bankr. D. Neb. 1980).
281. *Id.* at 900.
282. *Id.*
283. *Id.*
284. *See Redding*, 34 Bankr. at 973.
285. *In re* Kinser, 17 Bankr. 468 (Bankr. N.D. Ga. 1981).
286. *In re* Davis, 15 Bankr. 118 (Bankr. C.D. Ill. 1981).

other methods of valuation.[287] Courts holding that redemption value is equivalent to fair market value often do not recognize amounts provided for in repurchase contracts.[288] When acting as a financier, the creditor often is a party to a repurchase contract with the retailer and will argue that redemption value is the amount stipulated in the contract.[289] Courts consistently have disregarded these repurchase contracts.[290] Repurchase contracts are viewed as creating a "mythical market" to increase artificially the redemption value[291] without any relation to a rational method of valuation.[292] Courts also note that repurchase contracts conflict with the congressional goal of providing a debtor with the right of redemption without a high replacement cost.[293]

C. Creditor Expectations and Debtor Redemption

Although the *Siegler*[294] opinion is somewhat convoluted in its analysis and application of what the court termed "lien redemption value," the court struck upon one element deserving application in all redemption valuation cases. That element is the first of the court's two definitions of "lien redemption value," which is the amount a creditor could apply to its debt after deliberately selling the property.[295] This valuation method supports both of the following primary objectives of section 722: (1) to provide the debtor with a right of first refusal;[296] and (2) to keep the creditor in the same position as if the creditor repossessed and sold the property.[297]

The next problem is determining what the creditor would receive if it repossessed and sold the property. The wholesale value cases offer good analysis because they examine the nature of the

287. *See, e.g., In re* Shweitzer, 19 Bankr. 860, 862 (Bankr. E.D. N.Y. 1982) (allowing a debtor to redeem his property "by paying the holder of the lien the amount of its allowed secured claim, i.e., its fair market value"); *Kinser*, 17 Bankr. at 469 (stating that "any redemption of property . . . pursuant to 11 U.S.C. § 722 must be at fair market value"); *Davis*, 15 Bankr. at 119 (finding the redemption value to be the fair market value).

288. *In re* Davis, 15 Bankr. 118 (Bankr. C.D. Ill. 1981).

289. *Id.* at 119.

290. *In re* Cooper, 7 Bankr. 537, 539 (Bankr. N.D. Ga. 1980).

291. *In re* Klien, 20 Bankr. 493, 495 (Bankr. N.D. Ill. 1982).

292. *Id.* at 495.

293. *Cruseturner*, 8 Bankr. at 585.

294. 5 Bankr. 12 (Bankr. D. Minn. 1980).

295. *Id.* at 14.

296. *See supra* note 249 and accompanying text.

297. *See supra* note 252 and accompanying text.

creditor and the property,[298] precisely the approach recommended by section 506(a).[299] The cases seem to indicate that few dehtor entities or redeemable items warrant full retail value. Although not cited by any cases deciding the valuation issue, *The Report of the Commission on the Bankruptcy Laws of the United States* (the Commission Report) adopts a position in full accord with the first part of the *Siegler* test.[300] The Commission Report stated that "fair market value" would be "the net amount the creditor would receive were he to repossess the collateral and dispose of it as permitted by the applicable nonbankruptcy law."[301] This approach necessarily requires inquiring into the creditor's method of sale and into the market available for the type of property subject to the lien. An examination of many of the section 722 cases on the basis of these two factors would lead to the conclusion that wholesale value would be the appropriate valuation method under many circumstances. Therefore, Congress should adopt a presumption in favor of wholesale value for section 722 valuation.

VI. Conclusion

Each Code section examined by this Note requires an independent valuation of debtor property and, accordingly, applies different standards to comport with competing legislative objectives and policies. Section 522 specifically requires that property be valued at "fair market value" when determining whether a debtor asset is fully or partially exempt.[302] Section 547 values debtor assets at "a fair valuation" to determine debtor solvency[303] and also values debtor assets under the contextual approach of section 506(a) to determine if a creditor, because its claim was only partially secured, received a greater amount than it otherwise would have received upon liquidation.[304] Section 548 values debtor assets under a "reasonably equivalent" standard to determine whether a debtor defrauded creditors by executing a prefiling transfer for insufficient consideration.[305] Finally, section 722 values debtor assets under the contextual approach of section 506(a) to determine the

298. *See supra* notes 276-81 and accompanying text.
299. *See supra* note 147 and accompanying text.
300. H.R. Doc. No. 137, 93d Cong., 1st Sess. 131 (1973).
301. *Id.*
302. *See supra* note 21 and accompanying text.
303. *See supra* note 88 and accompanying text.
304. *See supra* note 147 and accompanying text.
305. *See supra* note 173 and accompanying text.

extent to which a creditor's claim is secured so that the debtor can redeem the property for that amount.[306] Because these sections are the result of distinct historical developments and achieve different purposes, any attempt to standardize a method of valuation would cause further confusion and uncertainty. Each section, however, should not operate to surprise unwary litigants with a new approach for each case. Naturally, each case will differ, but the approach to valuation should be consistent within each Code section.

Courts have interpreted the section 522 statutory language of "fair market value" to mean two possible standards of valuation.[307] *Walsh* articulates the standard as meaning liquidation value because section 522 operates in a liquidation context and because even if the creditor were to repossess and sell the debtor's property, the price would be at liquidation.[308] *Nellis* interprets the standard as the ordinary and traditional meaning of "fair market value," the market between willing buyers and sellers.[309] Courts have interpreted a seemingly clear definition differently because, upon close examination, "fair market value" does not specify which market is to be considered in the valuation determination. Congress should reexamine the standard of value most appropriate under 522 and adopt a standard that will allow liquidation value. This standard alone enhances redemption policies without harming creditor expectations.

The valuation standard for determining debtor solvency under section 547 enjoys a consistently applied definition.[310] That definition, however, lacks clarity because it contemplates a hypothetical market somewhere between ordinary full fair market value and liquidation value. To foster consistency and predictability, courts should examine the nature of each asset and determine the highest value realizable by the debtor at the time of the alleged preferential transfer. Additionally, although courts are just beginning to recognize the valuation issue inherent in the "greater amount received" requirement,[311] valuation for purposes of the "insolvency" requirement should serve as a guide to preserve consistency within the Code section.

Section 548 presents the strongest calling for congressional ac-

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306. *See supra* note 254 and accompanying text.
307. *See supra* notes 37-55 and accompanying text.
308. *See supra* note 23 and accompanying text.
309. *See supra* note 37 and accompanying text.
310. *See supra* note 88 and accompanying text.
311. *See supra* note 154 and accompanying text.

tion. Two circuits hold that a properly conducted foreclosure sale is conclusively presumed to produce a "reasonably equivalent value."[312] Two other circuits hold that any foreclosure sale should be scrutinized for insufficient consideration.[313] The resolution of these conflicting views requires a congressional position on the policy issue of whether section 548 implants a federal standard on state foreclosure laws.[314]

Section 722 is subject to the widest variety of interpretations, which is perhaps tolerable because section 722 calls for the contextual approach to valuation under section 506(a).[315] In most cases the creditor's expectation interest is wholesale value, a value that also enhances the debtor's redemption possibilities. Accordingly, Congress should consider a presumption in favor of wholesale value. Congress, however, should allow an inquiry into the circumstances of each case to determine whether a different valuation standard for that particular case would be more appropriate.

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312. *See supra* notes 202-15 and accompanying text.
313. *See supra* notes 188-201 and accompanying text.
314. *See supra* notes 244-45 and accompanying text.
315. *See supra* note 147 and accompanying text.