

AVOIDANCE OF TAX FORECLOSURE SALES

The Statutes:

11 U.S.C. § 547(b) allows the trustee to set aside a transfer to a creditor as preferential if the transfer was:

- (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 on or within 90 days before the date of the filing of the petition...; and
- (5) that enables such creditor to receive more than the 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 payments of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 548(a)(1)(B) allows the trustee to avoid any transfer incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

- (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
- (ii)
 - (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 a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
 - (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 522(h) provides that:

The **debtor** may avoid a transfer of property of the debtor or recover a setoff to the extent that the debtor could have exempted such property under subsection (g)(1) of this section if the trustee had avoided such transfer, if—

- (1) such transfer is avoidable by the trustee under section 544, 545, 547, 548, 549, or 724(a) of this title or recoverable by the trustee under section 553 of this title; and
- (2) the trustee does not attempt to avoid such transfer.

11 U.S.C. § 550(a) “to the extent that a transfer is avoided . . . the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of the property . . .”

Cases:

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

Mortgage foreclosure sales are not fraudulent conveyances under § 548. “[A] fair and proper price, or a ‘reasonably equivalent value,’ for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State’s foreclosure law have been complied with.” *Id.* at 545.

BUT.....

See fn. 3- “We emphasize that our opinion today covers only mortgage foreclosures of real estate. The considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different.”

New Jersey Bankruptcy Caselaw Analysis

DEBTORS CAN UTILIZE § 547 AND § 548 FOR TAX SALE FORECLOSURES DESPITE THE HOLDING OF BFP

In re Berley Associates, Ltd., 492 B.R. 433 (Bankr. N.J. 2013)- distinguishes BFP by comparing New Jersey tax sale foreclosures with New Jersey mortgage foreclosures:

- bidding occurs on tax certificate, *not* transfer of title to property
- value of tax certificate is fixed, bidding is on interest rate;
- transfer of property occurs over two years after bidding process (strict foreclosure)

“The Court views the absence of competitive bidding, together with appropriate advertising, as a significant bar to adjudicating ‘reasonably equivalent value’ in a tax sale foreclosure scenario.” Id. at 440.

- Question- what is the remedy? Is the property returned to the debtor, or does the debtor receive monetary damages for the value of the property?

In re Varquez, 502 B.R. 186 (Bankr.D.N.J. 2013)

- Sale of the tax lien does not relate to the value of the property.
- Bidding at a tax sale is only as to the interest rate to be paid on the initial tax sale certificate.
- There is no sale, forced or otherwise, unlike a mortgage foreclosure sale which is conducted by the sheriff and subject to public advertisement and public auction.

In re GGI Properties, LLC, 568 B.R. 231 (Bankr. D.N.J. 2017)

- Transfer under 101(54) (C) and (D) includes foreclosure of an equity of redemption and an involuntary transfer.
- No correlation between value received at the foreclosure of the equity of redemption and the value of the property, therefore BFP does not apply.

In re Hackler, 938 F.3d 473 (3d Cir. 2019)- the Third Circuit holds that a tax sale foreclosure can be avoided as a preferential transfer under § 547, noting that BFP was based upon statutory analysis of a term, “reasonably equivalent value,” which does not appear in § 547(b). Court additionally noted the “divergent procedures and attendant considerations in tax foreclosure proceedings in New Jersey [in comparison to mortgage foreclosures].” Id. at 479.

POTENTIAL LIMITS TO UTILIZING § 547 AND § 548

Date of Transfer

In re Polanco, 622 B.R. 631 (Bankr. D.N.J. 2020)- 90 day preference period under § 547(b)(4) runs from the date of the filing of a *lis pendens*. 11 U.S.C. 547(e)(1) provides “[f]or the purposes of this section, (A) a transfer of real property ... is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee.”

The Court analyzed New Jersey state law and found that “the filing of a notice of *lis pendens* in New Jersey meets the requirements for perfection laid out in section 547(e)(1) of the Bankruptcy Code, and that [the creditor’s] interest was properly perfected, for preference purposes, prior to the Preference Period.” 622 B.R. at 637.

In re Stahlberger, 20-23388-ABA, Adv. No. 20-1627-ABA (Bankr. D.N.J. 2021)

Debtor sought to avoid the transfer of real property pursuant to 547 (preference) and 548 (fraudulent transfer). The issue for both counts was when did the transfer occur? The transfer occurs when it is perfected, when a bona fide purchaser from the debtor or the trustee cannot acquire an interest that is superior to the interest of that transferee, in this case the date the tax lien holder filed the *lis pendens*.

Since the language is very similar in 548(d)(1), the same applies for a fraudulent transfer. In this case, the filing of the *lis pendens* was the date of the transfer, and that was filed more than two years prior to the filing of the bankruptcy. Therefore, the debtor could not meet the requirements to prove either a preference or a fraudulent transfer.

Insolvency of Debtor

In re Kopec, 621 B.R. 621 (Bankr. D.N.J. 2020)- Debtor could not satisfy the requirement of § 547(b)(3) that the transfer be made while the debtor was insolvent. A debtor is presumed to be insolvent within 90 days of the filing of the petition pursuant to § 547(f). The Bankruptcy Code defines “insolvent” as a “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.” 11 U.S.C. § 101(32). The existence of significant equity in the property, far in excess of the total debts of the debtor, was sufficient to rebut the presumption of insolvency.

But the insolvency requirement under § 548(a)(1)(B)(ii)(I) differs from that in § 547 in that the transfer may be avoided if it was made while the debtor was insolvent or if the transfer caused the debtor to become insolvent. Because the debtor had *de minimis* assets aside from the property, the transfer rendered her insolvent.

Standing (Generally)

Issue raised- does a debtor have the independent standing to utilize the trustee's avoidance powers under § 547 and § 548, beyond what is provided by § 522(h)?

11 U.S.C. § 1303 sets forth what rights and powers of a trustee a debtor shall have in Chapter 13. Does not include avoidance powers. This can be compared to §1107 and § 1203, which provide do allow a debtor to utilize avoidance powers in Chapter 11 and 12.

There is a split in caselaw on the issue. One notable New Jersey case is In re Ryker, 315 B.R. 664 (Bankr. D.N.J. 2004), where Judge Winfield found that the existence of 11 U.S.C. 522(h) demonstrates that Congress has contemplated narrow exceptions to authorize the debtor to exercise avoidance powers under section 544:

Section 1303 merely provides Chapter 13 debtors with the rights and powers of a trustee under specified subsections of §363. Congress' restrictive grant of trustee powers to Chapter 13 debtors must surely be viewed as intentional. This understanding is also buttressed by the fact that Congress provided Chapter 13 debtors with a limited use of the avoidance powers in 522(h). Had Congress intended for Chapter 13 debtors to have unrestricted use of the avoidance powers, there would be no need for this section.

Ryker 315 B.R. at 670.

Judge Steckroth, in In re Hannah, 316 B.R. 57, 61 (Bankr.D.N.J. 2004) also pointed out that under 1107, the debtor in a Chapter 11 is specifically granted all the rights and powers of a trustee. Likewise, 1203 grants the same to Chapter 12 Debtors. But he noted the absence of such language in 1303, and reasoned that if Congress had intended to give a Chapter 13 debtor trustee-like powers, it would have stated so.

In re Knapper, 407 F.3d 573, 583 (3d Cir.2005), the Third Circuit ruled that a Chapter 13 debtor does not independently have standing in his or her own right to bring an avoidance action in a bankruptcy proceeding.

Other courts have found in favor of a debtor's standing. Those arguments generally, "focus on the economic realities of chapter 13, including the limited role of chapter 13 trustees, and emphasize anomalies that would result if viable avoiding actions were allowed to linger . . . [T]hese courts regard the statute as ambiguous and emphasize legislative history statements urging that chapter 13 should be construed expansively." Houston v. Eiler (In re Cohen), 305 B.R. 886, 894 (B.A.P. 9th Cir. 2004). The legislative history behind Section 1303 provided that the list of exclusive powers "does not imply that the debtor does not also possess other powers concurrently with the trustee." Id. (citing 124 Cong. Rec. H11106 (daily ed. Sep. 28, 1978); id., S. 17423 (daily ed. Oct. 6, 1978))

Standing Under § 522(h) / Remedies Under § 550(a)

In re Nealy, 623 B.R. 278 (Bankr. D.N.J. 2021) - it is not in controversy that a debtor has explicit statutory authority under § 522(h) to avoid a transfer of property “to the extent that the debtor could have exempted such property under subsection (g)(1).” This is only allowable if the trustee does not attempt to avoid such transfer. § 522(h)(2).

“A debtor must, however, tailor the relief sought in an action brought under 11 U.S.C. § 522(h) to comport with the limitations prescribed by statute—meaning that a Debtor can only recover to the extent of any valid exemptions.” 2021 WL 115639 at *4.

There is additional caselaw cited by the Nealy court, noting that, based upon the language of § 550(a), a debtor may only recover property:

if it is “for the benefit of the estate.” *In re Majestic*, 716 F.3d at 761 (quoting *In re Messina*, 687 F.3d 74, 82–83 (3d Cir.2012) (citing 11 U.S.C. § 550(a)). “A debtor is not entitled to benefit from any avoidance . . . and ‘courts have limited a debtor's exercise of avoidance powers to circumstances in which such actions would in fact benefit the creditors, not the debtors themselves.’” *In re Majestic*, 716 F.3d at 761 n.26 (citing *In re Messina*, 687 F.3d at 82–83 and quoting *In re Cybergenics Corp.*, 226 F.3d 237, 244 (3d Cir.2000).

Id.

In re Stahlberger, 2021 WL 509849 (Bankr. D.N.J. Feb. 10, 2021) at fn. 1-

“As chapter 13 debtor, not a trustee, Ms. Stahlberger yet has standing to seek avoidance here because “(1) the transfer was not voluntary; (2) the transfer was not concealed; (3) the trustee did not attempt to avoid the transfer; (4) [she] seeks the avoidance pursuant to §§ 544, 545, 547, 548, 549, or 724(a) of the Bankruptcy Code; and (5) the transferred property is of a kind that [she] would have been able to exempt from the estate if the trustee had avoided the transfer under one of the provisions in § 522(g).” Matter of Varquez, 502 B.R. 186, 190 (Bankr. D.N.J. 2013) (quoting *In re Dickson*, 655 F.3d 585, 592 (6th Cir.2011)).”