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General Rules for Liquidation of Bankruptcy Debtor's Property

General Rules of Sale of Bankruptcy Debtor's Property

- Basic goal of the bankruptcy procedure is **settlement of bankruptcy creditors**
- In regular order of events in bankruptcy procedure, that goal is achieved by **liquidation bankruptcy debtor's property** and distribution of proceeds (art. 2, par. 1)
- The goal of the bankruptcy procedure, in exceptional cases, can also be achieved by **reorganization** of bankruptcy debtor (art. 2, par. 2), but only if the assembly of creditors decides so
- In case of settlement of claims through reorganization, the assembly of creditors must make that decision at the reporting hearing

Decision on Sale

- Sale of bankruptcy debtor's property is **legal obligation**, and it requires a decision neither from bankruptcy judge nor assembly of creditors at the reporting hearing (art. 101, par. 1)
- In the reporting hearing, the assembly of creditors has the right, according to article 98, par. 2, to decide **not to sell** the property, but to approach designing plan for reorganization of bankruptcy debtor
- Unless the decision from article 98, par. 2 has been made, then by the force of the law, **and not of bankruptcy judge's decision**, bankruptcy trustee approaches the sale of bankruptcy debtor's property immediately after the reporting hearing (101, par. 1)
- **CONCLUSION:
COURT DECISION ON SALE IS NOT NECESSARY!**

Question: What does bankruptcy trustee indicate as his/her basis for sale (when advertising for example?). Article 101, par. 2?

Terms and Method of Sale I

- According to LEP, **terms** of sale are considered the value, price, deadline, special terms to be met by the buyer etc (art. 85 of LEP)
- The **method**, according to art. 84 of LEP, means public auction and direct settlement (but institutions of bankruptcy procedure are not limited just to these methods)
- Terms and methods of sale of bankruptcy debtor's property are determined by the **assembly of creditors in the reporting hearing** (art. 99, par. 2), except for property encumbered by secured rights (art. 38, par. 1), when real property is sold according to the rules of the enforcement procedure (art. 102), i.e. rules set in art. 103 through 107, for pledged personal assets
- Unless the assembly of creditors determines method and terms of the sale, rules of the enforcement procedure are applied to **real property** (art. 99, par. 2, related to article 102), regardless whether it is pledged or not
- Unless there is a decision of the assembly of creditors on liquidation of **personal** assets, bankruptcy debtor determines terms and method of sale of personal assets pledged, and if the items are unencumbered, the rules are given in articles 103-107.

Terms and Method of Sale II

- Based on article 99, par. 2, the assembly of creditors can decide on the sale:
 - in enforcement procedure
 - in enforcement procedure with modification of rules of that procedure (with respect to minimum price, number of hearings, payment deadline etc)
 - in any other way (public auction with own rules, gathering written bids, free settlement), and under any terms (minimum price, payment deadline etc)
- The most rational solution would be for bankruptcy trustee to propose adopting method and terms of sale to the assembly in the reporting hearing, already in his/her report on financial position of debtor

Terms and Method of Sale of Encumbered Property

- Assembly of creditors cannot set the terms and method of sale for **encumbered property of bankruptcy debtor**, since, according to article 38, par. 1, that property can only be sold in accordance with articles 102 through 107 of the law
- The result of that is that real property encumbered by collateral can be sold only according to the rules of the enforcement procedure (art. 102), whereas for personal assets, bankruptcy trustee can choose the method of sale (public auction or settlement – art. 103, par. 1)
- QUESTION: Can secured creditor change the rules of sale (enforcement procedure), and who then decides on that, the creditor or assembly of creditors?
- From the legal text, since the rules of the enforcement procedure are applied, the result is positiv answer to this question, and the secured creditor and trustee decide on that according to the rules of article 84, par. 4 of LEP

Who Sells the Property of Bankruptcy Debtor?

- Entire property of bankruptcy debtor, encumbered or not, is **sold by bankruptcy trustee** (art. 101, par. 1)
- The option to have the judge perform the sale of real property in bankruptcy, because article 102 stipulates that real property is sold in accordance with provisions of enforcement procedure, is based on obligation of literal application of LEP, where sale of enforcement items is performed by an enforcement judge.
- If, based on this option, provisions of LEP must be literally applied, must then, based on article 102, the following institutions of enforcement law be applied:
 - -third person objection
 - -coverage objection
 - -debtor's objection and appeal against that decision
 - -counter enforcement
 - -stay of enforcement
 - -withdrawal of the motion for enforcement option etc

Literal Application of LEP – in Bankruptcy on the Basis of Article 102 of BL?

- Literal application of LEP would mean that in bankruptcy all of these institutions of enforcement law are applied, from motion for stay to coverage objection
- Since, surely, some of the institutions of enforcement law cannot be applied to bankruptcy procedure literally, it is then clear that article 102 can only speak about appropriate application of LEP, where it is no longer necessary for sale of real property in bankruptcy procedure to be performed by a judge

Supervision Over Sale Performed by Bankruptcy Trustee

- Bankruptcy trustee is obligated to start selling immediately after the reporting hearing (art. 101, par. 1)
- Except for sale of property encumbered by collateral, trustee must have approval of board of creditors or assembly of creditors for any significant actions (art. 108), whereas that article does not specify all situations where that approval is required (examples are given)
- If such approval is not given by board or assembly of creditors, it can be given by bankruptcy judge (art. 29 par. 6)
- Every sale is, therefore, under control of assembly or board of creditors, and the judge does not have to control the sale with method and terms, different from rules of enforcement procedure, have been established by the assembly of creditors
- When it comes to the rules of enforcement procedure, bankruptcy judge only has limited role (court practice and appropriate application of LEP)

Role of Bankruptcy Judge in Sale Procedure

- According to article 22, par. 3, bankruptcy judge performs legal supervision over the work of bankruptcy trustee, how is this achieved in sale of bankruptcy debtor's property performed by trustee?
- According to rules of our civil law (ZOSPO art. 68/ ZOSVO art. 73), collateral over property can only cease to exist by settlement of claims, waiver, or based on order on award in enforcement procedure, regardless whether the mortgagee has been satisfied in enforcement procedure or not (art. 74, par. 2 and 93, par. 1 of LEP)
- How is legal control achieved over the work of bankruptcy trustee, and simultaneously delete collaterals in bankruptcy procedure, without satisfaction of claims, or without consent of mortgagee that can not be satisfied from the collateral?

Solution?

- Court bankruptcy practice in certain parts of BiH has already adopted the solution according to which **bankruptcy trustee** sells property according to the rules of enforcement procedure (whether it was so decided by the assembly, or there is secured right, or the assembly made no decision whatsoever on method and terms of sale), and **bankruptcy judge** only issues the **order on adoption of report** of bankruptcy trustee on sale and **order on award**, based on which new owner is registered, and all encumbrances deleted as prescribed by the rules of enforcement procedure
- The solution to have trustee perform all actions in sale, and to transfer ownership rights onto buyer on the basis of classical sales agreement, does not resolve the problem of deletion of collateral which belongs to unsatisfied creditor, because then its collateral can be deleted from the LR only with its consent
- The previous option has no answer either to the question how to exert legal supervision over the sale performed by bankruptcy trustee

What is Being Sold in Bankruptcy Procedure?

- In bankruptcy procedure, trustee can sell entire property of bankruptcy debtor, including property encumbered by **collateral (101, par. 1)**
- In case of sale of pledged **real estates** in bankruptcy procedure, in the name of **lump expenses** of sale in bankruptcy, 5% of realized price goes to the bankruptcy estate with priority (art. 102, par. 4)
- In case of sale of pledged **personal assets** in bankruptcy, expenses of identification and sale of items are settled in fixed amount of 5%, and in case of higher expenses, even more (art. 105)
- Only property and rights of bankruptcy debtor can be sold in bankruptcy procedure

REALIZATION OF RIGHT TO SEPARATE SETTLEMENT

- Mortgage creditor can realize its right to separate settlement before the sale in bankruptcy commences, because one item cannot be sold in two procedures (analogous application of article 73, par.1 ZIP-a)
- Sale in bankruptcy starts with bankruptcy trustee starting the sale (making the sale public – advertisement for example, analogy with registration of enforcement from article 73 of LEP)
- Problem of determining this moment in sale through direct or free sale