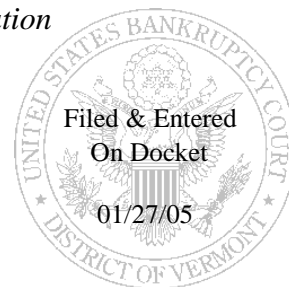


**UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT**

In re:**LAUREN JO CHASE,
Debtor.****Chapter 13 Case
02-10582**

**JAN M. SENSENICH et al,
Plaintiffs,****v.****ROBERT MOLLEUR,
Defendant.**

**Adversary Proceeding
03-1058****ORDER****DETERMINING TRANSFERS EFFECTED UNDER THE VERMONT STRICT FORECLOSURE PROCESS
MAY BE AVOIDED AS FRAUDULENT CONVEYANCES**

The Plaintiffs seek to avoid a transfer effected pursuant to the Vermont strict foreclosure process, as a fraudulent conveyance under 11 U.S.C. § 548(a)(1) and 9 V.S.A. § 2289(a). The legal question presented is whether a transfer of property under the Vermont strict foreclosure statute is vulnerable to avoidance under § 548 or, posed another way, whether adherence to the strict foreclosure statutory scheme creates a presumption of reasonably equivalent value.¹ This question has not been decided by the Vermont state courts nor squarely addressed by this Court. For the reasons articulated below, the Court holds that a transfer of property effected following the Vermont strict foreclosure statute is not entitled to an automatic presumption of reasonably equivalent value under the principles enunciated in BFP v. Resolution Trust Corp., 512 U.S. 531 (1994), and thus, may be avoided as a fraudulent conveyance. The issue of whether the instant transfer may be avoided as a fraudulent conveyance will be determined based upon the factual evidence presented at trial.

PROCEDURAL BACKGROUND

The Parties recently filed a Joint Pre-Trial Statement (doc # 30) indicating that there are no contested legal issues to be addressed at the trial to be held on Friday, January 28, 2005. The Court determined that there were open legal issues and issued an order directing the Parties to address the outstanding legal issues (doc. # 31). During a status hearing on January 25th, it became clear that previous orders issued by the Court were interpreted differently by the Parties and the Court and the viability of the asserted cause of action must be resolved prior to the Parties' presentation of evidence on the merits of the requisite elements under § 548. Consequently, the Parties agreed to bifurcate the legal and factual issues, waived their right to brief and present argument to the Court on the legal issue and agreed to the Court's issuance of a decision based upon

¹ Unless otherwise indicated, all statutory references are to the United States Bankruptcy Code.

the record before it and its independent research. Evidence regarding the factual issues would still be presented on January 28, 2005, as scheduled, if necessary. Although the Court recognizes that the Parties had interpreted previous orders to be a determination, at least implicitly, that a transfer under the strict foreclosure process is vulnerable to avoidance, the Court has not yet announced that holding or its rationale on this important point of state law. The Court enters this order to resolve explicitly the open legal issues.

In the prior adversary proceeding brought by these same parties (#02-1054)(the “first Adversary”), the Court considered a Motion to Dismiss the complaint on the ground, *inter alia*, that the Complaint failed to state a cause of action upon which relief could be granted (the First Adversary, doc. # 10). In an order dated September 29, 2003, the Court denied the Motion to Dismiss in the First Adversary, ruling that the pertinent issue before the Court was whether the Plaintiffs pleaded a cause of action sufficient to proceed with the First Adversary on a novel and unique question of law that has not been previously addressed by either the state courts of Vermont or this Court, namely, whether a transfer effected under Vermont’s strict foreclosure procedure was susceptible to avoidance as a fraudulent conveyance. The Court did not reach the question of whether the Plaintiffs could ultimately prevail or even whether a Vermont strict foreclosure transfer could ever be avoided as a fraudulent conveyance. Rather, the Court ruled only that the Plaintiffs were entitled to proceed to present their case (the First Adversary, doc. # 16). The Court found that the Plaintiffs raised a colorable argument and that they should be permitted to present their case in support of the position that a transfer effected through a strict foreclosure proceeding and for less than reasonably equivalent value is subject to avoidance under § 548. On December 24, 2003, the Court certified this question of the vulnerability of strict foreclosure transfers to fraudulent conveyance avoidance to the Vermont Supreme Court, and on February 17, 2004, the Vermont Supreme Court issued a decision declining to consider the issue (the First Adversary, doc.## 36, 39).

The First Adversary was dismissed without prejudice, on April 12, 2004, to allow the Plaintiff to assert a separate cause of action on the basis that the alleged transfer occurred pre-petition. (In the First Adversary, the Plaintiffs had pleaded it occurred post-petition, see First Adversary, doc. # 48.) Shortly thereafter, the Plaintiffs filed the instant adversary proceeding (the “Current Adversary”) alleging that the strict foreclosure transfer occurred pre-petition, was for less than reasonably equivalent value, and was avoidable as a fraudulent conveyance (doc. #1).

The Court issued an Order and Memorandum of Decision herein granting partial summary judgment for the Plaintiffs on the basis that the “transfer” under § 548 occurred pre-petition (docs. ## 22 and 23). Before the Court were the Parties’ arguments regarding the elements of a § 548 cause of action. The Court was not asked to determine whether a transfer in a strict foreclosure context could be vulnerable to avoidance under either § 548 or 9 V.S.A. § 2289(a).

DISCUSSION

A. VERMONT'S STRICT FORECLOSURE PROCEDURE AND FORECLOSURE SALE OPTION

The Second Circuit Court of Appeals recently articulated the following description of Vermont's strict foreclosure procedure:

Strict foreclosure is the normal method of foreclosure only in Connecticut and Vermont. In Vermont, a mortgage conveys legal title to the mortgagee at the time the mortgage is granted. Once the condition of a mortgage is broken, the mortgagee becomes at law the absolute owner of the property and is entitled to immediate possession. A mortgagee may assert its right to possession by peaceable entry, by eviction, or by seeking a foreclosure judgment in county court. **Strict foreclosure does not involve a foreclosure sale.** Upon the borrower's default, the court will normally set a time period in which the borrower may pay off or redeem the mortgage debt. If the borrower fails to do so in the allotted time, the lender is given an immediate right to possession of the property. Through a foreclosure judgment, a mortgagee formally takes "possession" of the property. A foreclosure judgment vests full legal and equitable title to the property with the mortgagee, subject only to the mortgagor's "equity of redemption," which is a contingent equitable interest in the property, and limited rights to possession, rents, and profits of the property during the period of redemption. **Under Vermont law if no one redeems foreclosed property within the prescribed period, the foreclosing mortgagee, pursuant to the Vermont strict foreclosure procedure, 12 V.S.A. chapter 163, subchapter 6, obtains full and complete title and has the right to sell the property and retain the surplus, if any.**

In re Canney, 284 F 2d 362, 368 (2d Cir. 2002) (emphasis added; internal citations omitted). This summary, however, paints only a part of the strict foreclosure picture. The issue presented in Canney was the extent and nature of the mortgagor's rights in the property at various points in the redemption process and hence, the Court had no need to address either the mechanics of the sale option or the relationship between the strict foreclosure process and fraudulent conveyance statutes. Since the instant adversary proceeding does raise the fraudulent conveyance queries, we begin by filling in the picture of the Vermont strict foreclosure process. As will be discussed below, other federal courts that have considered this question have considered two key components within the strict foreclosure provisions: (1) whether the state court has discretion in determining the length of the redemption period; and (2) the availability and terms of sale. The Court will direct its attention to describing those aspects of the Vermont strict foreclosure statute.²

In Vermont, the prescribed period for redemption is six months from the date of the decree; however, the court has discretion to order a shorter time period (§ 4528). The statute provides a strict foreclosure

² Vermont's foreclosure process is codified in 12 VSA chapter 164, subchapter 6, sections 4526 - 4533(a).

exception, allowing a sale process to be used, “if a lien or interest in such realty is held by any person or federal agency which may not be foreclosed by strict foreclosure pursuant to federal law” (§ 4531). If the exception applies, the court *may* enter a decree (1) providing for whatever redemption period the court deems appropriate; (2) providing for a sale of the mortgaged premises at the conclusion of said redemption period if the property is not redeemed, (3) establishing the time, manner and notice of sale, and (4) if required by federal law, directing the application of the sale proceeds. A foreclosure sale option may also be exercised where the mortgage contains a power of sale clause and either the plaintiff requests a sale in the foreclosure complaint or the defendant requests a sale in the answer. When those events coincide, pursuant to § 4531a, the court *may* order the property to be sold if it is not redeemed within the period specified in the judgment of foreclosure and determine the time and manner of the sale. The language of the statute in both instances is discretionary, providing that the court “may,” not that the court “must” order a sale.³ The state court must take into account the circumstances of the case and exercise its discretion to determine whether to order a foreclosure sale.

Where the mortgage deed at issue in a foreclosure action provided for the power of sale and the defendant indicated that she built equity in the property which she felt should be returned to her in the event of foreclosure, these facts, in light of the parties’ stipulation to invoke the power of sale, were enough to establish that [§4531a] was invoked, and the trial court properly ordered foreclosure by power of sale.

Harrington v. McCarty, 174 Vt. 69, 73-74 (2001).

B. BFP v. RESOLUTION TRUST CORPORATION

In order to ascertain whether Vermont’s foreclosure scheme is vulnerable to avoidance as a fraudulent conveyance, the Court must begin its analysis with the touchstone case of BFP v. Resolution Trust Corporation, 512 US 531 (1994)(“BFP”). In BFP, the United States Supreme Court articulated the circumstances under which a transfer may be deemed to have occurred in exchange for reasonably equivalent value without regard to the actual price paid and hence, be immune to attack as a fraudulent conveyance when the established process of sale contains the requisite due process safeguards. The Connecticut bankruptcy courts have recently addressed how strict foreclosure fits within the parameters established by BFP. This Court adopts its sister court’s able analysis of this point:

³ Sections 4531a and 4532 of the Vermont statute also establish restrictions on foreclosure sales of property and delineate the procedures and notice requirements when the subject property is either farmland or dwelling houses of two units or less

C. Applicability of *BFP*

Bankruptcy Code § 548(a)(1)(B) permits the avoidance of certain prepetition transfers of the debtor if made in exchange for less than “reasonably equivalent value”. 11 U.S.C. § 548(a)(1)(B). In *BFP*, the Court held that the price received at a mortgage foreclosure sale conducted in accordance with applicable state law conclusively establishes the value of the subject property for determining Section 548(a)(1)(B) “reasonably equivalent value”. A question addressed in *Fitzgerald I* and revisited here is whether the *BFP* conclusive presumption of “reasonably equivalent value” is applicable to a Connecticut strict foreclosure. The required analysis begins with an analysis of *BFP* itself. In *BFP*, the Court was faced with the task of construing the § 548(a)(1)(B) phrase “reasonably equivalent value” in a real estate foreclosure sale context while giving appropriate weight to the traditional sovereignty of the states over real estate foreclosures. The Court decided *BFP* based upon the evidentiary value of the foreclosure sale process itself, concluding that the evidence of value produced by the foreclosure sale process (i.e., the successful bid) is “the only *legitimate evidence* of the property's value at the time [the property] ... is sold.” *See BFP*, 511 U.S. at 548- 49 (emphasis added). A close reading of *BFP* indicates the reasons why the Court took an “evidentiary” approach rather than carving out a blanket exception for foreclosures from the federal fraudulent transfer laws. First, an “evidentiary” approach is consistent with the Court's admonition that: [t]he language of [§ 548(a)(1)(B)] ... (“received less than a reasonably equivalent value in exchange”) *requires judicial inquiry* into whether the foreclosed property was sold for a price that approximated its worth at the time of sale. *BFP*, 511 U.S. at 538-39 (emphasis added). Second, an “evidentiary” approach allowed the Court to refute “the dissent's characterization of [the majority's] ... interpretation as carving out an ‘exception’ for foreclosure sales ... or as giving ‘two different and inconsistent meanings’ ... to ‘reasonably equivalent value.’”

In *re Fitzgerald*, 255 BR 807, 810-11 (2000) (“*Fitzgerald II*”) citing *BFP*, 511 U.S. at 538. In essence, *BFP* creates a protective zone within which transfers are deemed to have occurred in exchange for reasonably equivalent value using procedural protections rather than fair market value as the criteria for admission into the zone.

C. CASE LAW FROM THE STRICT FORECLOSURE JURISDICTIONS

Vermont and Connecticut are the only two jurisdictions that utilize a strict foreclosure process. There is no case law in Vermont determining whether transfers effected under the strict foreclosure process may be avoided as fraudulent conveyances, or put another way, whether following the procedural mandates of the strict foreclosure process creates a presumption of reasonably equivalent value. The Connecticut bankruptcy court is split on the question of whether its strict foreclosure statute guarantees admission into the protected zone.

First, the Connecticut bankruptcy court (Weil, J) ruled that a debtor’s filing of an adversary proceeding seeking the avoidance of a transfer effected under the Connecticut strict foreclosure statute constituted

“cause,” under 11 U.S.C. §362, for denying the creditor - mortgagee’s motion for relief from stay, In re Fitzgerald, 237 BR 252 (Bankr. Conn. 1999) (“Fitzgerald I”). Approximately one year later, the Connecticut bankruptcy court (Krechevsky, J) entered an order noting its agreement with Fitzgerald I in the context of motions for relief from stay, but going on to hold, in the context of an adversary proceeding squarely presenting the issue, that a judgment of strict foreclosure entered in accordance with Connecticut law conclusively established that “reasonably equivalent value” was received and precluded the debtors from challenging the foreclosure judgment as fraudulent under 11 U.S.C. § 548. In re Talbot, 254 BR 63, 71 (Bankr. Conn. 2000). Then, just two months later, the Connecticut bankruptcy court (Weil, J) decided Fitzgerald II, taking a position diametrically opposed to Talbot, denying the creditor- mortgagee’s motion to dismiss the debtor’s complaint precisely on the basis that the creditor-mortgagee’s compliance with the Connecticut strict foreclosure procedures does not conclusively establish that the debtor-mortgagor had received “reasonably equivalent value.” In re Fitzgerald, 255 BR 807, 814 (2000) (“Fitzgerald II”). Fitzgerald II relies primarily upon an analysis of the Connecticut fraudulent conveyance statute and a finding that a judgment of strict foreclosure does not constitute a determination that the debtor did not have substantial equity in the property. Interestingly, the debt, property value and equity figures in the Fitzgerald cases and the Talbot case were almost identical, being approximately \$157,000, \$137,000 and \$20,000 respectively. Nothing in the facts of either transfer shocked the conscience. Rather, the different outcomes appear to turn on how much weight each of the judges’ assigned to the procedural safeguards built into the Connecticut strict foreclosure scheme. The Court finds these cases instructive and borrows from their rationale in evaluating the Vermont strict foreclosure procedure.

The Connecticut strict foreclosure statute is summarized by the Fitzgerald I court and then relied upon in Fitzgerald II and Talbot. In order to be certain that this Court is describing accurately Connecticut’s strict foreclosure process the Connecticut bankruptcy court’s description is set forth in full:

Connecticut is considered a "title theory" state wherein the mortgagor pledges property to the mortgagee as security for a debt and conveys "legal title" to the mortgaged premises; the mortgagor retains "equitable title" or the "equity of redemption." The equity of redemption permits the mortgagor to regain legal title to the mortgaged property upon satisfying the conditions of the mortgage, which usually entails the payment of the mortgage debt in full.

An action to foreclose a mortgage of real property is commenced by the service and filing of a complaint for foreclosure. **The mortgagee's motion for judgment must be served with a copy of an appraisal report stating the value of the subject property. Connecticut provides for the foreclosure of a mortgage of real property by either public sale or by strict foreclosure. The property is foreclosed by strict foreclosure unless the court orders foreclosure by sale. Conn.Gen.Stat. § 49-24. The foreclosure court has the discretion to order foreclosure by sale on the motion of a party if there is**

"substantial equity" in the property for the mortgagor or junior encumbrancers.

If strict foreclosure is ordered, the court, in its discretion, sets the redemption period, or "law day", for the owner of the equity of redemption, and directs that "subsequent days be given subsequent encumbrancers in the inverse order of their priorities." **When there is little or no equity in the property, the redemption period is short. In cases where there is equity in the property but foreclosure by sale has not been ordered, a longer redemption period may be set by the foreclosure court in its discretion. Such longer redemption period is intended to give the mortgagor an opportunity to pay the mortgage debt by selling the property or refinancing the mortgage debt.** Prior to the passage of each "law day", each respective defendant in the foreclosure action may redeem the property (and obtain title thereto) by paying the foreclosing mortgagee in full. The passing of the first law day without redemption by the mortgagor extinguishes the mortgagor's right of redemption and unconditional legal title vests in the "redeeming encumbrancer" or, if none, the mortgagee. The redeeming encumbrancer, if any, or the mortgagee is required by statute to file a certificate of foreclosure asserting "absolute" title. Conn.Gen.Stat. § 49-16. Consequently, the mortgagor is divested of equitable title and the ability to obtain legal title, and has no remaining title or interest which he may convey.

Fitzgerald I, at 9-10 (emphasis added, internal citations omitted).

The Talbot court emphasized that there was an essential state interest at stake in the determination of whether transfers through strict foreclosure were entitled to a presumption of reasonably equivalent value. The Talbot rationale was concise and methodical: first, the state's interest in the security of the titles of property transferred under strict foreclosure proceedings is no less compelling than its interest in titles transferred by way of foreclosure sales; second, the state courts, not market forces, are entitled to define "value" of the property in the mortgage foreclosure context; and third, the Connecticut statute's provisions for a discretionary redemption period, court oversight of the debt-value ratio, and the debtor's right to move for a sale (even if the mortgage does not contain a sale provision) constitute sufficient safeguards to bring the Connecticut strict foreclosure process with zone of protection erected by BFP. While this Court finds that reasoning sound, it also finds that this may be reconciled with Fitzgerald I & II for the purpose of scrutinizing the Vermont strict foreclosure process.

This Court offers no analysis of the Connecticut statute or the persuasiveness of the conclusions of these cases. Rather, the Court includes them and relies upon them because it finds that, taken together, the three Connecticut cases thoroughly and accurately discern the characteristics any strict foreclosure process needs to include in order to meet the criteria for a presumption of reasonably equivalent value established by BFP. The Talbot and Fitzgerald I & II cases, when read together, appear to be consistent with the proposition

that under BFP, a strict foreclosure process that does not include a discretionary redemption period, court oversight of the debt-value ratio, and the debtor's right to move for a sale (even if the mortgage does not contain a sale provision) is not entitled to a presumption of reasonably equivalent value and requires a case-by-cases analysis of the fraudulent conveyance allegations. (Indeed, the Fitzgerald I & II court holds that even a process including these protections is unworthy of admission into the protective zone of BFP).

The rationale of these three cases, when read together with BFP, convinces this Court that transfers effected under the Vermont strict foreclosure statute are not *ipso facto* entitled to a presumption of reasonably equivalent value. Under the Connecticut scheme, the mortgagee's obligation to file an appraisal report with its motion for judgment, the state court's duty to make a determination as to the amount of equity in the foreclosed property and discretion to order a sale if there is substantial equity in the property, and the state court's discretion to set the length of the redemption period according to the amount of equity in the property are essential to its eligibility for the BFP presumption. The fact that Vermont's strict foreclosure statute lacks all of these protections is likewise fatal to its eligibility for the BFP presumption. For example, under the Connecticut statute, the standard for determining the necessity of a foreclosure by sale is whether the value of the property substantially exceeds the value of the lien being foreclosed. The Connecticut state court must make a specific finding on this point. By contrast, Vermont's process does not set forth any safeguard regarding the difference between the value of the property and the debt owed, and does not provide for a foreclosure sale option unless the mortgage deed provides for a sale and one of the parties requests a sale in the foreclosure pleadings, see 12 V.S.A. § 4531a(a), or there is a written stipulation between the parties see Harrington v. McCarty, 174 Vt 69 (2001).

D. THE SCOPE AND LIMITATIONS OF THIS RULING

The scope of this determination is limited; it is circumscribed to the threshold question of whether strict foreclosure transfers are vulnerable to avoidance or enjoy a presumption of reasonably equivalent value. It holds that such transfers are vulnerable to avoidance as fraudulent conveyances specifically because there are not sufficient protections in the strict foreclosure process to warrant a presumption of reasonably equivalent value under BFP. This Court is not determining that a transfer effected under the Vermont strict foreclosure statute is *per se* avoidable as a fraudulent conveyance. Rather, we hold that since Vermont strict foreclosure transfers occur without the price incentives of a transfer effected by sale and also lack the types of procedural protections offered by the Connecticut strict foreclosure statute, transfers effected via strict foreclosure in Vermont are not entitled to a presumption of reasonably equivalent value. The determination of whether these transfers are avoidable under 11 U.S.C. § 548 must be determined on a case-by-case basis, taking into account not just the debt-to-value ratio but also all the other facts and circumstances surrounding the transfer. See Fitzgerald I, at 264.

There is no question that the finality of real estate titles is of paramount importance and a critical state interest in Vermont. Citibank, N.A. v. Groshens, 171 Vt. 639 (2000). The Court is acutely aware that its determination may open the door to parties challenging strict foreclosure transfers. However, the Court expressly does not find that fair market value and the debt must coincide in order for the sale to survive challenge under a fraudulent conveyance statute, nor speculate as to what portion of strict foreclosure transfers may ultimately be avoided as fraudulent conveyances. The Court leaves to the legislature the question of whether and how to modify the Vermont strict foreclosure statute to incorporate protections sufficient to meet the standards described in BFP so that transfers thereunder are entitled to a presumption of reasonably equivalent value.


In the context of a bankruptcy case, this Court must examine the applicability of the fraudulent conveyance statute against the debtor's right to a fresh start and the each creditor's right to equal treatment. These principles constitute the bedrock underlying the bankruptcy system. By its terms, Vermont's strict foreclosure statute permits an unmitigated windfall to the mortgagor, and that in turn, endangers the debtor's homestead exemption and fresh start, and deprives other creditors (the "bankruptcy estate") from a distribution that they would otherwise receive. This Court must balance the rights of the bankruptcy estate and debtor against the importance of title finality. In so doing, it finds that while it is quite possible for a strict foreclosure scheme to warrant a presumption of reasonably equivalent value, the Vermont statute does not. Accordingly, each transfer that is effected under the Vermont strict foreclosure process and alleged to be a fraudulent conveyance must be examined on a case-by-case basis.

The Court is making no determination with respect to the constitutionality of Vermont's strict foreclosure statute. It is not in issue. It is long settled that the Vermont strict foreclosure procedure is constitutional. The Second Circuit has held that it does not violate due process or equal protection because a mortgagee obtaining possession and selling the property is not required to turn over surplus proceeds to the mortgagor. Dieffenbach v. Attorney General of Vermont, 604 F.2d 187 (2d Cir. 1979).

CONCLUSION

The subject transfer may be avoided as a fraudulent conveyance if the plaintiff establishes all of the elements of the fraudulent conveyance statute. The defendant is not entitled to a presumption that reasonably equivalent value has been paid simply because the transfer was effected pursuant to Vermont's strict foreclosure law. This memorandum constitutes the Court's conclusions of law. The trial on the factual issues shall proceed as scheduled on January 28, 2005.

January 27, 2005
Rutland, Vermont


Colleen A. Brown
United States Bankruptcy Judge