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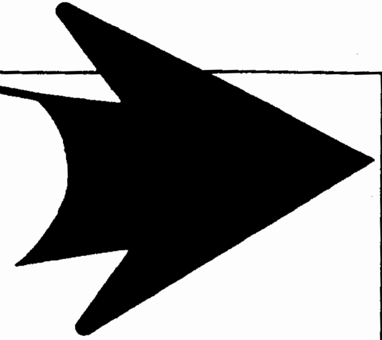

U. S. SUPREME COURT EASES BURDEN OF MORTGAGE LENDERS

Those institutions that finance real estate do not enter into such mortgage lending with the idea that they will profit in the event the loan goes into default and foreclosure upon the real estate becomes necessary. Foreclosure is simply a means for a real estate lender to limit its losses. Unfortunately, it is also true that foreclosure sales seldom result in a sale for fair market value. Mortgage lenders, in order to better limit their losses and protect their secured position, will routinely purchase the real estate at the foreclosure sale themselves rather than have the real estate sell to a third party at distress sale prices.

Foreclosure laws generally protect the debtor/mortgagor by requiring an appraisal of the real estate and a minimum percentage of the appraisal figure, for example, two-thirds of appraised value, to be bid at the foreclosure sale in order for the purchaser to take the real estate free and clear of the claims of the debtor.

In the past, so long as a recourse mortgage lender observed the foreclosure law of the jurisdiction in which the real estate was located, it could safely bid in the real estate (or allow it to be sold to a third party), apply the amount of the bid to its balance, and then pursue the debtor for any deficiency remaining. In recent years, however, courts have used a special section of the Bankruptcy Code to set aside some foreclosure sales as fraudulent conveyances..

The statute in question is 11 U.S.C. Section 548 (a) (2), which allows a bankruptcy trustee to avoid certain transfers of an interest of a debtor for less than "reasonably equivalent value." Some federal appellate courts have held in the past that even though a mortgage lender scrupulously followed the foreclosure laws of the jurisdiction in question, a foreclosure sale could be set aside if the amount received at the sale was less than the "fair market value" of the subject real estate.

The U.S. Supreme Court, in a case known a BFP v. Resolution Trust Corporation, 114 S. CT. 1757 (1994), has now laid the issue to rest and allowed mortgage lenders to rely upon the integrity of their foreclosure sales so long as they properly followed state law.

In BFP v. Resolution Trust Corp., a Chapter 11 debtor brought a fraudulent transfer proceeding to avoid a mortgage foreclosure sale on the theory that the sale price had been less than "a reasonably equivalent value" under 11 U.S.C. Section 548 (a) (2).

The home in question had been purchased at a foreclosure sale for $433,000.00, whereas the debtor claimed the residence was actually worth $725,000 when sold.

Overruling prior decisions by federal Courts of

Appeals, the Supreme Court, in an opinion written by Justice Scalia, held that "reasonably equivalent value" as used in the Bankruptcy Code's fraudulent conveyance provision, is not to be equated with fair market value or with fair foreclosure price, but in such situations merely means the price received at the foreclosure sale, so long as all the requirements of the state's foreclosure law have been met.

The Court went on to state, however, that any irregularity in the conduct of a mortgage foreclosure sale that would permit a state court to set it aside would change this, and the foreclosure sale might be avoided by a bankruptcy court under Section 548 as a fraudulent transfer if the sale price was not reasonably equivalent to the property's actual value at the time of sale.

This is good news for both mortgage lenders and purchasers of property at foreclosure sales. The lesson is a clear one – follow state law scrupulously in regard to how the foreclosure sale is conducted and you need not fear a challenge later from your debtor turned debtor in possession.

The decision by the Supreme Court was not a unanimous one. A spirited dissenting opinion, as authored by Justice Souter, is longer than the majority opinion and replete with footnotes and jabs at the majority opinion.

The majority opinion, however, is now the law of the land. Putting aside for a moment the legal intricacies argued in both the majority opinion and the dissent, we can generally state that the majority opinion is not only good one for creditors, but also a good result for the public generally because it promotes a very important element of the legal system – certainty. All parties should be able to rely on the results of a properly conducted judicial foreclosure sale under state law.

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