

Judicial Criteria for Supervising Bankruptcy Auctions



All bankruptcy court auctions are subject to the overall supervision and review of the federal bankruptcy courts. The Bankruptcy Code has specific provisions concerning notice and procedures for approving sales and auctions. However, the standard used to determine the appropriateness of an auction format or court approval of the results of a sale are found in judge-made law and cases decided under the Bankruptcy Code. This article discusses how judicial criteria are applied to auction sales.

Bankruptcy auctions affect the economic interests of the bankruptcy debtor, secured creditors, unsecured creditors, shareholders, and other parties. The result of most bankruptcy auctions is that someone is left unpaid and unhappy, and may complain about the sale procedures, the fairness of the auction, or claim that notice or marketing was inadequate. We will discuss how to anticipate and respond to common complaints, and how auctioneers can assure that auctions run smoothly and are approved by the courts.

Chester Salomon, a New York City attorney specializing in bankruptcy and creditors' rights, says: "Courts have wide discretion to strike a balance between fairness, finality, integrity, and maximization of asset value." Salomon described a Court of Appeals case, *In re Wintz Companies*, 219 F.3d 807 (8th. Cir. 2000). "In *Wintz* the auction procedure for real estate relied on a broker to solicit written bids. The three highest bidders then were given the right to submit additional bids." Salomon says the interesting part of the auction procedure was that the high bidder was given what was called a "last look" right to increase its bid if the bankruptcy court did not approve the high bid as reasonable. "The appellate court held that because the broker's auction was subject to approval by the bankruptcy court as to the adequacy of the purchase price, giving only the high bidder the right to increase its bid was an appropriate way to enhance bidding and protect the buyer from a last minute attack on its bid," says Salomon.

The case illustrates the broad discretion that bankruptcy judges have to approve the format for auctions, including creative bidding incentives. The involvement of a broker/auctioneer enhances the judge's comfort that the sale process is being run by experienced professionals. In many cases the auctioneer will be called as a witness or asked to submit an affidavit describing the marketing process in order to create a judicial record on the fairness and integrity of the sale. In a contested case where objections have been filed, the court will make findings of fact, which will not be overturned on appeal unless found to be "clearly erroneous."

Another example of judicial discretion to approve the sale process involved the attempt of a chapter 7 trustee to quickly liquidate retail inventory of fur garments at a public auction. When the debtor objected to a public auction, the court instead approved a going-out-of-business or "inventory reduction" sale, using a court-appointed manager, as the best way to maximize value while being fair to both creditors and the debtor. Operating trustees will often look to experienced auctioneers for professional advice on the best way to sell assets for maximum value and to minimize risks that the sale will be challenged. While bankruptcy judges are very knowledgeable about the sale process, they do not have the day-to-day working knowledge of market conditions that affect the best way to hold a sale.

Once the bankruptcy trustee has decided who to hire and the best way to conduct the sale, a written application is filed with the bankruptcy court that states both the legal and factual reasons for approving the proposed sale process. If other parties have questions or comments about the proposed procedures, it is usually best to sit down and explain why a particular strategy is being followed and to try to satisfy any objections before a court hearing is held. This is not only faster, but saves money by avoiding litigation before the bankruptcy judge. Restructuring advisors may recommend a controlled going-out-of-business sale for some assets along with an auction of other property, and may collaborate with local auctioneers depending on the type of property, where the property is located, and whether buyers are local or national.

When planning a bankruptcy auction the auctioneer should create a written record of the reasons for adopting a particular sale or marketing strategy and should also preserve the records showing how and to whom the property was marketed. This planning process is usually undertaken as a joint effort with the bankruptcy trustee and the trustee's lawyer. While the goal is always to get the best auction price in a reasonable time, an equally important goal is to create a record showing the court that the sale process was fair, done on proper notice, and that the property was reasonably marketed to maximize recoveries. The court needs to be able to rely on the factual record as part of the basis for approving sale procedures and, ultimately, approving the sale. Also, following the proper procedures and insuring that there is a proper record gives buyers assurance that the sale will be final and not subject to later attack on appeal.

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