



TECHNOLOGY

Selling Bankruptcy Estate Assets On the Internet

By Warren E. Agin

Internet sites, particularly online auctions, provide new tools for liquidating bankruptcy estate assets. These tools, properly developed and monitored, will improve recoveries on estate assets and broaden trustees' ability to liquidate such estates.

Historically, trustees have relied on local "brick and mortar" auction houses to liquidate property of bankruptcy estates. All the advertising and marketing was left to the auction house and its local/regional client base. Selling assets with marginal or uncertain value is risky using an auction house, because they charge auction and advertising fees regardless of the auction result.

Trustees often abandon such assets because they lack a mechanism to efficiently market those assets and make a sale. Alternatively, the trustee will attempt to market these assets to a small group of potential purchasers with whom he or she has had previous contact. At best, trustees receive only a highly discounted sale price for such assets.

The Internet expands trustees' sale options, creating new value from old techniques. By its very nature, the Internet substantially increases the number of people who know about and can participate in an asset sale. Internet auction sites attract large numbers of

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COMPENSATION IN BANKRUPTCY

Perks and Parachutes: Severance, Bonuses And Other Employee Payments in Chap. 11

By Shari Siegel

When a company files for protection under Chapter 11 of the Bankruptcy Code, its management and other employees normally stay in place. Postpetition salaries are generally paid in the ordinary course of business. Absent a court order, compensation claims for work performed prepetition would not be paid until a reorganization plan is confirmed.¹ Therefore, to preserve employee relations, one of the first motions (or set of motions) a new Chapter 11 debtor usually presents to the bankruptcy court is a motion seeking an order permitting the debtor to pay current salary and benefits without holding back compensation for prepetition work.

It is in this context that the debtor's management may first become aware of the distinctions and restrictions applicable to compensation and benefits in the Chapter 11 context. There are, however, numerous ways in which a debtor's relationships with its employees, particularly employees with individually negotiated contracts, are affected by its status as a Chapter 11 debtor.² Employees may find that golden parachutes,³ severance packages and other such devices do not afford them as much protection against termination by an employer in Chapter 11 as they thought. Moreover, retention or other bonus programs must be re-evaluated in the context of a Chapter 11 case. This article summarizes the key issues that affect golden parachutes, severance packages and bonus programs in Chapter 11 and outlines the standards for court approval of postpetition severance and retention programs.

Prepetition/Postpetition Distinction

The distinction between prepetition and postpetition creditors is one of the most critical distinctions made in the bankruptcy context. Creditors are entitled to receive distributions on their claims in the order of their claims' respective priorities. Because postpetition (or "administrative") creditors are generally accorded higher priority of payment than prepetition creditors, whether a claim is considered pre- or postpetition may determine when it is paid and whether it is paid in full. Moreover, the aggregate amount of administrative claims against the debtor will affect its ability to confirm a reorganization plan,

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estate to make its point, stating: "What these examples show is that line drawing is often required in the law and at the boundary, the appearance of unfairness is unavoidable. Simply pointing out that some arbitrariness occurs is not a compelling objection."

The Court also points out that any perceived unfairness in its ruling cuts both ways. When there is some nominal value in the property to support the junior lien, preventing modification of the partially secured mortgage, "Any unfairness in that circumstance falls on the debtor."

Finally, the Court points out that its result is consistent with the treatment that inures to the lender in a Chapter 7 case, because the debtor is discharged from personal liability for the debt while the junior lender retains its lien on the collateral for whatever value the lender may realize in any subsequent foreclosure process based on *Deusnup v. Timm*, 502 U.S. 410 (1992).

One point specifically not decided, and which is noted at the end of the opinion, is the appropriate valuation date. The Court points to a conflict in the case law and to the language of § 506(a), which provides the Court with substantial discretion in this regard. This is one area where Chapter 13 practitioners may benefit from a review of Chapter 11 confirmation case law dealing with the appropriate date to value collateral for plan confirmation purposes.

Beyond the valuation date issue, another practical issue of concern to a practitioner in this area is that for the stripoff of the wholly unsecured junior lien to succeed, the debtor must complete performance of the confirmed plan and receive a discharge. If the case is dismissed, then § 349 restores the parties to the status quo ante under applicable nonbankruptcy law. If the case is converted to a Chapter 7, then the rule of *Deusnup* applies and the lien will survive the debtor's discharge unaffected by the bankruptcy.



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interested buyers, and usually include systems to notify customers of auctions by e-mail. The Internet enables trustees or fiduciaries to post due diligence information online, reducing reproduction and distribution costs. It has built-in efficiencies that allow lower entry fees. In addition, it eliminates the middleman, which increases sale prices and reduces sale costs.

Several web sites now allow asset listings, letting trustees broaden the potential buyer population. The listing site run by the National Association of Bankruptcy Trustees (<http://www.nabt.com>) is free to members of that organization. A new commercial site, Bankruptcy-assets.com (<http://www.bankruptcyassets.com>) provides listings for a relatively nominal fee. Some bankruptcy courts, such as the bankruptcy court for the District of Massachusetts, post asset sale notices on their sites.

Internet Auctions

Internet asset listing sites can help offline sales produce better results, but Internet auctions will revolutionize how trustees sell bankruptcy estate assets. More than 150 auction sites, such as eBay (<http://www.ebay.com>), operate on the Internet, providing new methods to efficiently sell property to an international audience. Internet auctions specializing in insolvency liquidations, like Silver Spring, Md.-based bid4assets.com (<http://www.bid4assets.com>), are designed to meet bankruptcy estates' and

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lenders' special needs.

Like the NABT site and bankruptcyassets.com, bid4assets.com focuses on bankruptcy work. Unlike those two sites, bid4assets.com offers a fully functional online auction process and designs and implements additional marketing for individual asset sales. Additionally, bid4assets.com combines bankruptcy assets with similar assets from government agencies and financial institutions—thereby creating a one-stop shopping location for special assets.

The power of an online auction to sell bankruptcy estate assets was demonstrated for the first time in the AtlanticRancher Company Inc bankruptcy case, in the U.S. Bankruptcy Court for the District of Massachusetts. AtlanticRancher, a catalog clothing company, also sold its product line through a Yahoo! web site. An attempt to sell the business as a going concern attracted an offer of less than \$300,000. After its Chapter 11 bankruptcy case converted to a Chapter 7 case, the trustee decided to auction the company's inventory over the Internet with the help of FairMarket Inc. of Woburn, Mass. Outside the bankruptcy context, FairMarket provides the machinery for Internet auction sites run by companies like Dell Computer and ZDNet.

In the AtlanticRancher case, FairMarket downloaded pictures and marketing descriptions of the clothing from the existing web site and developed a branded auction site just to auction AtlanticRancher inventory. The trustee could select the actual items submitted for auction and control factors such as the reserve price, payment terms and auction terms. FairMarket also advertised the auction using its and the debtor's existing customer lists. The result was an auction process directly under the trustee's control and easily supervised by the court. The auction was more successful than predicted, generating revenue in excess of \$900,000.

Another Internet success story occurred in the Websecure Inc. case, also before the U.S. Bankruptcy Court for the District of

Massachusetts. No. 98-1316. The Chapter 7 estate included 15 domain names. After a year, the trustee had obtained no offers for the domain names and was ready to abandon them. bid4assets.com was selected to auction the domain names over the Internet. It conducted a global search of companies with any derivation of the words in the domain names and contacted them through phone calls, e-mails and faxes.

The auction was scheduled to close at 4 p.m., Jan. 19, 2000. At 4, one package of five domain names had received a bid of \$5,200. The bid4assets.com auction mechanism kept the auction open until one hour passed without a bid, and so the auction continued past the closing time. At the end of the auction, the domain names sold for \$28,000. The bidders, a major European radio station group and an Australian entertainment company, would never have been contacted and would not have been able to participate, but for the Internet.

Internet auctions possess a number of attributes that make them superior to traditional auctions. A traditional auction requires the participant's physical presence at the auction location at the time of the auction. Online auctions allow anyone with an Internet connection to participate.

Another advantage of most online auction mechanisms is their ability to run over an extended period of time, such as a week or even longer. During the auction period, participants can continue to access the auction on the Internet and place a bid.

Online auctions are also very efficient, because the web sites run software that automates the auction process through online bidding. Thus, the expense per transaction can be relatively low, and auctioneers can accept fees based solely on the auction's success.

When seeking approval to sell assets using an Internet auction, practitioners should remember that the issues relevant to traditional auctions remain relevant to Internet auctions. However, generalized

Internet auction sites, such as eBay (the most popular Internet auction) were not developed for the liquidation market and may not fit the needs of the bankruptcy process or the particular sale. Internet auctions fit many molds, and trustees must select the proper auction mechanism. Right now, additional attention is required in the approval process. On the positive side, although Internet auctions are new, the court approval process remains largely unchanged. Many of the issues are the same, just cast in a new light.

Obtaining Approval for The Internet Auction

The requirements that the Bankruptcy Code places on "professional persons" raise an important issue. Internet auctions, being highly automated, will have difficulty complying with the required affidavit, fee application and approval processes.

Most Internet auctions use automated listing and payment processes that do not accommodate Bankruptcy Code requirements. For example, eBay automatically charges fees against a credit card provided prior to the auction. bid4assets.com, on the other hand, addresses this issue by agreeing to provide statements when required and otherwise complying with Bankruptcy Code requirements. It also includes clear disclosures when sales are subject to bankruptcy court approval. However, strict compliance with 11 U.S.C. § 327 may not be necessary.

Automated online auctions do not fit the mold of the professional auctioneer, who brings personal service and talent to the process. Instead, the trustee does the work of controlling the auction. Courts could treat the online auction, not as an "auctioneer," but as a sales tool, similar to an advertisement, that the trustee can pay for without the prerequisite of a fee application.

The motion for approval should address the Internet auction's ability to deal with other special issues, important to the bankruptcy process, that traditional auctions

take for granted. These include:

- **Disclose bidders' identities.**

With a traditional auction, bidder identities are disclosed. With Internet auctions, a bidder can hide its identity behind a registration name. For example, well-publicized instances exist of eBay auctions receiving fraudulent bids. This practice can easily lend itself to abuse in the bankruptcy context. The Internet auction should, at a minimum, require that bidders provide true and accurate information about themselves when registering to bid.

- **Prequalify bidders.** At a traditional auction, bidders must often provide proof of funds at the time of the auction. In some cases, such as the sale of a business, the trustee may require more stringent bidder prequalification. These mechanisms can be incorporated into Internet auctions. bid4assets.com, for example, has adopted mechanisms to allow bidders to escrow deposits as a condition of bidding.

- **Accept non-Internet bids.**

Not everyone is on the Internet. All interested parties must have access to the auction to ensure fairness and satisfy due process requirements. Most Internet auctions do not provide an easy mechanism for receipt of "off-line" bids. bid4assets.com resolves this problem by allowing trustees to forward offline bids, which the bid4assets.com staff enters into the auction system.

- **Allow "as is" sales.** Trustees need the ability to sell assets "as is" and without warranty. The Internet auction must communicate this to potential bidders and allow sellers to waive all warranties.

- **Provide due diligence materials.** An Internet auction allows a seller to provide substantial due diligence materials online. Thus, bidders can quickly and easily evaluate the value of the asset, resulting in better bids. bid4asset.com assists trustees in scanning due diligence materials and placing them on the bid4assets.com web site. With auction sites like eBay, the trustee will have to scan the materi-

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als, post them on his own web site and link that site to the eBay auction listing.

Otherwise, the approval issues are similar to those relevant to a traditional auction. The motion should address the use of minimum bids and reserve prices, which most Internet auction mechanisms allow. While minimum bids and reserves can protect the price, some online auction sites have discovered their customers obtain better results when minimum bids and reserves are not used.

The motion should disclose the terms agreed to by sellers and buyers, known as terms of service, and the mechanics of the auction process. Unlike a traditional auction, the web site's terms of service will control the auction, perhaps supplanting the terms set by the court. A specialty site like bid4assets.com will recognize a bankruptcy court's authority over the auction process and its jurisdiction over disputes. A traditional auction site, like eBay, might not. The auction listing should provide bidders with notice of the bankruptcy court's jurisdiction and access to the official sale notice.

The motion should discuss the auction site's fee structure. Some auctions charge more for preferred listings: Does the trustee want authority to pay for preferred listing? Will the auction site abide by the court's local rules governing auction procedures and auctioneer payment? For example, the bid4assets.com site automatically generates auctioneer's reports for filing with the court.

The auction notice should address the dates for the auction and the length of the auction. One advantage of Internet auctions is their ability to last over several days, or even months. The bid4assets.com auction site even provides a "preview" mode, allowing a trustee to give advance notice of the auction and generate interest during the court approval process.

Future of Bankruptcy Auctions

Despite the extra attention initial-

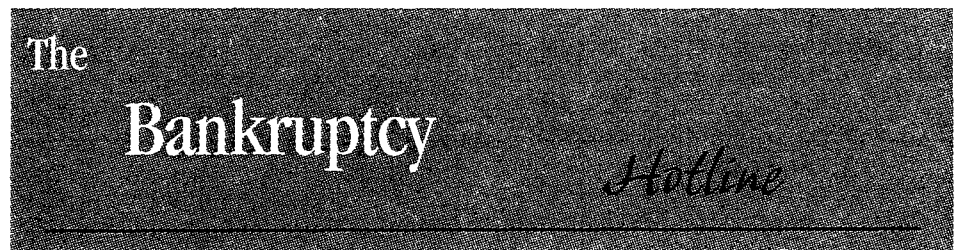
ly required to assess a motion to sell estate assets on the Internet, the advantages make the effort worthwhile. The Internet provides a superior auction mechanism and forum. Its low entry cost and ease of use allow new uses for auctions.

For example, a trustee can put up for auction items that previously would have been abandoned. Also, an Internet auction can be used in connection with a private sale. Given an offer of \$5,000 for an estate asset, the trustee can auction the asset with a minimum bid of \$6,000. If no bid is received, the private sale is approved at a nominal additional cost to the estate. If a better offer is obtained through the auction, the asset is sold

through the auction. In some cases, the trustee may be able to negotiate an auction fee based on the sale price in excess of the minimum bid. Similarly, an Internet auction could be used for complying with the U.S. Supreme Court's decision in *Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. Partnership*, 1999 WL 257631 (May 3, 1999).

While Internet auctions seem strange and complex now, that will change. Eventually, as specialized Internet auction mechanisms like bid4assets.com grow and develop, approving Internet auctions will be as routine a task as approving traditional auctions today.

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DISCLOSURE

Law Firm Owed No Duty To Disclose It Hired Judge's Clerk

A law firm does not owe a duty to its client to disclose that it hired the law clerk of a judge before whom it was appearing in a pending matter, the U.S. Court of Appeals for the Ninth Circuit has held, affirming a lower court ruling. *First Interstate Bank v. Murphy, Weir Butler*, No. 99-15410, (April 20).

A law firm represented two secured creditors in a Chapter 11 proceeding. Unbeknownst to the partner assigned to this matter, the firm hired the presiding judge's law clerk for employment at the end of the clerkship. It was later learned that the "Chinese wall" was not secure because the law clerk continued to have some contact with the case. The judge ruled in favor of the secured creditors, but later recused herself on the debtor's motion after learning about the clerk's relationship with the firm.

A new trial before a different judge was conducted, resulting in

a decision with which the clients were not as happy. Consequently, the law firm was sued for malpractice. The district court held it was not foreseeable that hiring the law clerk without disclosure would ultimately result in the original judge's recusal, because judges and law clerks are required to preserve the court's impartiality and the appearance of impartiality. As a result, the counsel had no duty to disclose that the firm had hired the judge's clerk.

The Ninth Circuit affirmed. The court found that under the presumption of judicial impartiality, it was not reasonably foreseeable that the law clerk would continue to work on the law firm's matters in violation of the Code of Conduct for Law Clerks; that the judge would fail to screen off the law clerk completely, in violation of the Code of Judicial Conduct; and that the conduct of both the judge and the law clerk would amount to an appearance of impropriety such as to require recusal. The court reasoned that because judges and their law clerks are in the best position to prevent impropriety, it would