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## **Can the Failure of a Secured Creditor to Object to the Sale of Assets be Construed as Implied Consent to such Sale?**

As we all know, Chapter 11 filings often take place to facilitate a sale of select assets of a business or to orchestrate an entire sale of a company or business unit. Chapter 11 of the Bankruptcy Code (the "Code") may be used in this fashion usually where there exists extensive secured debt or significant unsecured payables, and thus the buyers require a "clean bill of health" in the form of a Bankruptcy Court Order approving the sale of assets free and clear of liens and encumbrances. Oftentimes, the sale of assets in bankruptcy may occur in the first few weeks of a case on motion papers served on all creditors. Vigilance by secured creditors is crucial to ensure that the interest in collateral sought to be sold is protected.

Generally, these types of sales are governed by Section 363 of the Code and will be authorized by the Court, even in an expedited fashion, provided that certain requirements are met and certain facts established. Specifically, Section 363(f) of the Code allows for the sale of property of a debtor's property free and clear of liens in certain limited circumstances. The Code provides:

The Trustee<sup>1</sup> may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of any entity other than the estate, only if-

- (1) applicable non bankruptcy law permits sale of such property free and clear of such interest;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. Section 363(f). For purposes of this discussion, we will only focus on Subsection 363(f)(2) of the Code and the question of what constitutes "consent" by a secured creditor to a sale and whether silence or inaction by the secured creditor can be deemed consent. The significance of this interest has significant practical application to secured lenders and equipment lessors. In many instances, a sale of the Debtor's assets is scheduled before a secured creditor engages outside counsel. The result will often be inaction in response to a Debtor's motion to sell assets. This Alert focuses on the "risks of inaction".

In a recent case in Michigan (In Re Roberts), it was argued by the Debtor that the failure by the secured parties to respond to a notice of proposed sale and object to the proposed sale of property free and clear of liens, claims and encumbrances constituted "implied consent" which was sufficient to satisfy the requirements of Section 363(f) of the Code. While, courts in Missouri, Pennsylvania and New Jersey have held that the consent required by Section 363(f)(2) of the Code may be implied by the lienholders' failure to object after notice, the Court in the Roberts case rejected this analysis finding a lack of support for this conclusion. We believe that this conclusion is sound, for the reasons discussed below.

<sup>1</sup>In the context of a Chapter 11, Trustee includes the Debtor.

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As the Court in the Roberts case recognized, the question of obtaining permission to sell assets based upon actual consent as opposed to obtaining authority without a lender's consent if the lender was given notice and an opportunity to be heard, are two separate and distinct concepts. Put more simply, the Court found that a debtor could not satisfy the condition of obtaining consent under Section 363(f)(2) of the Code by simply providing creditors with notice of the sale and an opportunity to be heard on the issue. Rather the Court found that the debtor actually had to obtain written consent for the sale from the secured creditor of an asset subject to a security interest. The Court based its decision on essentially four grounds.

**First**, a review of other Code Sections clearly establishes that had Congress intended the rights afforded under Section 363(f) of the Code to be authorized based solely upon a failure to object, Congress would have so indicated. The Court pointed out that other Sections of the Code, for example, Section 502(b) of the Code, specifically provide that relief under that Section may be obtained upon objection to the Claim after notice and a hearing, with no affirmative consent required. Section 102(i) of the Code defines notice and a hearing to authorize an act if "a hearing is not requested timely by a party in interest." 11 U.S.C. Section 502(1)(A)(i).

**Second**, the Roberts Court found authority for making a distinction between notice and consent in the cash collateral provisions of the Code. Specifically, Section 363(c) of the Code which allows a trustee to use cash collateral if the entity with the interest in cash collateral consents or the Court, after notice and a hearing, authorizes such use. As the Court recognized in In re Roberts, "Congress' juxtaposition of the word 'consent' and the phrase 'after notice and a hearing' in Section 363(c)(2) establishes beyond doubt that these two separate and distinct concepts." 249 B.R. at 156.

**Third**, the Roberts Court pointed out that the courts which have held consent can be obtained through inaction, offer no independent analysis of this concept. See J.A.M. Co. v. Schindler (In Re Salzman) (rejecting the concept of implied consent even in this context); see General Electric Credit Corporation v. Peltz (In Re Flagstaff Foodservice Corp.) (only allowing surcharges where creditors caused expense to be incurred).

**Fourth**, a review of the legislative history of Section 363 of the Code does not reveal any intention other than to give the word "consent" its ordinary meaning. In fact, resort to the common-law meaning of the word consent reveals that it has been defined to require an affirmative act "to give assent" or "approval" American Heritage Dictionary of the English Language, 4<sup>th</sup> Edition, 2000, thereby not including an act secured by omission or inaction. The reason for requiring an affirmative act of consent is clear if the debtor or trustee wishes to avail itself of this extraordinary remedy. Under Section 363(f) of the Code, there exist alternate grounds which will allow a sale free and clear of liens to proceed even absent consent. These other provisions (i.e. Section 363(f)(1), (3), (4) and (5)) allow a sale to continue over the objection of a secured creditor, because these Sections, by definition, indicate a lack of prejudice to the lienholder. In fact, under the other alternatives there are built-in protections such as: (a) the existence of sufficient proceeds to pay all liens in full, or (b) the lienholders are not otherwise prejudiced by the unique nature of bankruptcy (i.e. the lienholder could be compelled to accept this relief even outside of bankruptcy), or (c) the integrity of the bankruptcy process outweighs any detriment to the lienholder (i.e. there is a bonafide dispute justifying allowing a sale to proceed in the best interest of the estate). All of the foregoing either protect, or do not further harm, the lienholder and as such provide justification for omitting consent.

Finally, it should be noted that we believe that some of the confusion in interpreting the notice requirements of Section 363(f) of the Code may arise from the fact that Section 363(b) of the Code in general allows a trustee to sell property of the estate out of the ordinary course of business, requiring objections to such relief to be affirmatively stated. However, it must be realized that the ability to sell "free and clear" is an additional type of relief which has its own independent requirements. See In Re Roberts. As such, the debtors should accordingly be required to obtain affirmative consent before proceeding to sell under Section 363(f)(2).

As a practical matter, the uncertainty in the law underscores the need for secured creditors to take action when confronted with an application by its borrower to sell assets free and clear of liens.

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