Section 6
DOT.COM BANKRUPTCIES

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I. DOT BOMBS?

Having gone public this year, our stock has hit 2.5. I have never seen anything leave a container so quickly, including water. I think we're losing 5 to 10 people a week.

Anonymous dot.com employee, as quoted in the *Boston Globe*, August 28, 2000

Scarcely a day passes without media commentary on the precarious financial position of many fledging dotcoms. Recent headlines have involved Living.com, streamline.com, and a bevy of others. Set forth below are short descriptions of some notable dotcom failures to date, each illustrative of some of the unique challenges dotcoms present for bankruptcy lawyers.

A. TOYSMART.COM and the Privacy Debate

1. Background

Toysmart is a Massachusetts-based company that ranked among the most popular online toy retail sites during the last year. Disney acquired a controlling stake in the company in August 1999 and incorporated the company in its Go.com Internet business. Disney owned 60 percent of Toysmart.com stock and controlled its board of directors. Disney invested approximately $20 million in the company and provided it with $25 million in advertising.

2. Bankruptcy

Strapped with cash flow problems, Toysmart stopped taking orders for its products in May. In June, 2000, creditors filed an involuntary petition against the company in the U.S. Bankruptcy Court for the District of Massachusetts. As part of its Chapter 11 reorganization efforts, the debtor sought Court authority to sell of one of its significant assets, its detailed customer list. The FTC in response to the request sought a preliminary injunction to prevent such an order because selling the customer lists directly contravened the language of Toysmart's own privacy policy:

> At toysmart.com, we take great pride in our relationships with our customers and pledge to maintain your privacy while visiting our site. Personal information

voluntarily submitted by visitors to our site, such as name, address, billing information and shopping preferences, is never shared with a third party. All information obtained by toysmart.com is used only to personalize your experience online.

Word of the controversy spread quickly. In Washington, senators introduced a bill, The Privacy Policy Enforcement in Bankruptcy Act of 2000," which would prevent dotcoms from selling any personal information in violation of the company's privacy policy. The House has also introduced a bill to empower the FTC to commence investigations and actions against online companies that violate their own privacy policies.

On July 20, the FTC voted 3-2 to accept a settlement with Toysmart.com which would permit the company to sell its customer data only as part of the entire business sale to a successor-in-interest. Under the proposed settlement, Toysmart.com is prohibited from selling the data as a separate asset. Moreover, the buyer must also be a company doing business in a related market. Numerous attorneys general have criticized the settlement contending that it should require notification to Toysmart's customers that their personal data is for sale. Other settlement alternatives required specific permission by customers or permitted sale of data relating only to those customers who did not expressly opt out. As of August 30, 2000, the Bankruptcy Court refused to approve the FTC settlement until an actual sale of the customer list is pending before the Court.

3. *The Privacy Statement Debate*

Is it possible to avoid the issues faced by Toysmart.com by changing the company's privacy policy before seeking bankruptcy protection? Can the company draft a "buyer of assets" carve-out into the policy? Is the debtor protected if its web site disclaims that its privacy policy is subject to change without notice, or if it allows consumers the ability to "opt out" of dissmination of customer information? These types of issues are likely to arise in Toysmart.com's wake.

With these issues in mind, compare the privacy policies of Amazon.com and a now-defunct retail website, SaviShopper.com, excerpted below:

From AMAZON.COM

Does Amazon.com Share the Information It Receives?

Information about our customer
ness, and we are not in the busin
customer information only wi
Inc., controls and as described b

- **Affiliated Businesses We**
with our affiliated business
store.com, our Health & Bea
businesses operate stores a
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services, or sell product li
You can tell when another
actions, and we share cust
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- **Agents**: We employ other
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moving repetitive informat
data, providing marketing
payments, and providing c
to personal information nee
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- **Promotional Offers**: Som
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name and address. If you
please adjust your Customer

- **Business Transfers**: As w
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customer information gene
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or substantially all of its a
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- **Protection of Amazon.co**
and other personal informa
propriate to comply with la
Use and other agreements;
safety of Amazon.com, ou
changing information with
for fraud protection and cre

Information about our customers is an important part of our business, and we are not in the business of selling it to others. We share customer information only with the subsidiaries Amazon.com, Inc., controls and as described below.

- **Affiliated Businesses We Do Not Control**: We work closely with our affiliated businesses, an example of which is drugstore.com, our Health & Beauty merchant. In some cases, these businesses operate stores at Amazon.com or sell offerings to you at Amazon.com. In other cases, we operate stores, provide services, or sell product lines jointly with these businesses. You can tell when another business is involved in your transactions, and we share customer information related to those transactions with that business.

- **Agents**: We employ other companies and individuals to perform functions on our behalf. Examples include fulfilling orders, delivering packages, sending postal mail and e-mail, removing repetitive information from customer lists, analyzing data, providing marketing assistance, processing credit card payments, and providing customer service. They have access to personal information needed to perform their functions, but may not use it for other purposes.

- **Promotional Offers**: Sometimes we send offers to selected groups of Amazon.com customers on behalf of other businesses. When we do this, we do not give that business your name and address. If you do not want to receive such offers, please adjust your Customer Communication Preferences.

- **Business Transfers**: As we continue to develop our business, we might sell or buy stores or assets. In such transactions, customer information generally is one of the transferred business assets. Also, in the unlikely event that Amazon.com, Inc., or substantially all of its assets are acquired, customer information will of course be one of the transferred assets.

- **Protection of Amazon.com and Others**: We release account and other personal information when we believe release is appropriate to comply with law; enforce or apply our Conditions of Use and other agreements; or protect the rights, property, or safety of Amazon.com, our users, or others. This includes exchanging information with other companies and organizations for fraud protection and credit risk reduction.

- **With Your Consent:** Other than as set out above, you will receive notice when information about you might go to third parties, and you will have an opportunity to choose not to share the information.

<u>From SAVISHOPPER.COM</u>

> In keeping with our Privacy Policy and promise to you, our mailing list, customer database and your personal information has never and will never be shared, transferred, sold, etc. To ensure your privacy in this regard, we are destroying the contents of our database and all backup copies.

Amazon.com's privacy statement as excerpted above is the latest version (on August 31, 2000) of its privacy policy. This new policy was emailed to 23 million customers and highlighted on the company's web page and made clear that it regard customer data as a corporate asset it can sell or liquidate. Most experts speculate that the change in Amazon.com's policy was a direct result of the Toysmart dispute. As a result of its change in its privacy policy, Amazon.com has maximized the possibility that its customer list is an asset that could be liquidated for the benefit of creditors. The privacy policy of Savishopper.com, on the other hand, would create more challenges for a trustee to liquidate of the customer list to satisfy claims of creditors.

B. LIVING.COM

Living.com was an Texas-based online furniture store that had raised $ 69 million in venture capital from sophisticated players in the venture markets, including Austin Ventures, Benchmark Capital, Comdisco Ventures, GE Capital, Pivotal Asset Management, and Starbucks. The e-tailer launched a national ad campaign and spent millions for network television ads during prime time shows. The concept of Living.com began with selling furniture from a variety of manufactures in a range of styles and evolved into selling accessories such as linens and small appliances. Living.com attracted millions of visitors to its web site and was noted for its experienced and high-caliber management team. Amazon.com agreed to an 18% stake in Living.com and featured the startup as its home furnishings store. However, when the stock market turned against Internet retailers in April, the company had to delay its IPO hopes and laid off 50 employees. Living.com was the fourth most visited home-décor site and was rated first in customer service among such sites.

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ran out and investors, including Amaz
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Living.com's website is now displays
Statement of Financial Affairs. It als
releases from the Chapter 11 Trustee
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C. Who's Buying These Assets A

Some insolvency specialists conclude
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the typical structure of dotcoms—all
common problem of a lack of a suffi
financing. Other specialists disagree a
they develop revenue, many startups
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imbedded links and technology infras
economy, who are the buyer of such
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1. APBNEWS.COM

a. Background

APBnews.com is a New Y
police and crime news, per
safety information.

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High overhead and a strain on cash reserves forced the startup to go back to investors for additional rounds of financing. By August, 2000, funds had ran out and investors, including Amazon.com, were not interested in a rescue operation. The day before its August 16, 2000 bankruptcy filing, Living.com stopped taking offers on its site and laid off all 275 employees.

The assets of Living.com appear to be ordinary e-tailer assets: remaining inventory, a database of customers, office and warehouse leases, and, of course employees. Living.com's most valuable asset? Its "link" on Amazon.com that directed online furniture shoppers to Living.com. Living.com signed a contract in February, 2000 agreeing to pay Amazon.com $145 million over five years for this link. Although this contract reportedly contributed to Living.com's cash flow struggles, it is also expected to be the crown jewel of its asset packages.

Living.com's website is now displays a series of links to its Schedules and Statement of Financial Affairs. It also contains an October 9, 2000 press releases from the Chapter 11 Trustee advising consumers of a pending motion to conduct a going-out-of-business sale.

C. Who's Buying These Assets Anyway?

Some insolvency specialists conclude that dotcom companies are not realistic candidates for Chapter 11 on the grounds that startups lack cash flow and/or a viable business to continue to operate. These specialists further cite the typical structure of dotcoms—all equity and no debt - as well as the common problem of a lack of a sufficient asset base with which to obtain financing. Other specialists disagree and speculate that upon maturity when they develop revenue, many startups will have solid assets and can be reorganized through a Chapter 11 case. These professionals see domain names, imbedded links and technology infrastructure as valuable assets. In a cyber economy, who are the buyer of such assets? As illustrated below, so far, in the short life of dotcoms, quite often the buyers are other dotcoms.

1. APBNEWS.COM

a. Background

APBnews.com is a New York-based online news site providing police and crime news, personal and community anti-crime and safety information.

b. Bankruptcy

APB burned through all its cash and ended up with $7 million in debt. After failing to find a third round of private funding, APB fired all of its employees. In July, APB filed for Chapter 11 relief in the U.S. Bankruptcy Court for the Southern District of New York. On August 23, 2000, APB announced that it will sell its assets to SafetyTips.com, a Massachusetts-based Web site that launched in June, for $ 950,000.

2. *BOO.COM*

a. Background

Boo.com was a London-based online trendy clothing retailer. Boos primary investor was venture capital fund LVMH. Other investors included Goldman Sachs, J.P. Morgan and Benetton Group.

b. The Demise

The company burned through $120 million during only six months of operation. Website technical problems were noted to be a significant cause of the company's failure. The site utilized some of latest software technology achievements but many consumers reportedly found the site difficult to navigate. In May, Boo.com relinquished control to KPMG Corporate Recovery liquidators. As part of the liquidation, Boo.com's back-end technology was sold to Bright End, a London-based IT firm for $375,000 (this technology is believed to be Boo.com's most valuable asset.) In June, 2000 Fashionmall.com announced its acquisition Boo.com's domain names, Web design elements, trademarks and editorial concepts for an undisclosed amount. Fashionmall.com was also one of Boo.com's creditors. Fashionmall recently announced that the site will resurface on October 30, 2000 as its bridgehead for European sales.

3. *Pixelon*

a. Background

Founded in 1998, Pixelon is a California-based video-streaming startup. Pixelon's major investor is Advanced Equities, a Chicago investment bank.

b. Bankruptcy

Pixelon's troubles began
half of the money it had r
party to launch the compa
by The Who and other to
shareholders brought a c
claiming material misrepr
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voluntary Chapter 11 petiti
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Recently, received three o
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D. Employees

Some of your most valuable assets a

The common consensus in dotcom
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How valuable are dotcom employee
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An interesting side-effect of the wide
of workers back to corporate Americ
chief beneficiary of the dot.com imp
with reports that dot.com refugees h
corporate technology firms such as IE

b. Bankruptcy

Pixelon's troubles began after it spent $ 11 million—more than half of the money it had raised—for an October, 1999 Las Vegas party to launch the company. The extravaganza featured a concert by The Who and other top music artists. One year later, Pixelon shareholders brought a class-action suit against the company claiming material misrepresentations and omissions of material fact in connection with Pixelon's raising of initial capital. An involuntary Chapter 11 petition was filed against Pixelon on April 27 in the U.S. Bankruptcy Court for the Central District of California. Recently, received three offers as a part of its continuing bankruptcy proceedings from Catalyst Holdings LLC, Entertainment Boulevard and eSynch Corp. The offers are pending before the Bankruptcy Court and while the first two offers would enable the company to continue operating, eSynch's offer is to buy Pixelon's computer equipment.

D. Employees

Some of your most valuable assets are wearing sneakers.

The common consensus in dotcom cases is that the employees are some of the most valuable—and mobile—assets. Without key employees, many dotcoms are little more than idea-based businesses with no intrinsic value. The need to retain employees will accelerate the pace of dotcom cases and require a deft balancing act with the anemic cash flow typical of such cases.

How valuable are dotcom employees? The recent demise of Petstore.com provides a telling example. Petstore, another victim of market consolidation, announced in June, 2000 that it was selling its assets to pets.com and leaving its employees without jobs. According to published reports, within one day of posting her resume on online job sites, a marketing executive received 30 inquires. Employers and headhunters were randomly dialing Petstore extensions in search of the soon-to-be jobless. Other members of management received over a dozen offers that increased salaries by one-third.

An interesting side-effect of the widespread failure of dot.com's is the flood of workers back to corporate America. Corporate America appears to be the chief beneficiary of the dot.com implosion, as recent news articles are rife with reports that dot.com refugees have returned positions with traditional corporate technology firms such as IBM, Microsoft & G.E.

E. Other Dotcom Failures of Note

1. *Value America*

Value America, which at one time sold everything from caviar and furniture to software, office equipment, electronics, and computer products, sought Chapter 11 protection on August 11, 2000. It bankruptcy schedules listed $21.8 million in debt and $62.7 million in assets.

The demise of Value America is significant because it is one of the first prominent, publicly traded online retailer to file Chapter 11. After posting a 139 percent gain on its opening day in April 1999 and trading in the high $ 70 range, the stock fell every month since and closed at 71 cents before Nasdaq suspended trading and the company filed bankruptcy.

In May, Value America secured commitments for $90 million in financing: $30 million from existing investors such as Paul Allen's Vulcan Ventures and FedEx, and the remainder from Acqua Wellington North American Equities Fund, which planned to provide Value America with $60 million through periodic purchases of Value America stock at a small market discount over the next 14 months. That, it appears, only prolonged the inevitable.

According to the Debtor's Chairman and CEO, Value America believes that its technology infrastructure will prove valuable to other companies who want to launch an e-commerce solution of their own on the Internet. Value America has such confidence in this technology that its Chapter 11 exit strategy is based on closing all retail operations and rebuilding the company through licensing and other dispositions of its e-commerce software to other online retailers.

2. *WebHouse Club, licensee of PRICELINE.COM*

Continuing the format of the purchase of airline tickets and hotel rooms, Webhouse Club offered consumers the ability to name their own price for groceries or gasoline. Opened in 1999 by the founder of Priceline.com, WebHouse had attracted over 2 million customers within a year and served approximately 7,200 grocery stores, 6,000 gas stations and 125 consumer packaged goods manufacturers.

Despite a recent cash infusion in excess of $ 125 million, WebHouse was unable to fund ongoing operations and achieve profitability. Citing an inability to raise additional capital, in early October, 2000,

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end of the calendar year. WebHouse's clo
of licensing fees drove Priceline.com's sh
from the $ 100 share price in March, 2000
tracted the attention of investors, but als
generals offices, who are investigating con
practices.

3. *CRAFTSHOP.COM*

Craftshop.com, a closely-held corporatior
and Connecticut, specializes in online art
shop is backed by the venture capital firm
approximate five to ten percent stake in t
received approximately $4.5 million from
tors.

a. Bankruptcy

Craftshop was burning through almos
investors refused to reinvest in early
operations and laid off all 49 emplo
second round of financing. On May 2
11 relief in the U.S. Bankruptcy Cou
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Online Inc. and DoubleClick Inc. Cra
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season sales. Just before the bankrupt
stated:

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> Year.

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competition from several new craft retail
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4. *Are Hollywood Dot.Coms Headed for*

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backed start-ups are joining the dot.com

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WebHouse announced that it would cease business operations by the end of the calendar year. WebHouse's closure and the subsequent loss of licensing fees drove Priceline.com's shares down to $ 6, a free-fall from the $ 100 share price in March, 2000. WebHouse has not only attracted the attention of investors, but also of several state attorneys generals offices, who are investigating complaints of alleged fraudulent practices.

3. *CRAFTSHOP.COM*

Craftshop.com, a closely-held corporation with offices in New York and Connecticut, specializes in online arts and crafts retailing. Craftshop is backed by the venture capital firm CMGI Inc. which holds an approximate five to ten percent stake in the company. Craftshop also received approximately $4.5 million from other venture capital investors.

a. **Bankruptcy**

Craftshop was burning through almost $1 million a month before investors refused to reinvest in early February. Craftshop halted operations and laid off all 49 employees after it failed to obtain second round of financing. On May 22, Craftshop filed for Chapter 11 relief in the U.S. Bankruptcy Court for Delaware listing $1.8 million in debts owed to such creditors as Lycos Inc., America Online Inc. and DoubleClick Inc. Craftshop's site did not go live until January 18, missing the opportunity to benefit from holiday season sales. Just before the bankruptcy filing Craftshop's founder stated:

> [our late start] killed us. All the content was for Thanksgiving and Christmas, and we had to rip [the content] down and put up a sign saying, Happy New Year.

Although attracting approximately 20,000 registered site users, Craftshop failed to meet its target level of average daily shoppers and faced competition from several new craft retailing sites. Craftshop's assets may include software and other intangibles but were listed in the bankruptcy filing with "uncertain" values.

4. *Are Hollywood Dot.Coms Headed for the Hills?*

As the following examples illustrate, even high-profile Hollywood-backed start-ups are joining the dot.com deadpool.. Two high-profile start-ups have closed down since October 1, 2000, and a third has significantly. scaled down operations.

a. SCOUR, INC.

Scour Inc., a Beverly Hills multimedia company backed by former Hollywood super-agent Michael Obits, filed for protection Chapter 11 protection in October, 2000. The debtor was facing at least two lawsuits and recently laid off all but 12 of its 70 employees. Scour, Inc. reported that it has more than $100 million in debt, and estimated its assets at between $1 million and $10 million.

Scour was created in 1997 by a group of UCLA students who developed a computerized search engine that hunted for multimedia files, such as music, video and pictures. Score's search technology attracted the attention of Obits and the Yucaipa Cos., the investment vehicle for supermarket magnate Ronald Burkle. Together they took a majority stake in Scour in 1999 and moved the company's offices to Beverly Hills. Scour's attempts to obtain additional financing over the last few months failed, and the company blamed a lawsuit filed against the company in July by the Motion Picture Assn. of America and the Recording Industry Assn. of America for scaring off potential investors. The suit sought to block the debtor from allowing consumers to copy and swap with one another digitized versions of songs, movies, photographs and other multimedia files.

b. POP.COM

Pop.com, a start-up that promised a mix of live action and animation, video on demand and live Web events, closed before it opened. Despite being backed by Hollywood heavyweights such as Steven Spielberg, Jeffrey Katzenberg and Ron Howard, the site's backers determined that shifts in the marketplace have made the site "a less-viable business." DreamWorks SKG and Imagine Entertainment had teamed Pop.com with Vulcan Ventures, run by Microsoft co-founder Paul Allen, who invested $50 million. Despite landing Eddie Murphy and Steve Martin to star in specially produced short films for the site, Pop.com was unable to get off the ground.

According to news reports, Katzenberg's last minute efforts casting for a potential merger partner or alternative exit strategy failed.

c. Z.COM

In mid-October, 2000, Z.com laid off
workers). Z.com is a "netcaster" and has
rities such as Chris Rock, Oliver Sto
Alanis Morissette. The layoffs were in
round of financing made up of licensing
outside investments.

G. Bankruptcy Alternatives

Because startups typically have little traditional
is common for failing dotcoms to simply close
ruptcy altogether. Some dotcoms consolidate o
business focus; others cease operations in their
nouncement on their web site and advise consu
operations and future intentions.

H. Resources

Where do you find out about failed—or, perhaps
dotcoms? Other than the mainstream press, som
are:

www.sv.com (SilconValley.com, an ind

www.digitalmass.com

www.zdnet.com

www.webmergers.com

http://216.150.27.141 (an alternate route to an r
daily reports of dying dotcoms but, if stated in l
be offensive to some readers.)

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c. Z.COM

In mid-October, 2000, Z.com laid off half its staff (50 of 100 workers). Z.com is a "netcaster" and has content deals with celebrities such as Chris Rock, Oliver Stone, Ellen DeGeneres and Alanis Morissette. The layoffs were in conjunction with a new round of financing made up of licensing fees, advertising deals and outside investments.

G. Bankruptcy Alternatives

Because startups typically have little traditional debt and tangible assets, it is common for failing dotcoms to simply close up shop and avoid bankruptcy altogether. Some dotcoms consolidate operations and narrow their business focus; others cease operations in their entirety. Most make an announcement on their web site and advise consumers of their cessation of operations and future intentions.

H. Resources

Where do you find out about failed—or, perhaps more importantly, failing - dotcoms? Other than the mainstream press, some helpful online resources are:

www.sv.com (SilconValley.com, an industry news site)

www.digitalmass.com

www.zdnet.com

www.webmergers.com

http://216.150.27.141 (an alternate route to an rumor mill site that contains daily reports of dying dotcoms but, if stated in letters, has a name that may be offensive to some readers.)