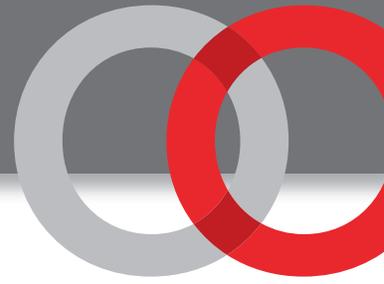


The Importance of Notice in Bankruptcy Sales and Auctions



This article discusses a crucial legal formality that must be met before holding a bankruptcy sale or auction—formal notice of the sale. We will discuss the legal requirements for adequate notice and how satisfaction of the requirements can facilitate an auction and help get the best recovery for creditors.

Under the federal Bankruptcy Code, which applies in all states, the sale of property at auction is not in the “ordinary course of business” and can only be done after notice and the opportunity for a hearing. The seller will usually be either a bankruptcy trustee or the bankrupt company, referred to as the “debtor.” Initially, the trustee or the debtor files a written application with the bankruptcy court seeking court approval to sell the assets at auction. Notice informs creditors and others with a financial stake in the debtor of the sale and gives interested parties a chance to monitor the sale, seek offers, and object to any irregularities. Notice is essential to achieve a true public sale. The notice requirements are set forth in the Bankruptcy Code and in the Bankruptcy Rules. It is usually the debtor’s lawyer that is responsible for deciding who is required to get notice, and for seeing that notice is properly given, that the pleadings are filed with the court, and that the court enters an order authorizing the sale. In addition, the attorney for the trustee or debtor should obtain a court order authorizing the retention of the auctioneer. The auctioneer should receive copies of the court pleadings, the affidavits of service showing that proper notice was given, and of any court orders relating to the auction.

In a bankruptcy case the debtor is required to file written schedules listing all its creditors and all litigation. Even if a claim is disputed or is not yet due it still needs to be listed on the schedules. In some case where management or key employees are no longer working, it may be hard to prepare accurate schedules, which, of course, makes it hard to give proper notice to all creditors. In this situation notice by mail to the creditors should be supplemented by publication of the notice in a newspaper or other journal. Since the auctioneer will probably advertise the auction in any event, there may be advantages in combining the marketing notices/advertisement with a legal notice to creditors. This is frequently done in cases where a business is being sold as a going concern, but it also may be a good approach when significant assets are being sold and there are issues about the ability to give the required notice.

Buyers will want to know that the court order permits the auctioneer to sell “free and clear” of liens, claims and judgments so that the buyer gets good title. This can only be done if proper notice was given to all creditors holding liens, tax liens, security interests or judgments. The auctioneer should discuss the issue with the seller’s lawyer and be prepared to answer questions or to refer the questions to the lawyer. Since questions may arise at the time of the auction, the auctioneer should have available for inspection by bidders copies of the court pleadings and the court order. In chapter 7 liquidations the trustee may have a representative at the auction, in which case any legal or procedural questions should be referred to the trustee’s representative. If there are legitimate issues about whether proper notice was given, it may be better to adjourn the auction (or withdraw the property in dispute from the auction) and ask the bankruptcy judge for a supplemental opinion.

The auctioneer should anticipate any problems that might arise concerning delivery of the assets being sold to the buyer. For example, property being auctioned may be on leased premises, in the custody of a sub-contractor, or held by a third-party for repairs. Any of these parties might assert liens or claims. The auctioneer should alert the debtor and its lawyer as to any property in the possession of third parties. This will enable the lawyer to give proper notice, and, if necessary, obtain an order of the court directing the other party to deliver the property to the auctioneer or the successful bidder. At the time of the initial property inventory the auctioneer should anticipate any problems in later deliveries and let the judicial system handle the problem in advance of the auction. The usual outcome is that the court enters an order directing the turnover of the property to the buyer, and any liens or claims attach to the sale proceeds. This procedure permits the sale of the property and the parties can then litigate in the bankruptcy court over who is entitled to the sale proceeds.

The content of the legal notice of sale is another area where problems can develop if the notice does not fully and accurately describe what is to be sold. The notice should describe the basic proposed transaction and where and from whom additional information can be obtained. It should include the date, time and place of any hearing and must identify the parties whose rights may be affected. In a liquidation of a company it is important that the notice be broad and describe by general category what is being sold. However, if a significant asset is overlooked, it may be



wise to give supplemental notice or go back to the court and ask that additional notice be waived. However, if the overlooked property is subject to a lien or security interest then either supplemental notice needs to be given or the secured creditor needs to consent to the sale in writing. This consent will usually take the form of a court order. If the secured creditor is consenting to the sale, the form of consent should provide that the creditor specifically agrees to pay the auctioneer's fee and expenses out of the proceeds of its collateral that is being auctioned.

The general advertisement of a sale has been held to be a matter of the trustee's discretion. However, unless a private sale is warranted (which is rare), some amount of publicity is necessary to have a sale that is fair to creditors, and a clear lack of notice would be grounds for objecting to the sale. In many cases the seller's lawyer will seek the auctioneer's professional advice on where, how and when to conduct the auction, including specific advice on where to advertise and what type of advertisements are effective for the property to be auctioned. If significant expense is involved

the trustee/debtor may also advise the court on the proposed publicity and seek express approval of any significant expenses. This keeps the judge informed about the progress of the case and also protects the trustee and auctioneer from second-guessing by creditors who have a chance to object to the cost of the proposed advertising.

If proper notice is given and the proper procedures have been followed then the auctioneer is in the position to run an auction where any defects in title have already been cleared up by a federal court order. Naturally, this gives buyers a high level of comfort and may induce them to make fair bids. The auctioneer plays an important role in providing information to other professionals and in managing the auction process to meet the goal of maximizing recovery for creditors.

Disclaimer: This article is solely for informational purposes and does not constitute legal advice.