No. 17-2889

IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re: MARGARET ADELINE VELTRE,
Debtor.

MARGARET ADELINE VELTRE,
Plaintiff/Appellant,

– v. –

FIFTH THIRD BANK,
Defendant/Appellee.

On Appeal from the United States District Court
for the Western District of Pennsylvania (No. 17-cv-239)

BRIEF OF AMICI CURIAE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AND NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER IN SUPPORT OF APPELLANT AND SEEKING REVERSAL OF THE DISTRICT COURT'S DECISION

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Veltre v. Fifth Third Bank, No. 17-2889

Pursuant to Fed. R. App. P. 29(c)(1) and 3d Cir. R. 26.1.1, *Amici Curiae*, the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center, make the following disclosure:

1) For non-governmental corporate parties, please list all parent corporations. **NONE.**

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3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. **NONE.**

4) In all bankruptcy appeals, counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant. **NOT APPLICABLE – THE DEBTOR AND TRUSTEE ARE BOTH PARTIES TO THE APPEAL.**

This 5th day of February, 2018.

s/ Tara Twomey
Tara Twomey
Attorney for Amici Curiae

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STATEMENT OF INTEREST OF AMICUS CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization of approximately 3,000 consumer bankruptcy attorneys nationwide. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NCBRC, NACBA and its membership have a vital interest in the outcome of this case. NACBA member attorneys represent individuals in a large portion of all consumer bankruptcy cases, the vast majority of whom are honest but unfortunate debtors who seek nothing more than a fresh start under the Bankruptcy Code. That fresh start can be hindered if creditors are allowed to make a run for the debtor's assets in the weeks leading up to a bankruptcy filing, thereby preemptively

draining the bankruptcy estate of property that can be exempted or distributed to creditors.

AUTHORSHIP AND FUNDING OF AMICUS BRIEF

Pursuant to Fed. R. App. P. 29(c)(5), no counsel for a party authored this brief in whole or in part, and no person or entity other than NACBA and NCBRC, their members, and their counsel made any monetary contribution toward the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The two main purposes of the Bankruptcy Code are to provide a fresh start for the debtor and to facilitate the equitable and orderly repayment of creditors to the extent possible. To achieve these goals the Code discourages creditors from racing to the courthouse to grab for themselves the debtor's scarce resources. For example, after a bankruptcy petition is filed the automatic stay prevents most collection efforts against the debtor. 11 U.S.C. § 362. The Code also permits the unwinding of certain property transfers that may have occurred prior to the bankruptcy, such as "preferential" or fraudulent transfers. *See* 11 U.S.C. §§ 547, 548. The ability to unwind or avoid preferential transfers ensures that creditors do not receive a windfall at the expense of other creditors because they were first to the "courthouse." At issue in this case is whether a pre-bankruptcy foreclosure

created a preferential transfer. That is, whether the creditor, Fifth Third Bank received more as a result of the foreclosure sale than it would have in a hypothetical chapter 7 case. 11 U.S.C. § 547(b)(5).

The courts below erroneously assumed that, as a matter of law, a chapter 7 trustee could not obtain a higher price on property than what was paid at the foreclosure sale. This assumption derives from a misguided expansion of *BFP v. Resolution Tr. Corp*., 511 U.S. 531 (1994). *BFP* interpreted specific language—"reasonably equivalent value"—from another Code section, which addresses fraudulent transfers. 11 U.S.C. § 548. That language does not appear within section 547 and is not applicable to preferential transfers such as the one in this case. As other courts have recognized, conflating these two standards is contrary to the plain text of the Bankruptcy Code and ignores the practical differences between a foreclosure and an orchestrated trustee sale. Chapter 7 trustees, who typically hire realtors and take time to market real estate to maximize proceeds, can usually obtain much better prices than a foreclosure sale.

Because valuation for purposes of a chapter 7 liquidation analysis is typically a question of fact that cannot be determined on a motion to dismiss, this Court should reverse the decision of the lower courts and remand for further determination of whether, as a result of the foreclosure within ninety days of the

bankruptcy petition, Fifth Third Bank received more than it would have in a chapter 7 bankruptcy liquidation.

ARGUMENT

I. THE STATUTORY FRAMEWORK OF THE BANKRUPTCY CODE ENCOURAGES THE UNWINDING OF PREFERENTIAL TRANSFERS FOR THE BENEFIT OF THE ESTATE.

In order to understand why the courts below erred in their analysis, it is important first to understand some basic bankruptcy concepts and how preferential transfers fit into that framework.

A. THE BANKRUPTCY PROCESS IN GENERAL

Bankruptcy is a balancing act. It has two main purposes: to provide a fresh start for the debtor and to facilitate the fair and orderly repayment of creditors to the extent possible. *Kokoszka v. Belford*, 417 U.S. 642, 645 (1974); *In re Sanchez*, 372 B.R. 289, 296-98 (Bankr. S.D. Tex. 2007).

The primary tool to achieve the second goal is the bankruptcy estate. "The commencement of a case under the Bankruptcy Code creates an estate which, with limited exceptions, consists of all of the debtor's property." *Ohio v. Kovacs*, 469 U.S. 274, 284 n.12 (1985) (citing 11 U.S.C. § 541). The scope of this bankruptcy estate is "broad," including "all legal or equitable interests of the debtor in property as of the commencement of the case." *United States v. Whiting Pools*, 462 U.S.

198, 204-205 (1983) (quoting 11 U.S.C. § 541(a)(1)); *see also Gladstone v. U.S. Bancorp*, 811 F.3d 1133, 1139-40 (9th Cir. 2016). The automatic stay, which is initiated upon the filing of a bankruptcy petition, helps protect this property during the bankruptcy process. *See* 11 U.S.C. § 362.

Certain property may also be added to the bankruptcy estate after the commencement of the case. For instance, property acquired by inheritance by the debtor within 180 days of the filing of the petition may become property of the estate. *See* 11 U.S.C. § 541(a)(5). Similarly, property recovered by the bankruptcy trustee or debtor, because it was part of a preferential or fraudulent transfer, also becomes property of the estate. *See* 11 U.S.C. § 541(a)(3) (incorporating property of the kind specified under section 550(a)).

The Code vests the bankruptcy trustee, and in some circumstances the debtor, with the power to unwind certain transactions occurring before or after a bankruptcy is filed. *See* 11 U.S.C. §§ 544, 545, 547, 548, 549, 550, 551, 553 and 724(a). For example, the trustee can avoid fraudulent transfers of the debtor's property occurring in the two years preceding the bankruptcy case. 11 U.S.C. § 548. Also, as relevant here, the trustee can avoid transfers occurring in the 90-day period preceding the case if the transfer resulted in a creditor receiving preferential treatment over other creditors. 11 U.S.C. § 547. By avoiding such transactions,

the trustee adds value to the estate, and that value can ultimately be distributed to creditors in a fair and orderly manner.

If the trustee chooses not to exercise these powers, then the debtor is sometimes permitted to seek avoidance in the trustee's place. *See* 11 U.S.C. §§ 522(h); 1107(a) (Chapter 11 debtor-in-possession shall perform the functions and duties of a trustee); 1306(b) (chapter 13 debtor maintains possession of estate property); *see also Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 567-69 (3d Cir. 2003) (creditors committee in chapter 11 bankruptcy can pursue avoidance actions).

B. PREFERENTIAL TRANSFERS UNDER SECTION 547

This case specifically involves the avoidance of preferential transfers under section 547, which prevents creditors from receiving pre-bankruptcy windfalls at the expense of the bankruptcy estate and other creditors. *Friedman's Liquidating Tr. v. Roth Staffing Cos. LP (In re Friedman's Inc.)*, 738 F.3d 547, 557-58 (3d Cir. 2013).

"A preference is a transfer that enables a creditor to receive payment of a greater percentage of his claim against the debtor than he would have received if the transfer had not been made and he had participated in the distribution of the assets of the bankrupt estate." *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991) (quoting H.R. Rep. No. 95-595, at 177 (1977)). The Code outlines five specific

requirements that must be met in order for such a preference to be avoided. Specifically:

> the trustee may avoid any transfer of an interest of the debtor in property—
> (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;
> …
> 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).[1] Even if a transaction meets these threshold requirements, however, it may still be subject to one of several enumerated exceptions to these avoidance powers, none of which are applicable here. 11 U.S.C. § 547(c)(1)-(9).

The power to avoid these preferential transfers is a crucial piece of the Code's balancing act. As Congress explained in its drafting of section 547:

> The purpose of the preference section is two-fold. First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy. The protection thus afforded the debtor often enables him

[1] All parties agree that subsections one through four of section 547(b) were satisfied by the foreclosure of the debtor's home. The sole issue on appeal, as discussed further below, is the fifth subparagraph.

> to work his way out of a difficult financial situation through cooperation with all of his creditors. Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally. The operation of the preference section to deter 'the race of diligence' of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section—that of equality of distribution.

H.R. Rep. No. 95-595, at 177-178 (1977); *see also Union Bank v. Wolas*, 502 U.S. 151, 161 (1991); *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."); *see also In re First Jersey Sec., Inc.*, 180 F.3d 504, 511 (3d Cir. 1999).

The careful way Congress crafted this section illustrates its desire to increase the value of the bankruptcy estate that could be liquidated and distributed to creditors. H.R. Rep. No. 95-595, at 178 (1977) (criticizing a previous provision that led "to far fewer preference recoveries than otherwise would be the case."). For example, in enacting these provisions, it dispensed with any *mens rea* requirements because "a creditor's state of mind has nothing whatsoever to do with the policy of equality of distribution." H.R. Rep. No. 95-595, at 178 (1977). Dispensing with such a requirement facilitated the avoidance of preferential transfers.

It is also clear that Congress intended foreclosure actions to be amongst the transfers that could be avoided by section 547. First, there is no doubt that the Code defines "transfer" broadly enough to include such transactions. *See* 11 U.S.C. § 101(54); *see also In re Rambo*, 297 B.R. 418, 423 (Bankr. E.D. Pa. 2003) (citing *BFP v. Resolution Tr. Corp.*, 511 U.S. 531, 535 (1994)). Further, the legislature expressly contemplated this scenario. S. Rep. No. 95-989, at 88 (1978) ("The trustee may avoid a transfer of a lien under this section even if the lien has been enforced by sale before the commencement of the case."). As described by Justice Souter:

> Permitting avoidance of procedurally regular foreclosure sales for low prices (and thereby returning a valuable asset to the bankruptcy estate) is plainly consistent with those policies of obtaining a maximum and equitable distribution for creditors and ensuring a 'fresh start' for individual debtors, which the Court has often said are at the core of federal bankruptcy law."

BFP, 511 U.S. at 563. (SOUTER, J., dissenting). To the extent a foreclosure sale constitutes a preference for one specific creditor, it falls squarely within the ambit of section 547.

The foreclosure action in this case had precisely that effect. The debtor filed this preference action to avoid the foreclosure of her home so that she could equitably distribute the proceeds of her home to her creditors, and prevent Fifth Third Bank from obtaining a windfall by virtue of the race to the courthouse.

C. THE HYPOTHETICAL CHAPTER 7 BANKRUPTCY

The Code has a number of provisions that require the bankruptcy court to analyze the payout of a hypothetical chapter 7 bankruptcy. For example, in chapter 11 and chapter 13 cases, reorganization plans must often satisfy the "best interests of the creditors" test. *See* 11 U.S.C. § 1129(a)(7); 1325(a)(4). This test measures whether creditors receive as much in the proposed reorganization as they would in a hypothetical chapter 7 case. *See Jensen v. Dunivent (In re Dewey)*, 237 B.R. 783, 788-89 (B.A.P. 10th Cir. 1999); *In re Engle*, 496 B.R. 456, 461-62 (Bankr. S.D. Ohio 2013); *In re Weiss*, 251 B.R. 453, 463-64 (Bankr. E.D. Pa. 2000). A preference action also uses a hypothetical chapter 7 case as a point of comparison. However, unlike the best interest of the creditor test, the analysis is used to determine whether the creditor received more than it would have received in that hypothetical chapter 7 case.

The key question in this analysis, is "what the Chapter 7 trustee could obtain in a liquidation sale. Thus, fair market value of property, rather than its forced sale, governs…" Hon. W. Homer Drake, Hon. Paul W. Bonapfel & Adam M. Goodman, Chapter 13 Practice & Procedure § 9E:7, at 1017 (2012); *In re Chapman*, 51 B.R. 663, 667 (Bankr. D.D.C. 1985) (adopting the appraised value of property); *In re Raschke*, 41 B.R. 182, 188 (Bankr. W.D. Wis. 1984) (using market value); *In re Frazier*, 33 B.R. 175, 176 (Bankr. D. Md. 1983); *In re Weiss*, 4 B.R.

327, 331 (Bankr. S.D.N.Y. 1980) (debtor must submit proof of market value); *In re Evans*, No. 10-80446C-13D, 2010 Bankr. LEXIS 2491, at *2 (Bankr. M.D.N.C. July 28, 2010); *In re Gilbert*, No. 05-32786, 2006 Bankr. LEXIS 2780, at *8-9 (Bankr. M.D. Ala. Oct. 6, 2006).

As detailed in Part IID, *infra*, in a hypothetical chapter 7, Fifth Third Bank would have been entitled to $25,000 based on its lien. Instead, it obtained a property allegedly worth $196,000 for $90,000. It thus received $106,000 through the transfer, which is $81,000 more than it would have received in a chapter 7.

II. FIFTH THIRD BANK RECEIVED AN AVOIDABLE PREFERENCE WHEN IT RECEIVED MORE FROM THE FORECLOSURE SALE THAN IT WOULD HAVE UNDER A CHAPTER 7 CASE.

Under the plain text of section 547, a foreclosure sale can result in an avoidable preference if a creditor receives more than it otherwise would have received in a chapter 7 liquidation and other statutory criteria are met.

In applying the hypothetical chapter 7 analysis, the courts below erred because they assumed, as a matter of law, that the discounted price a creditor bid at a foreclosure sale would be the same price that a chapter 7 trustee would have obtained on the open market. This assumption misapplies the language from *BFP* related to "reasonably equivalent value" in fraudulent transfers under section 548. Applying *BFP* here is like comparing apples and oranges. Not only is the "reasonably equivalent value" language absent from section 547, but imposing that

standard in this context ignores the reality that foreclosure prices rarely, if ever, reflect the price a chapter 7 trustee could obtain for real property.

Properly analyzing the hypothetical chapter 7 bankruptcy in this case according to the debtor/plaintiff's factual allegations, it is clear that the creditor received a substantial windfall over what it would have received in a hypothetical chapter 7 case. This windfall – the preference – should be avoided for the benefit of the bankruptcy estate pursuant section 547.

A. FORECLOSURE SALES MAY RESULT IN PREFERENTIAL TRANSFERS

The issue before this Court is squarely answered by the text of the Bankruptcy Code, which bars creditors from reaping pre-bankruptcy windfalls at the expense of the bankruptcy estate, including those obtained by foreclosure.

The starting point for the court's inquiry should be the statutory language of 11 U.S.C. § 547(b)(5). *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004); *Friedman's*, 738 F.3d at 553. It is well established that when the "statute's language is plain, the sole function of the court, at least where the disposition required by the text is not absurd, is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotations omitted). A result will be deemed absurd only if it is unthinkable, bizarre or demonstrably at odds with the intentions of its drafters. *See Lamie*, 540

U.S. at 536-38; *In re Spradlin*, 231 B.R. 254, 260 (Bankr. E.D. Mich. 1999) (citing *Public Citizen v. Dept of Justice*, 491 U.S. 440 (1989)).

The statutory text here is clear that a transfer can be avoided as a preference if *inter alia* it allowed the "creditor to receive more than such creditor would receive if the case were a case under chapter 7…" 11 U.S.C. § 547(b)(5). As described in Part II.D., *infra*, the foreclosure proceeding alleged here constitutes such a preference.

The text of section 547 is so clear that there was not even a question about its applicability in this scenario prior to the 1994 *BFP* decision. *See, e.g.*, *Winters v. First National Bank of Florida (In re Winters)*, 119 B.R. 283, 284 (Bankr. M.D. Fla. 1990); *Park North Partners Ltd. v. Park North Associates (In re Park North Partners, Ltd)*., 80 B.R. 551, 554-55 (N.D. Ga. 1987); *Federal National Mortgage Ass'n v. Wheeler (In re Wheeler)*, 34 B.R. 818, 822 (Bankr. N.D. Ala. 1983); *Morris Plan Company v. Fountain (In re Fountain)*, 32 B.R. 965, 967-68 (Bankr. W.D. Mo. 1983). This consistent line of authority applied the plain text of section 547 to facts that are similar to the instant case. For example, *Wheeler* involved a secured creditor purchasing a property at foreclosure for the exact amount of its claim. The court had no difficulty applying the same straightforward liquidation analysis from section 547 at issue here:

> The only § 547 element at issue is whether the foreclosure sale enabled FNMA to receive more than they would receive under a Chapter 7 liquidation. The property was purchased by FNMA for $15,044.79, this sum representing the indebtedness owed on their mortgage plus the expenses of foreclosure. The court, however, has determined that this property has a market value of $24,000.00. It is clear that under a Chapter 7 liquidation, FNMA, as a fully secured creditor, would be entitled to receive the full value of their $15,044.79 claim upon the disposition of the secured property. However, FNMA would be entitled to no more than the amount of their claim. Yet, by reason of this foreclosure FNMA is receiving property with a market value several thousand dollars in excess of the amount of their claim. Thus, it becomes evident that the foreclosure sale did enable FNMA to receive more than they would receive in a Chapter 7 liquidation. The court determines that this foreclosure sale was a preferential transfer.

Wheeler, 34 B.R. at 822. Similarly, in *Winters*, the creditor purchased the property at foreclosure for $14,284.26, the amount of its secured claim, and then promptly resold it for $30,000. The *Winters* Court also had no difficulty finding the windfall to be a preference, reasoning that "[o]bviously, the defendant received more than it would have had the transfer not been made." *Winters*, 119 B.R. at 284; *see also Park North*, 80 B.R. at 555 (if the creditor received equity beyond the value of its claim, then "the foreclosure sale must be set aside as a preference."). These cases all illustrate situations where a creditor is able to reap a windfall through a foreclosure sale, and those situations can constitute preferences under the plain text of section 547.

Of course, neither the statutory text of section 547 nor the nature of a foreclosure sale has changed since this consistent line of authority. The only development since these cases were decided is the Supreme Court's *BFP* decision, which has no applicability to section 547.

B. THE *BFP* DECISION ONLY INTERPRETED LANGUAGE FROM SECTION 548.

The courts below extrapolated too much from *BFP* and improperly applied it to section 547. *BFP* involved entirely different language in the Code with an entirely different set of policies.

At issue in BFP was a purported fraudulent transfer that the debtor sought to avoid pursuant to section 548. Despite the allegations of fraud, however, the transaction at issue in *BFP* was entirely legitimate. The debtor's home was purchased by a third party at a foreclosure sale for approximately 60% of its alleged market value. *BFP*, 511 U.S. at 533-34. "[T]he foreclosure sale had been conducted in compliance with California law and was neither collusive nor fraudulent." *Id*. at 534. Nevertheless, the debtor sought to avoid the foreclosure, asserting that it was fraudulent because the *bona fide* purchaser did not pay "reasonably equivalent value" for the property. *Id*. at 535-36.[2]

[2] The other elements of a fraudulent transfer were not at issue in *BFP*. *See* 11 U.S.C. § 548(a)(1)(B)(ii)(I)-(IV).

The meaning of the phrase "reasonably equivalent value" thus came before the Court. Applying common sense, the Supreme Court recognized (1) that the phrase "fair market value" was used elsewhere in the Code, but that section 548 apparently "goes out of its way to avoid that standard term;" and (2) that the phrase "'fair market value' presumes market conditions that, by definition, do not obtain in the context of a forced sale." *Id*. at 537-38. Using those building blocks, the court concluded that the sales price at a *bona fide* foreclosure would automatically constitute "reasonably equivalent value" for purposes of section 548.

The *BFP* Court squared this interpretation with principles of comity: although the federal government had the authority to interfere with these state law foreclosure proceedings, it should not be assumed it was exercising that power on such a grand scale without a clear congressional directive. *Id*. at 543-45.

Further, if the *BFP* Court adopted the debtor's rationale, the impact would have been substantial. Section 548 applies to "any transfer" that meets its requirements, one of which is that the transaction was supported by less than reasonably equivalent consideration. 11 U.S.C. § 548(a)(1). It is a safe assumption that all (or almost all) foreclosure sales fetch prices below fair market value. Thus, every single foreclosure had the potential to be swept up by section 548, even though the buyers of such properties are typically bargain hunters, not fraud conspirators. "The title of every piece of realty purchased at foreclosure

[truly] would be under a federally created cloud." *Id*. at 544. While recognizing this potential impact, it was not lost on the Court that the transaction had none of the hallmark characteristics of fraud. *See id*. at 542 ("To our knowledge no prior decision had ever applied the 'grossly inadequate price'" badge of fraud under fraudulent transfer law to set aside a foreclosure sale.").

In the end, the *BFP* Court decided one issue: the meaning of the phrase "reasonably equivalent value" as it is used in section 548. It concluded that, given the nature of foreclosure proceedings, the price paid at one was "reasonably equivalent" enough to remove the suggestion of fraud from the transaction.

C. Valuation Under The Hypothetical Chapter 7 Analysis Is Different Than "Reasonably Equivalent Value" For Fraudulent Transfers.

The courts below both erroneously conflated the *BFP* Court's analysis of "reasonably equivalent value" for fraudulent transfers with the hypothetical chapter 7 analysis for preferential transfers. Nothing in *BFP* applied to preferential transfers or section 547. In fact, the language in Section 548 at the center of *BFP*, "reasonably equivalent value," is wholly absent from section 547. Further, section 547 has a much narrower scope, as it only reaches creditors, as opposed to any subsequent purchasers.

The valuation inquiry for fraudulent transfers is expressly different than for preferential transfers. The relevant inquiry to avoid a fraudulent transfer is

whether the transaction was supported by "reasonably equivalent value." *See* 11 U.S.C. § 548(a)(1)(B). Was the price reasonable enough for the transaction to be legitimate, or was it low enough to raise the inference that it was a sham? By contrast, the inquiry to avoid a preferential transfer is concerned with the benefit received by a creditor, not with the reasonableness of any price paid. 11 U.S.C. § 548(b)(5). Did a creditor receive more than it would have under a chapter 7 liquidation? The only reason valuation becomes relevant in the latter inquiry is to help determine what creditors would have received had the transfer not occurred. *See* Part I.C., *supra*. The phrase "reasonably equivalent value" is not part of this analysis.

There is a significant practical difference between these two valuation inquiries. There may be reason to accept, as a matter of law, that a foreclosure price is "reasonably equivalent value" to prevent the consequences of a fraudulent transfer action. But the extension of that rationale by the court's below to assume (as a matter of law) that a chapter 7 liquidation would fetch the same price as a foreclosure sale ignores crucial differences between the two types of sales.

Sales by chapter 7 trustees operate much like common real estate transactions. The chapter 7 trustee, whose commission is based upon the price obtained, *see* 11 U.S.C. § 326, will typically take the time and effort to sell real estate at the best possible price. Obtaining this price often means retaining a

realtor, and putting the home on the market without rushed deadlines. *See, e.g.*, *Heath v. Farmer (In re Heath)*, No. CC-06-1275-PaDMo, 2007 Bankr. LEXIS 4847, at *2 (B.A.P. 9th Cir. Apr. 2, 2007) (trustee employed realtor, and sold debtor's residence approximately 18 months after the chapter 7 was filed – at a price well beyond the debtor's estimated value); *In re Locklear*, 386 B.R. 911, 914 (Bankr. S.D. Ga. 2007) ("This Court takes judicial notice of the hundreds of cases over which it has presided over the past twenty-plus years in which realtors are hired by trustees to assist in the liquidation of assets."); *see also* Hon. W. Homer Drake, Hon. Paul W. Bonapfel & Adam M. Goodman, Chapter 13 Practice & Procedure § 9E:7, at 1017 (2012) ("the key question is what the Chapter 7 trustee could obtain in a liquidation sale. Thus, fair market value of property, rather than its forced sale, governs…"). In other words, "a chapter 7 liquidation does not have the same constraints as a foreclosure sale. A chapter 7 liquidation affords the trustee the time to orchestrate an orderly sale that produces a greater value than would be received at a foreclosure sale." *Villarreal v. Showalter (In re Villarreal)*, 413 B.R. 633, 639 (Bankr. S.D. Tex. 2009).

The foreclosure process works differently, and results in a lower price than an orchestrated sale by a trustee. In Pennsylvania, a foreclosure sale can occur with only 21 days of notice to the general public. Pa. R. Civ. Pro. No. 3129.2(d). On the day of the actual public sale, as long as the bid is sufficient to satisfy the

outstanding judgment, or is otherwise accepted by the creditor, it appears that the bid must be accepted. *See* Pa. R. Civ. Pro. No. 3124. In these transactions, real estate agents typically are not hired to help lubricate the sales process, buyers typically are unable to inspect the properties, buyers take the risk that a homeowner will not leave without a further lawsuit for possession, and sellers typically do not invest resources to make properties marketable to the general public. Given these constraints, "it is not only possible but probable that a trustee will secure more than the foreclosing creditor will on his own." *Whittle*, 463 B.R. at 802; *see also Rambo*, 297 B.R. at 432 ("Clearly there are circumstances… [when] the price the trustee could secure could not be the equivalent of the amount bid-in at a foreclosure sale.").

Furthermore, the scope of section 547 is narrower than the fraudulent transfer provisions of section 548. As described above, the *BFP* Court was concerned with the "federally created cloud" that could be cast over all foreclosure sales under a broad interpretation of section 548. *BFP*, 511 U.S. at 544. Because an avoidance action under section 548 can be brought against any purchaser of the foreclosed property, those concerns may have been well-founded.

Unlike section 548, however, avoidable preferences under section 547 concern only the creditors themselves – not the world at large. This difference was succinctly described by the *Whittle* Court:

> [T]he risks to third parties who buy the property at the foreclosure are non-existent. A purchaser without a claim against the debtor is not subject to a preference action, regardless of the price it pays at the foreclosure sale, since the section only allows avoidance of transfers "to or for the benefit of a creditor." 11 U.S.C. § 547(b)(1). The risk is to the creditor-purchaser who buys the property at foreclosure at an artificially low price and either sells it for a profit or holds it for later investment or use. The difference in the value between what the creditor would have received and what it actually recovered will be taken from the creditor, and not from the third party who represents the *bona fide* purchaser of the property. Thus, the concerns addressed in *BFP* are moot in the context of section 547 avoidance action.

Whittle Dev., Inc. v. Branch Banking Tr. Co. (In re Whittle Dev., Inc.), 463 B.R. 796, 802 (Bankr. N.D. Tex. 2011). Further, even against those creditor-purchasers there is no need to disturb title to the property itself as the bankruptcy court is authorized to assess money damages against the creditor to the extent of the preferential transfer. *See* 11 U.S.C. § 550(a); *Winters*, 119 B.R. at 285. For example, rather than unwind the foreclosure in this case, the court could order Fifth Third Bank to pay to the trustee the amount equivalent to the preference it received. Thus, in the context of section 547, there is no "federally created cloud" hovering over the property's title as it is transferred to subsequent buyers.

In enacting section 547, Congress was explicit about its intent to enable the avoidance of preferential foreclosure sales. *See* S. Rep. No. 95-989, at 88 (1978). Thus, unlike in *BFP*, where the Court was concerned about the lack of any clear

mandate from Congress to use section 548 as a mechanism to avoid foreclosures, such legislative intent is present in this context. S. Rep. No. 95-989, at 88 (1978).

D. THE DEBTOR'S ALLEGED VALUATIONS UNDER THE HYPOTHETICAL CHAPTER 7 ARE FACTUAL ISSUES THAT SHOULD SURVIVE A MOTION TO DISMISS.

The open question is what the creditor would have received in a hypothetical chapter 7 case. *See In re Whittle Development, Inc.*, 463 B.R. 796 (Bankr. N.D. Tex. 2011); *In re Villarreal*, 413 B.R. 633 (Bankr. S.D. Tex. 2009); *In re Andrews*, 262 B.R. 299 (Bankr. M.D. Pa. 2001). Here, if the debtor's allegations concerning the value of the property are proven, then Fifth Third Bank clearly received more than it would have received under a chapter 7 liquidation. This Court should accordingly remand the case for further factual development.

"The determination of what a trustee would receive in a liquidation of the asset is fact intensive." *Rambo v. Chase Manhattan Mortg. Corp. (In re Rambo)*, 297 B.R. 418, 432 (Bankr. E.D. Pa. 2003); *see also Rocco v. J.P. Morgan Chase Bank (In re Rocco)*, 255 F. App'x 638, 642 (3d Cir. 2007); *GGI Props., LLC v. City of Millville (In re GGI Props., LLC)*, 568 B.R. 231, 257 (Bankr. D.N.J. 2017) (denying summary judgment based on factual disputes about the price property would have received in the hypothetical chapter 7). The debtor/plaintiff here alleged that the property would have garnered $196,000 at sale in a chapter 7 liquidation. Accepting that fact as true, as the bankruptcy court must on a motion

to dismiss, *see Erickson v. Pardus*, 551 U.S. 89, 93-94 (2007) ("when ruling on a defendant's motion to dismiss, a judge must accept as true all of the factual allegations contained in the complaint."), then the transaction obviously met the test under section 547.

Here, after selling the property for $196,000, the hypothetical Chapter 7 trustee would distribute the proceeds in the order specified in the Code. *See* 11 U.S.C. §§ 506, 507, 726, 724. First would be payment for the realtor and closing costs, next would be payment of the liens against the real property, followed by any exemptions claimed by the debtor,[3] then the trustee's statutory commission, administrative claims of employed professionals (attorneys, accountants, appraisers), then payment of priority claims, and finally general unsecured claims. *See* 11 U.S.C. §§ 507, 726.

Applying this distribution scheme to the $196,000 sale here would thus provide the following results:

Sale price of Debtor's Real Property	$196,000.00
Realtor Commission of 6%	$11,760.00
Pennsylvania realty transfer tax (1%)	$1,960.00
Capital One, N.A. – first mortgage (approx.)	$90,000.00
Fifth Third Bank – second mortgage (approx.)	$25,000.00
Debtor's Claimed Exemption – 11 U.S.C. § 522(d)(1)	$23,675.00
Chapter 7 Trustee's Commission ($172,325.00 basis)[4]	$11,866.25

[3] Here, the debtor claimed a federal homestead exemption under section 522(d)(1) in the amount of $23,675.

[4] 11 U.S.C. § 326(a) (25% of $5,000, plus 10% of $45,000, plus 5% of $122,325).

Attorney fees & costs for Chapter 7 Trustee (est.)	$7,000.00
Accountant's fees for Chapter 7 Trustee (est.)	$1,000.00
Remaining proceeds for the Bankruptcy Estate	$23,738.75

Notably, in this hypothetical chapter 7 liquidation test, Fifth Third Bank would have received payment of $25,000.00, reflecting the full value of its lien against the property – no more, no less. The remaining proceeds for the bankruptcy estate would have allowed nearly full payment, or 99.6%, of the filed claims by other creditors against the bankruptcy estate, including $19,673.37 owed to the Internal Revenue Service.

The value that Fifth Third Bank received beyond that $25,000 threshold constituted a windfall that it would not have received if the property had been sold in a chapter 7 bankruptcy. Fifth Third Bank purchased an asset allegedly worth $196,000 for only $90,000, netting $106,000, and reaping a benefit well beyond that $25,000 threshold. Its handsome profits came at the expense of many other creditors, who will receive much smaller payouts or possibly nothing for their claims. According to the plain language of section 547(b), this taking of $81,000 in equity by Fifth Third Bank—over and above payment of its $25,000 lien—constitutes an avoidable preference.

The lower courts erred in determining that Fifth Third Bank would have received the same amount in a hypothetical chapter 7. Their failure to conduct the

above liquidation test shows why they are incorrect. This case should be remanded so that the lower courts conduct an actual chapter 7 liquidation analysis

CONCLUSION

For the reasons stated above, *amici curiae* ask this court to reverse and remand the decision of the lower courts below.

Respectfully submitted,

/s/ Tara Twomey

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I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Third Circuit by using the appellate CM/ECF system on February 5, 2018. I also certify that ten (10) paper copies of the brief have been mailed to the court. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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