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Connecticut Bankruptcy Court: A Court-Approved Judicial Foreclosure Sale May Be Avoidable as a Preference

Preston v. Nationstar Mortgage LLC (In re Preston), Case No. 24-21009 (JJT), Adv. No. 24-02016 (JJT) (Bankr. D. Conn. Apr. 16, 2025) – Decided April 16, 2025

The Connecticut Bankruptcy Court has held that a properly conducted, court-approved judicial foreclosure sale may be avoidable as a preference in a subsequent bankruptcy case by the borrower if the amount bid by the secured lender is less than the fair market value of the property—even though the U.S. Supreme Court has unequivocally held that such sales cannot be avoidable as fraudulent transfers.

The U.S. Supreme Court's decision in BFP v. Resol. Tr. Corp., 114 S. Ct. 1757 (1994) "does not present an unequivocal, per se bar to a claim that foreclosure may be a preference under § 547."

Caselaw Context:

In 1994, the U.S. Supreme court held that properly conducted mortgage foreclosure sales cannot be avoided as constructively fraudulent transfers under section 548 of the Bankruptcy Code^[1] because such sales inherently cannot be for “less than a reasonably equivalent value” as required by section 548. The court reasoned that “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.”^[2] In so holding, the court recognized that the “fair market value” of the property “cannot—or at least cannot *always*—be the benchmark” for the “reasonably equivalent value” analysis in the forced sale context, because “‘fair market value’ presumes market conditions that, by definition, simply do not obtain in the context of a forced sale.”^[3] Underpinning the court’s holding was a consideration of policy interests regarding the rights of secured lenders and the balance of state and federal law: The court was concerned that that allowing bankruptcy courts to avoid properly conducted foreclosure sales after their conclusion would “disrupt” the “harmony” of state foreclosure law and bankruptcy law and generate a “federally created cloud” on the title to real property purchased at foreclosure sales.^[4]

In the decades since *BFP*, courts across the United States have been asked to apply the reasoning of *BFP* to prohibit the avoidance of foreclosure sales and analogous forced sales^[5] as preferential transfers under section 547 of the Bankruptcy Code. Although section 547 does not require an assessment of whether the debtor received “reasonably equivalent value” in exchange for the transfer as in section 548, in order to be preferential a transfer must enable the creditor “to receive more than such creditor would receive” in a chapter 7 liquidation bankruptcy case.^[6] Section 547’s comparison of the value the creditor received from the transfer to the value of the distribution the creditor would have received in the context of a hypothetical chapter 7 bankruptcy invites consideration of essentially the same question posed in the “reasonably equivalent value” analysis: Did the foreclosing secured lender obtain a windfall at the expense of the debtor’s other creditors?

Courts have reached differing conclusions as to whether *BFP*’s reasoning applies in the preference context. Some courts have held that *BFP* is inapplicable in the preference context because section 547 does not contain the “reasonably equivalent value” language interpreted by the U.S. Supreme Court in *BFP*.^[7] However, other courts have found that *BFP* is controlling and that its underlying policy rationale—that allowing bankruptcy courts to avoid properly conducted foreclosure sales would create an untenable level of uncertainty in title to foreclosed properties—applies equally in the preference context.^[8] In *Preston*, the Connecticut Bankruptcy Court weighed in on this split of authorities.

Facts:

In December 2023, Nationstar Mortgage LLC filed a foreclosure action against individual Erica Preston in the Superior Court of Connecticut.^[9] After Ms. Preston failed to appear, the Superior Court authorized a foreclosure auction sale of Ms. Preston’s residential property in Woodstock, Connecticut.^[10] In accordance with the requirements of Connecticut’s foreclosure statute, a court-appointed appraiser filed an appraisal asserting that the property’s value was \$285,000.^[11]

At the auction, Nationstar's winning bid for the property was for \$146,853—just over half of the property's appraised value.^[12] The Superior Court entered an order approving the sale in July 2024 and Nationstar acquired title to the property shortly thereafter.^[13] Several months later, on October 21, 2024, Nationstar filed a motion in the Superior Court requesting entry of a supplemental judgment order ratifying and confirming the sale in accordance with Connecticut's judicial foreclosure procedures.^[14]

Just two days after Nationstar filed a motion seeking the supplemental judgment,^[15] Ms. Preston filed for chapter 13 bankruptcy protection and commenced an adversary proceeding seeking avoidance of the foreclosure sale as a preferential transfer.^[16] Nationstar sought dismissal of the adversary complaint for failure to state a claim based on the Supreme Court's reasoning in *BFP*, asserting that debtors cannot avoid properly conducted prepetition mortgage foreclosure sales because such sales establish the property's "forced sale" value—meaning that creditors cannot receive more as a result of the foreclosure sale than they would have received in a hypothetical chapter 7 liquidation.^[17]

Issue:

Does the U.S. Supreme Court's decision in *BFP* categorically bar claims asserting that a foreclosure is an avoidable preference under section 547 of the Bankruptcy Code?

Court's Holdings:

No—a foreclosure sale can be a preferential transfer under section 547. In *BFP*, the Supreme Court interpreted the meaning of "reasonably equivalent value"—a term not appearing in section 547 and therefore not relevant to the preference analysis. Instead, "allegedly preferential transfers under § 547 require inquiry into the specific facts underlying the transfer to determine whether a creditor received more as a result of the transfer than it would have received in a hypothetical Chapter 7 liquidation, as this is the standard Congress has imposed."^[18] The bankruptcy court in *Preston* did not invalidate the foreclosure sale: it simply denied a motion to dismiss the preference actions.

What It Means:

- The bankruptcy court in *Preston* joined a line of cases, most of which do not involve foreclosure auction sales, that purport to adopt a plain-language reading of section 547 of the Bankruptcy Code notwithstanding the obvious public policy concerns with allowing bankruptcy courts to invalidate properly conducted foreclosure sales *ex post facto*.^[19]
- The result in *Preston* is more troubling from a policy perspective, because it indicates that a procedurally compliant, court-approved foreclosure auction sale at which competing bids were permitted and the court expressly ordered the consummation of the sale to the highest bidder may be avoidable solely because of the difference between the appraised fair market value of the property and the highest bid.^[20]
- The *Preston* decision also fails to address the U.S. Supreme Court's reasoning in *BFP* that the "forced sale" value of a property is inherently lower than the "fair market value" of the property.^[21] Although the Supreme Court applied this reasoning for purposes of reaching the conclusion that the value received at a foreclosure sale is necessarily

“reasonably equivalent value” for purposes of the fraudulent transfer analysis, the same reasoning should apply in the preference context because a sale of the property in a chapter 7 case would more closely resemble a “forced sale” at a discounted price than full “fair market value” of the property.^[22]

- *Preston* may be distinguishable in bankruptcy cases involving debtors that are special purpose entities (SPEs). It would be logically unlikely, if not impossible, for an SPE to be insolvent for purposes of the preference analysis (i.e., for the SPE’s debts to exceed the value of its property^[23]) and at the same time for the secured lender to have received more from a foreclosure sale than it could have received in a chapter 7 case for the SPE. For most SPEs, the sole material debt is the mortgage and the sole material asset is the collateral. The property is either worth more than the value of the debt (in which case the SPE debtor was not insolvent), or the secured lender did not receive a windfall when it purchased the property at a foreclosure sale (in which case the creditor did not receive more than it would have in the chapter 7 bankruptcy context). Accordingly, courts analyzing forced sales of a SPE debtor’s property may hold that such foreclosures could not possibly be a preference absent very unusual facts.

^[1] See 11 U.S.C. § 548.

^[2] *BFP v. Resol. Tr. Corp.*, 114 S. Ct. 1757, 1765 (1994).

^[3] *BFP*, 114 S. Ct. at 1761. The court further explained that “‘fair market value’ could show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure. But property that *must* be sold within those strictures is simply *worth less*. No one would pay as much to own such property.” *Id.* at 1762 (emphasis in original).

^[4] *BFP*, 114 S. Ct. at 1764-65.

^[5] In *BFP*, the court noted that its opinion “covers only mortgage foreclosures of real estate” and that the “considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different.” *Id.* at 1761 n.3. However, courts have been asked to apply *BFP* to tax lien sales, both in the context of the section 548 fraudulent transfer analysis and the section 547 preference analysis. See, e.g., *In re Hackler & Stelzle-Hackler*, 938 F.3d 473, 479-80 (3d Cir. 2019) (collecting cases).

^[6] 11 U.S.C. § 547(b)(5). Generally, “a transfer may be voided as preferential if it (1) was made to or for the benefit of a creditor, (2) was made for an antecedent debt, (3) was made while the debtor was insolvent, (4) was made on or within 90 days before filing for bankruptcy, and (5) enabled the creditor to receive more than it would have received in a Chapter 7 liquidation proceeding.” *Hackler*, 938 F.3d at 477.

^[7] See, e.g., *In re Villarreal*, 413 B.R. 633, 642 (Bankr. S.D. Tex. 2009) (“Section 547, in straightforward language, requires the avoidance of transfers that allowed the creditor to receive more than the creditor would have received in a hypothetical chapter 7 liquidation. There is nothing in § 547 equivalent to § 548’s ambiguous use of ‘value’” (quoting 11 U.S.C. § 548)); *In re Andrews*, 262 B.R. 299, 304 (Bankr. M.D. Pa. 2001) (determining that “*BFP* has absolutely no bearing on the instant issue concerning whether the Defendant in this prepetition Sheriff’s sale

has received 'more' than that creditor would have received without the foreclosure sale and in a liquidation under Chapter 7 as contemplated by 11 U.S.C. § 547(b)(5)"); *In re Whittle Dev., Inc.*, 463 B.R. 796, 801 (Bankr. N.D. Tex. 2011) ("the application of the Supreme Court's reasoning in *BFP* to section 547 appears misplaced. The Supreme Court's analysis of section 548(a)(2)(A) concerned what, as a matter of law, 'reasonably equivalent value' meant. No such legal issue presents itself in avoidance actions under section 547(b)(5)(A)" (citations omitted)).

[8] *See, e.g., In re FIBSA Forwarding, Inc.*, 230 B.R. 334, 340-41 (Bankr. S.D. Tex.) (*BFP* "controls this decision because its principal rationale is applicable. . . . To hold this foreclosure to be a preferential transfer would create the same problems with state real property title records that would have been created by classifying the transaction as a fraudulent transfer"), *aff'd*, 244 B.R. 94 (S.D. Tex. 1999); *In re Cottrell*, 213 B.R. 378, 383 (Bankr. M.D. Ala. 1996) ("the court finds that [*BFP*] is equally applicable to both kinds of avoiding powers"); *In re Pulcini*, 261 B.R. 836, 844 (Bankr. W.D. Pa. 2001) ("Although *BFP* dealt with § 548(a), not § 547(b), we believe that the rationale of *BFP* applies . . . with equal force. . . . What is at stake is the essential sovereign interest in the security and stability of title to land").

[9] *Preston v. Nationstar Mortgage LLC (In re Preston)*, Adv. No. 24-02016 (JJT) (Bankr. D. Conn. Apr. 16, 2025) (hereinafter "*Preston*") at 2.

[10] *Id.*

[11] *Id.* at 2.

[12] *Id.* at 2.

[13] *Id.* at 2-3.

[14] *Id.* at 3.

[15] Notwithstanding the pending adversary proceeding, the Superior Court entered the supplemental judgment ratifying and confirming the sale on November 4, 2024. *Id.* at 3.

[16] *Id.* at 1. Ms. Preston also sought avoidance of the foreclosure sale as a fraudulent transfer, but the bankruptcy court dismissed the fraudulent transfer claims for the reasons stated in *BFP*. *See id.* at 19-20. Further, Ms. Preston asserted a claim against Nationstar for unjust enrichment in connection with the foreclosure sale, but the bankruptcy court dismissed the claim on the basis that it did not have subject matter jurisdiction to review the state court's order authorizing the foreclosure sale. *See id.* at 9-12.

[17] *Id.* at 4.

[18] *Id.* at 24-25.

[19] *Id.* at 24-25 (acknowledging "the public policy concern that permitting noncollusive foreclosures conducted in accordance with state law to be avoided as preferential transfers will result in calamity" but observing that "Congress can certainly rectify such a calamity"); *see also, e.g., Villarreal*, 413 B.R. at 642 (observing that "the Court may not ignore Congressional

language in favor of judicial policy”).

[20] By comparison, many of the other decisions that read *BFP* narrowly involved nonjudicial foreclosures (which do not involve the same level of court oversight as in the Connecticut judicial foreclosure at issue in *Preston*) or tax foreclosure sales pursuant to state laws that do not require public auctions. See, e.g., *Villarreal*, 413 B.R. at 633 (nonjudicial foreclosure in which there was no appraisal of the property’s value until after the sale concluded); *In re Smith*, 811 F.3d 228, 238 (7th Cir. 2016) (court observing that in the context of an Illinois tax sale with bidding limited solely to the penalty interest rate on the lien, rather than the value of the property, there was no correlation between the sale price and the value of the property and so *BFP* was not applicable).

Additionally, judicial foreclosures should theoretically have a lower likelihood of being avoidable than other types of forced sales due to the possibility that the *Rooker-Feldman* doctrine or principles of res judicata and collateral estoppel would apply to prohibit the bankruptcy court from second-guessing a prior state court’s order—but the *Preston* court considered and rejected these arguments with respect to Ms. Preston’s fraudulent transfer and preference claims, finding that the avoidance action claims brought in Ms. Preston’s adversary proceeding were not the same claims at issue in the state court judicial foreclosure proceeding. See *Preston* at 9, 14, and 18.

[21] See *BFP* at 1762.

[22] Cf. *Cottrell*, 213 B.R. at 383 (Bankr. M.D. Ala. 1996) (noting that “the value at foreclosure by [the secured creditor] establishes the ‘forced sale’ price, a price which would undoubtedly be duplicated by a trustee in a ‘forced sale’ in bankruptcy” and also observing that under the circumstances a chapter 7 trustee would have elected to abandon, rather than sell, the property and the secured lender would have foreclosed anyways); but see *Villareal*, 413 B.R. at 639 (asserting that “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.”). *Villareal* involved a nonjudicial foreclosure sale, however, and thus the sale was not required to follow the same level of value-preserving procedural protections as the Connecticut judicial foreclosure sale at issue in *Preston*.

[23] For purposes of the preference analysis, “insolvency” is defined in section 101(32)(A) of the Bankruptcy Code using a “balance sheet” test: The “sum of such entity’s debts” must be “greater than all of such entity’s property, at a fair valuation.” 11 U.S.C. § 101(32)(A); see also 5 Collier on Bankruptcy ¶ 547.03[5] (discussing the solvency analysis for preference avoidance actions). Insolvency is measured at the time of the alleged preferential transfer. See *id.* (“It is clear from the terms of 11 U.S.C. § 547(b) that the determination of insolvency must be directed to the time when the alleged preferential transfer was made”). By contrast, a transfer for less than reasonably equivalent value may be avoidable as a constructive fraudulent transfer if the debtor is insolvent, undercapitalized or unable to meet its debts when they come due. Therefore, a transfer by a balance sheet solvent debtor for less than reasonably equivalent value may be a constructive fraudulent transfer if the debtor possessed “unreasonably small capital” or would incur “debts that would be beyond the debtor’s ability to pay as such debts matured.” See 11 U.S.C. § 548(a)(1)(B)(ii).

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