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Time For Bankruptcy Auctions To Go Online

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The benefits of buying and selling via an online marketplace include lower information and transaction costs, better prices, and more confidence in a fair deal. Auctions in bankruptcy proceedings are in the relatively early stages of moving online. While multiple sites offer "online auctions" for sales of a range of relatively small-value items, more complex auctions under the Bankruptcy Code still are often conducted in the traditional manner — live and in person in law offices and courtrooms. Recent examples include the Chapter 11 filings of Sports Authority and the Big Apple Circus. An online auction that is designed specifically to meet the needs of all stakeholders can be better than the traditional approach.

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Getting the Design Right: Objectives, Asset Characteristics and Bidders

When deciding which transaction design or bidding format is best, a good place to start is confirmation of the objectives. There is no one design or format that is best in all situations. What works well for eBay may not be the best process or achieve the desired outcomes in other situations. In bankruptcy proceedings, the objectives typically include the following:

- maximize the value of the assets
- attract participation
- minimize information and transaction costs
- achieve the best outcome with minimal time and effort, and
- demonstrate that the process and the outcome were fair and reasonable.

Some bidding formats are better than others in achieving those objectives.

The next step is to characterize the assets being transacted. In more complex bankruptcy proceedings with multiple high-value assets, if the assets are substitutes or complements to each other (which is common), then the traditional in-person approach may not be the best. The bidding format should provide for an effective price discovery process that enables bidders readily to switch among substitutable assets as relative prices change during the bidding and to bid on combinations or packages of complementary assets. This encourages bidders to bid their full valuations on the assets. Some auction designs are better than others at inducing bidders to bid their full valuations when there are multiple assets.

The third step considers the potential bidders. What would motivate bidders to participate? Is there a range of sophistication among them? How many bidders could be encouraged to participate? Another factor to consider is the extent to which the assets are considered “common value” versus “private value” assets. Common value is present when the uncertain value of an asset is correlated among the bidders, while private value arises when the value of an asset to a bidder is independent of the asset’s value to other bidders. There would be no need for an auction absent uncertainty in the value of the assets and who values them the most. Common value gives rise to the “winner’s curse” problem: in order to avoid the risk of paying above-market prices and regretting being the winning bidder, bidders tend to bid conservatively rather than to their full valuations. This can result in winning prices that are lower than they could be and in winning bidders who do not value the assets the most. Thus, the bidding format needs to mitigate the winner’s curse problem. Some formats are better than others at addressing the winner’s curse.

Once the factors above have been determined, the best bidding format can be recommended. For more complex bankruptcy auctions, a structured form of iterative, round-by-round bidding normally is best. There are many ways to implement such auctions, but we suggest that some online auction implementations are better than other auction alternatives at encouraging and making it easier for bidders to express their maximum willingness and ability to pay for assets.

Auction Rules

The rules of the auction should be specified ahead of time and enforced equally for all bidders. All participants should have equal access to information, there should be no ambiguity as to what the bidders are bidding on, and all bidders should be given the opportunity to bid on the same assets under the same terms and conditions. (The assets or terms and conditions can change during the bidding, so long as all active bidders have the opportunity to bid on the new assets and terms and conditions.) Otherwise, bidders may be motivated to game and manipulate the process, and it cannot be demonstrated that maximum value was achieved once the auction is over. Bidders’ efforts should be focused on determining the maximum price they are willing to pay, not on finding loopholes in the process or outguessing and outmaneuvering their bidding competition. A bidder wins simply because no other bidder was willing to pay a price as high as the winning bidder for what the winning bidder was bidding on.

The Mechanics of Moving to an Auction Online

We suggest that a well-designed online auction process for more complex bankruptcy auctions are better-suited than the traditional in-person approach. As part of an effective online auction process, an information website should be set up as a central source of information equally accessible to interested parties. Documents, rules, schedule, background information, frequently asked questions, registration and contact information are typical of the content, which can be updated easily. Registered users can be notified of updates and reminders of deadlines. If necessary, some content can be made available only to registered users who have been provided login credentials.

The bidder qualification process also can utilize a secure, private portal in which prospective bidders can indicate their interest and provide documentation required to meet the qualification criteria. The portal helps to streamline the process and avoid errors and delays. The same portal also can be used to upload document revisions from the bidders and to handle the initial bid process. Submissions are time-stamped and logged automatically, and there always will be a record of the downloads and uploads that can be monitored and reviewed by the bankruptcy court. Bidders can always log into their own accounts and review their history.

The actual bidding can take place online using secure but standard web browsers. Rather than having to travel to a central location, a company's bidding team and advisers can be in their own convenient location. This enables more real-time analysis and decision-making, allowing the bidder to focus only on whether or not it is willing and able to pay the current announced price — i.e., the same price that other bidders are considering paying. This removes much of the emotional, in-person element from the traditional approach. If the auction is designed correctly, emotions are not needed to maximize value and, arguably, emotions can detract from value maximization because they provide a mechanism for bidders to manipulate and send signals to discourage other bidders. What maximizes asset value are the competitive forces among bidders who are focused on one thing: Am I willing to pay a price higher than the current price to beat (i.e., higher than my competitors)?

With online bidding, bankruptcy courts and other stakeholders, as appropriate, can monitor participation and bidding live and continuously. Changes in the assets or terms and conditions, or in the bidding parameters (e.g., price increments) can be made in real time and notified to all bidders instantaneously.

If It's Not Broken ...

We recognize that there may be resistance to some of the suggestions above. The perception may be that there is nothing wrong with the traditional approach of bankruptcy auctions and they seem to work fine. However, many institutions such as stock markets, exchanges and commodity markets (for example, energy, dairy and fruit markets) have successfully transitioned to online platforms. These changes occurred not necessarily because these institutions thought things were broken, but because they believed there was a better way to achieve their objectives, including better and more reliable pricing, a less costly and more efficient process, and demonstrating that the process and outcome were fair, objective and reasonable.

Bankruptcy proceedings seem to be moving in the same direction. We believe it is not a matter of time but rather how fast the changes will be adopted. We do emphasize, however, the importance of appropriate auction design. Too many times, across a range of industries, "auctions" have been tried and have failed — not because of anything inherently wrong with "auctions" but because the particular auction design and implementation were ill-suited for the specific circumstances. There is both an art and science to designing and implementing auctions successfully.

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