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# *Grissom v. Johnson*: Just The Facts...

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# *Grissom v. Johnson:* Just The Facts. . .

## I. INTRODUCTION

In *Grissom v. Johnson* (*In re Grissom*),[1] the Eleventh Circuit Court of Appeals established a case-by-case analytical model to determine when a foreclosure sale brought a "reasonably equivalent value" under 11 U.S.C. § 548.[2] Absent fraud, collusion, or illegal or unlawful procedures, courts should presume that the price brought at the legitimate foreclosure sale is a reasonably equivalent value of the property.[3] For a bankruptcy trustee "to avoid [a] foreclosure sale as [a] transfer of property for which [the] debtor received less than reasonably equivalent value,"[4] the trustee "must establish specific factors which undermine confidence in the reasonableness of the foreclosure sale price."[5] The court held that in order to determine reasonable equivalency under 11 U.S.C. § 548, the court must consider and analyze all of the circumstances and factors surrounding a foreclosure sale.[6] The seventy percent test set forth by *Durrett v. Washington National Insurance Co.*[7] should only be used as a guideline or one factor in a court's analysis.[8] As this casenote will discuss, courts experi-

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1. 955 F.2d 1440 (11th Cir. 1992).

2. *Id.* at 1442. 11 U.S.C. § 548 (1988). Section 548 provides in pertinent part that:

> (a) 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 . . . (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 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; or (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.

*Id.* § 548(a)(2)(A) & (B) (i), (ii), (iii).

3. 955 F.2d at 1442.

4. *Id.* at 1441.

5. *Id.* at 1446.

6. *Id.* at 1449.

7. 621 F.2d 201, 203 (5th Cir. 1980). *See infra* notes 19-23 and accompanying text.

8. 955 F.2d at 1445 (citing Walker v. Littleton (*In re* Littleton), 888 F.2d 90, 93 (11th Cir. 1989)). *See infra* notes 19-24 and accompanying text.

ence difficulty in interpreting the words "reasonably equivalent value" given the lack of both a statutory definition and prior legal precedent.[9]

## II. Statement of the Facts

Grissom borrowed $18,000 from Citizens & Southern National Bank ("C & S") and secured the loan with the Grissoms' residence. The Grissoms defaulted on the note. C & S notified the Grissoms of the default and of its intent to foreclose. After this notification, C & S advertised the foreclosure sale. Thereafter, C & S performed a nonjudicial foreclosure sale of the collateral. C & S complied with Georgia law and the parties' agreement in its foreclosure method. The Johnsons, the highest bidders at the sale, bought the property. The sale price of $14,059 was the exact amount owed on the note to C & S by the Grissoms.[10]

One day after the foreclosure sale, the Grissoms filed for Chapter 13 bankruptcy protection. Then the Grissoms filed an adversary proceeding against C & S and the Johnsons in the bankruptcy court.[11] In their complaint, the Grissoms claimed that their bankruptcy estate could avoid the foreclosure sale since they received less than the property's reasonably equivalent value from the sale.[12]

## III. Procedural Background of the Case

At trial in the United States Bankruptcy Court for the Southern District of Georgia, the parties agreed that the foreclosure sale took place within one year before the date that the Grissoms filed the bankruptcy petition and left the Grissoms insolvent.[13] The only issue for the trial court to decide was whether the price brought at the foreclosure sale was a reasonably equivalent value of the Grissoms' property.[14] The bankruptcy court found that the property's market value was $26,000.[15] The bankruptcy court, relying on the seventy percent test set forth in *Durrett*,[16] ruled that C & S's foreclosure sale was avoidable because the price at the foreclosure sale was not for the reasonably equivalent value of the home.[17] On appeal, the United States District Court for the Southern

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9. 955 F.2d at 1446.
10. *Id.* at 1443.
11. "The Johnsons are not a party to th[e] appeal." *Id.* at 1443 n.2.
12. *Id.* at 1443.
13. *Id.*
14. *Id.*
15. *Id.* at 1444.
16. 621 F.2d at 203. *See infra* notes 19-23 and accompanying text.
17. 955 F.2d at 1444.

District of Georgia also relied on *Durrett* and affirmed the bankruptcy court's order.[18]

## IV. Posture on Appeal: The Court's Opinion

The bankruptcy court relied primarily on *Durrett* in determining the reasonably equivalent value of the Grissoms' home.[19] In *Durrett* the Fifth Circuit determined under what circumstances the price brought at a foreclosure sale would be a "fair equivalent" within the meaning of Section 67(d)(1), (e)(1) of the Bankruptcy Act, the predecessor of 11 U.S.C. § 548.[20] A foreclosure sale price of 57.7% of the fair market value of the property is not a "fair equivalent" for the transfer of the property.[21] The court in *Durrett* stated:

> We have been unable to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the [Bankruptcy] Act, which has approved a transfer for less than 70 percent of the market value of the property.[22]

"[T]he '*Durrett* 70% rule' became entrenched in many courts, despite the fact that [it] . . . was the purest form of dictum."[23]

Prior to its ruling yet in *Grissom* after the trial in the bankruptcy court, the court decided *Walker v. Littleton (In re Littleton)*.[24] In *Littleton* the court held that "a determination of reasonable equivalence must be based upon all the facts and circumstances of each case."[25] In that case a nonjudicial foreclosure sale brought a price that was 63.49% of the fair market value of the property.[26] Since junior liens existed on the property, the foreclosure sale deprived the bankruptcy estate of little equity in the property.[27] Despite the fact that it was not in compliance with the *Durrett* seventy percent rule, the court of appeals did not avoid the foreclosure sale of the Grissoms' residence.[28] Under the facts of *Littleton*, the foreclosure sale brought a reasonably equivalent value of the

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18. *Id.* at 1445.
19. *Id.* at 1444.
20. *Id.*
21. 621 F.2d at 203.
22. *Id.*
23. 955 F.2d at 1444. *See, e.g.*, Federal Nat'l Mortgage Ass'n v. Wheeler (*In re* Wheeler), 34 B.R. 818, 821 (Bankr. N.D. Ala. 1983); Berge v. Sweet (*In re* Berge), 33 B.R. 642, 649-50 (Bankr. W.D. Wis. 1983).
24. 955 F.2d at 1444.
25. 888 F.2d at 93.
26. *Id.* at 92.
27. *Id.* at 93.
28. 955 F.2d at 1445-46.

property because, in addition to receiving 63.49% of the fair market value of the property in cash, the debtor was relieved from the junior liens.[29]

Courts have looked at factors other than the satisfaction of junior liens when examining all the facts and circumstances of the case and determining reasonably equivalent value.[30] Courts may look at the marketability of the property.[31] In *Fargo Biltmore Motor Hotel Corp. v. Metropolitan Federal Bank (In re Fargo Biltmore Motor Hotel Corp.)*,[32] Metropolitan Federal Bank foreclosed on the debtor's motel.[33] At a sheriff's sale, Metropolitan Federal Bank purchased the property at a price that was seventy percent of the fair market value of the property.[34] The debtor's motel suffered from many physical problems.[35] The motel was the oldest motel facility in the area. The motel had a poor reputation and an average occupancy rate of only sixty percent. The facilities were also in need of substantial capital improvement.[36] The court in *Fargo* held that in light of all "the facts and circumstances of this case . . . the payment by Metropolitan of seventy percent of the property's value was a reasonably equivalent value in exchange for the transfer of Biltmore's interest in the property."[37]

In *Gillman v. Preston Family Investment Co. (In re Richardson)*,[38] the court held that the determination of reasonable equivalency depends on the facts of a case.[39] The court in *Gillman* stated that "[i]n all cases, facts such as 'the bargaining position of the parties . . .' will be relevant."[40] Courts should also consider that, generally, sales in foreclosure markets bring less than sales in retail markets.[41]

Another important factor courts should use in determining whether the debtor received reasonably equivalent value is the fact "that the property was sold in the context of a lawful foreclosure proceeding."[42] A legitimate foreclosure sale, which is free from fraud, collusion, or irregular or unlawful procedures, results in a price that the court presumes to be a reasona-

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29. *Id.* at 1446.
30. *Id.*
31. *Id.*
32. 49 B.R. 782 (Bankr. D. N.D. 1985).
33. *Id.* at 784.
34. *Id.* at 784, 789.
35. *Id.* at 790.
36. *Id.*
37. *Id.*
38. 23 B.R. 434 (Bankr. D. Utah 1982).
39. *Id.* at 448.
40. *Id.* (citing Michael L. Cook, "*Fraudulent Transfer Liability Under the Bankruptcy Code*," 17 HOUS. L. REV. 263, 278 (1980)).
41. 888 F.2d at 93 (citing Adwar v. Capgro Leasing Corp., 55 B.R. 111 (E.D. N.Y. 1985)).
42. 955 F.2d at 1446 (citing Walker v. Littleton, 888 F.2d 90-93) (11th Cir. 1989)).

bly equivalent value.[43] To avoid a foreclosure sale under 11 U.S.C. § 548, the bankruptcy trustee must show factors that "undermine confidence in the reasonableness of the foreclosure sale price."[44] A showing that the foreclosure sale price was less than seventy percent of the market value of the property rebuts the reasonably equivalent value presumption.[45]

Several other factors exist that are relevant to a reasonable equivalency determination. "The bankruptcy court . . . must consider such factors as whether there was a fair appraisal of the property, whether the property was advertised widely, and whether competitive bidding was encouraged."[46]

At the beginning of Grissom's trial, the bankruptcy court informed the parties that the court would decide the case on the authority of *Durrett*.[47] The evidence that the parties presented at trial therefore focused on the market value of the property.[48] The clarification of 11 U.S.C. § 548 was not available to the parties at trial because the court decided *Littleton* two months after the trial in the bankruptcy court.[49] The bankruptcy court easily applied *Durrett's* seventy percent rule and found the foreclosure sale price inadequate under that rule.[50] Because of the lack of evidence regarding matters other than market value, the bankruptcy court could find " 'no basis for . . . determin[ing] that the foreclosure sale now before the court brought the debtor the reasonably equivalent value of the property' "[51] as it attempted to observe other factors of the sale as *Littleton* requires.[52]

The bankruptcy court incorrectly stated the burden of proof.[53] Courts should presume that lawful foreclosure sales bring a reasonably equivalent value of the debtor's property, and the trustee must then prove facts that rebut that presumption.[54] The bankruptcy court should have held that it could find no basis that the foreclosure sale did not bring the reasonably equivalent value of the property.[55]

The only findings in the record regarding the circumstances of the foreclosure sale were the following: C & S complied with Georgia foreclosure

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43. *Id.*
44. *Id.*
45. *Id.*
46. Bundles v. Baker, 856 F.2d 815, 824 (7th Cir. 1988).
47. 955 F.2d at 1447.
48. *Id.*
49. *Id.*
50. *Id.* at 1448.
51. *Id.* (quoting Order and Judgment of the Bankruptcy Court at 9, Exhibits Vol. 1).
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*

law; the foreclosure sale was advertised four times; and a comment by Birnet Johnson that " 'there were many bidders [at the foreclosure sale].' "[56] The court of appeals could not determine whether the foreclosure sale price was a reasonably equivalent value under that record.[57] Since courts should presume that lawful foreclosure sales bring reasonably equivalent values unless the trustee proves circumstances indicating otherwise, the Grissoms should lose under these circumstances.[58] A mere violation of the *Durrett* seventy percent rule will not make a foreclosure sale voidable under 11 U.S.C. § 548.[59] Since the bankruptcy court made clear to the parties before the trial that it would follow the *Durrett* seventy percent test, the court of appeals felt that justice would be better served by vacating the orders of the bankruptcy and district courts and remanding the case to the district court for further proceedings.[60]

## V. ANALYSIS

Under *Durrett's* seventy percent rule, trial courts could easily find reasonable equivalency.[61] Courts should no longer mistake it as "the law of [the eleventh] circuit."[62] If Congress had intended courts to use a fixed percentage to determine reasonable equivalency, it would have so provided.[63]

The purpose of 11 U.S.C. § 548 is to "ensur[e] that a foreclosing party takes all commercially reasonable steps to recover not only its own interest in the property sold, but also the debtor's equity."[64] Two competing policy concerns underlie this area of the law.[65] Secured creditors should be able to foreclose without insuring losses resulting when foreclosure property sells too cheaply.[66] If courts, however, allow secured creditors to ignore equity in foreclosures, the secured creditor's actions may undermine the purpose of 11 U.S.C. § 548 of ensuring against unnecessary depletion of the bankruptcy estate.[67]

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56. *Id.* (quoting Transcript at Trial at 54).
57. *Id.*
58. *Id.* at 1449.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. 888 F.2d at 93.
64. 955 F.2d at 1446.
65. *Id.*
66. *Id.*
67. *Id.* at 1446-47.

A totality of the circumstances best balances these competing policy concerns.[68] When a court avoids a foreclosure sale "because the market . . . could not bring 70% of the property's value,"[69] although it may promote bankruptcy policy, the avoidance is a violation of "the policy protecting [the] rights of secured creditors . . . and [a diminution of] the integrity of foreclosure sales."[70] The value of an item may be different at different times and for different purposes.[71] The standard of comparing the price at the foreclosure sale to an appraised market value to determine reasonable equivalent value is unrealistic because of the failure to take into account the nature of the foreclosure market.[72] Also, since a bankruptcy trustee may be able to void a foreclosure sale, a purchaser, other than the secured creditor, is further inhibited from buying at the foreclosure sale.[73] This further depresses foreclosure sale prices and increases deficiencies at foreclosure.[74]

When the court considers the foreclosure sale price to be a reasonably equivalent value if the mortgage holder complies with the minimal requirements of state foreclosure law, the courts "allow the interests of secured creditors to trump bankruptcy policy."[75] Therefore, courts should analyze all relevant facts and circumstances and not make "the achievement of a fixed percentage of value or compliance with state foreclosure law" decisive in the determination of reasonable equivalency.[76]

The court in *Grissom* felt that a court must perform a complete inquiry of all the relevant facts and circumstances in order to find reasonable equivalency.[77] The court in *Grissom* also agreed with *Littleton* in that a simple mathematical test cannot replace the analysis of the important factors, and that the *Durrett* seventy percent test is only a guideline.[78] Therefore, the Eleventh Circuit's decisions in *Littleton* and *Grissom*, in those respects, coincide with most circuit courts that have considered the issue.[79]

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68. *Id.* at 1446.
69. *Id.* at 1447.
70. *Id.*
71. *In re* Upham, 48 B.R. 695, 697 (Bankr. W.D. N.Y. 1985).
72. *Id.* at 697.
73. War Eagle Floats, Inc. v. Travis (*In re* War Eagle Floats, Inc.), 104 B.R. 398, 401 (Bankr. E.D. Okla. 1989).
74. *Id.* at 401 (quoting *In re* Winshall Settlor's Trust, 758 F.2d 1136, 1139 (6th Cir. 1985)).
75. 955 F.2d at 1447.
76. *Id.*
77. *Id.* at 1449.
78. *Id.* at 1445.
79. *Id. See* Barrett v. Commonwealth Fed. Sav. & Loan Ass'n, 939 F.2d 20, 23-25 (3d Cir. 1991); Cooper v. Ashley Communications, Inc. (*In re* Morris Communications NC, Inc.), 914 F.2d 458, 467 (4th Cir. 1990); Bundles v. Baker (*In re* Bundles), 856 F.2d 815, 824-25

## VI. CONCLUSION

After *Grissom* courts should no longer solely apply *Durrett*'s seventy percent test to determine reasonable equivalency.[80] Now the seventy percent test set forth in *Durrett* should only be used as a guideline.[81] Courts should presume that a price brought at a legitimate foreclosure sale that is free from fraud, collusion, or irregular or unlawful procedures, is a reasonable equivalent to the value of the property.[82]

A foreclosure sale price that is less than seventy percent of the property's value rebuts this presumption of reasonableness.[83] To avoid a foreclosure sale, the bankruptcy trustee must prove factors that undermine confidence in the foreclosure sale price's reasonableness.[84] For a court to determine reasonable equivalence, it should thoroughly consider all relevant facts and circumstances surrounding the foreclosure sale.[85] In determining reasonable equivalence, courts should usually consider the following factors: the parties' bargaining position, the property's marketability, the fact that foreclosure markets usually bring prices lower than those in other markets, the satisfaction of junior liens, if before the sale the foreclosing party got a fair appraisal of the property, the advertisement of the foreclosure sale, and the competitive nature of the sale.[86] Only a totality of the circumstances test "provide[s] adequate deference to state foreclosure proceedings and the rights of secured creditors, without unduly trammeling upon the policies of the bankruptcy laws."[87]

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(7th Cir. 1988); First Fed. Sav. & Loan Ass'n v. Hulm (*In re* Hulm), 738 F.2d 323, 327 (8th Cir. 1984), *cert. denied*, 469 U.S. 990 (1984).

80. 955 F.2d at 1449.
81. *Id.* at 1445.
82. *Id.* at 1446.
83. *Id.*
84. *Id.*
85. *Id.* at 1449.
86. *Id.* at 1445-46.
87. *Id.* at 1449.