

Control, Preservation, and Sale of Estate Assets for the Benefit of Creditors

by

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Section 704(a)(2) of the Bankruptcy Code provides that a chapter 7 trustee shall be accountable for all property received. Chapters 6 and 8 of the U.S. Trustee Program's *Handbook for Chapter 7 Trustees* ("Handbook") provide guidance for complying with this statutory duty. In this article we review these *Handbook* provisions in the context of the trustee's responsibilities to control and preserve estate property until it can be liquidated for the benefit of the estate's creditors.

Controlling and Preserving Estate Property

The *Handbook* notes that the trustee has the duty and responsibility to insure and safeguard all estate property and property that comes into the trustee's hands by virtue of his or her appointment. *Handbook* Chapter 6.B.2. Upon appointment to a case, the trustee should quickly assess whether there are assets that require immediate action to prevent a dissipation of value from damage, theft or other type of loss. In a business case with significant valuable inventory, it may be necessary to change the locks, remove all books and records, obtain insurance or ensure it is continued for the benefit of the estate, redirect the mail and/or hire a guard to watch the premises. A case with perishable inventory requires prompt action to prevent damage from spoilage.

In general, when an asset has value for the estate, the trustee should immediately obtain insurance in an amount sufficient to protect the estate property. *Handbook* Chapter 6.B.2. There are several companies that will insure estate property. If there are no funds for insurance, the trustee can contact the secured creditor so the secured creditor can protect its own interest in the property, or take the necessary steps to liquidate the property as quickly as possible in a reasonable manner.

When an asset does not have value for the estate but could expose the estate to liability, such as from a slip and fall accident in a vacant building, the trustee should promptly abandon the asset pursuant to 11 U.S.C. § 554(a). *Handbook* Chapter 8.D. The trustee should give particular consideration to property of no value to the estate that may be hazardous to the health or safety of the general public. Before abandoning such property, the trustee should take all precautions possible, in light of the available estate assets and after consultation with appropriate federal, state and local authorities to ensure adequate notice and consideration of public policy issues. *Handbook* Chapters 6.B.2 and 8.D.

¹This is the second in a series of articles featuring key provisions of the *Handbook for Chapter 7 Trustees*.

Note that an order granting relief from stay does not automatically constitute abandonment. *Handbook* Chapter 6.B.2. In an individual case, the estate may be liable for any taxable gain from foreclosure after relief from the automatic stay is granted, if the property is not abandoned before the foreclosure sale. *Handbook* Chapter 8.E.

Inventorizing Estate Property

Pursuant to Fed. R. Bankr. P. 2015(a)(1), the trustee must file a complete inventory of the debtor's property within 30 days after qualifying as a trustee, unless such inventory has already been filed. Generally, a debtor's Schedules A and B satisfy the requirements of Rule 2015(a)(1) as long as the trustee can verify at the section 341 meeting of creditors that the debtor's inventory, as shown on Schedules A and B or other documents, is complete. *Handbook* Chapter 6.B.2.

The Individual Estate Property Record and Report (Form 1), maintained by the trustee, may also provide a sufficient inventory of the debtor's assets. Nevertheless, the *Handbook* notes that there may be instances when the trustee will need a more detailed list to administer the assets properly. For example, if Schedule B lists two cars and a truck, the trustee should enter the make, model and year of the vehicles on Form 1. Trustees often find it invaluable to photograph or videotape the inventory; this method has been used to document a debtor's household goods or assets contained in a storage unit.

The timing of the inventory is also a consideration. If the estate includes portable, valuable assets such as jewelry, the trustee should inventory and secure the property as soon as possible. In other instances, it is appropriate to wait until after the section 341 meeting of creditors to conduct an inventory. The trustee should exercise discretion and general business judgment in these matters.

Hiring Others to Secure and Inventory Property

Trustees frequently ask auctioneers or other professionals to observe, inventory and take possession of estate property. The trustee is expected to supervise these professionals to ensure that estate property is fully accounted for and protected against loss. *Handbook* Chapter 8.M.6.

When an auctioneer is inventorying and selling the property, the trustee should be present during the inventory and should attend the auction. To ensure that all assets are accounted for, the trustee should also compare the inventory to the auctioneer's report.

Storing Assets Prior to Sale

The trustee should ensure that personal property is securely and properly stored prior to sale. Debtors should not be allowed to retain the assets until the trustee is ready to sell them. Trustees should promptly take possession or demand turnover if the debtor is not cooperative.

Small assets such as jewelry can be stored in the trustee's safe. Assets should not be stored in the trunk of the trustee's car, as has been reported on occasion--usually after the assets

have been stolen from the trustee's car. Assets can be held in secure facilities by an auctioneer who is bonded and insured. Before the auctioneer takes possession of the property, the trustee must verify that the auctioneer is adequately bonded and insured. If the auction is delayed, the trustee should periodically verify that the assets are on hand and in good condition. *Handbook* Chapter 8.M.6.

General Standards for Asset Sales

The *Handbook* contains a full discussion of general standards governing the sale of estate assets, at Chapters 8.K and 8.M. Here, we highlight two important topics: sales to trustees and related parties, and auction sales.

Sales to Trustees and Related Parties

It is a violation of federal criminal law for a trustee or officer of the court to purchase directly or indirectly or otherwise deal in property of the estate for which the trustee serves. 18 U.S.C. § 154. In addition, while a trustee is not specifically prohibited from purchasing assets administered by another trustee, the practice should be avoided to eliminate any appearance of impropriety. *Handbook* Chapter 8.K.1.

Similarly, sales to professionals regularly retained by a trustee should be avoided. The following individuals are not permitted to bid or to buy property at a private sale or at an estate sale conducted by the auctioneer: a trustee or a professional regularly employed by the trustee, including the auctioneer; a family member of the trustee or professional; or an employee of the trustee or professional. The United States Trustee will object to any proposed sale of estate property to the trustee or a professional regularly employed by the trustee, a family member of the trustee, or an employee of the trustee. *Handbook* Chapter 8.K.1.

Auctions

The trustee must actively supervise auctioneers to ensure that estate property is sold for reasonable prices to independent buyers, auction proceeds are promptly and fully remitted, auctioneers timely submit accurate sale reports, and auctioneer expenses are actual and necessary and paid in accordance with legal requirements. Methods by which a trustee can supervise auctioneers include attending auction sales, reviewing auctioneer reports and reviewing independently reported information. Failure to supervise auctioneers appropriately may result in claims against the trustee individually. *Handbook* Chapter 8.M.6.

The employment of an auctioneer and an auctioneer's compensation must be approved by court order. The auctioneer may not deduct its commission and expenses from the sales proceeds and remit the net amount, unless specifically authorized by court order. If the auctioneer fails to account for or turn over the auction proceeds within 30 days of the auction, the trustee should take immediate action to recover the funds and promptly notify the United States Trustee.

The trustee must also ensure that the auctioneer submits the report of sale required by Fed. R. Bankr. P. 6004(f) upon completion of the auction. If the report has not been provided

within 30 days of the auction, the trustee should request a copy and ensure that it has been filed with the court and the United States Trustee, or as otherwise provided by local rules and practices. This report must contain an itemized statement of the property sold; the name of each purchaser; and the price received for each item or lot, or for the property as a whole if it was sold in bulk. If the auctioneer's report does not account for all of the items on the initial inventory or if items are marked "lost" or "stolen," the trustee should notify the United States Trustee, obtain an explanation from the auctioneer and seek to recover the value of the items from the auctioneer's insurance company or bond, as appropriate.

Conclusion

This article highlights some of the key provisions in the *Handbook for Chapter 7 Trustees* governing the trustee's fiduciary responsibility to be accountable for estate property. We encourage you to review Chapters 6 and 8 of the *Handbook* to refresh your knowledge of these provisions and to ensure that your practices for securing, inventorying, insuring and selling estate assets are in compliance. As always, if you have any questions, please contact your local United States Trustee's office.