

Tips On Buying IP Assets Out Of Distressed Situations

By John G. Loughnane

A company needing specific intellectual property to round out its product or define its market has two options - build it or buy it.

The first option can prove costly and slow. The second option can be much faster and can offer tremendous cost savings.

Companies that have encountered financial or operational turbulence and are motivated to move assets quickly can be a good source of intellectual property. Often deals get done while the seller is in bankruptcy proceedings.

But not all distressed companies find themselves in formal bankruptcy proceedings. There are also opportunities outside of a formal bankruptcy (such as in a state law assignment for

the benefit of creditors or secured party's sale) for a buyer to acquire valuable assets at bargain prices.

There are opportunities - and risks - inherent in distressed sales. Companies looking to make such purchases need to exercise careful due diligence. It's critical to develop strategies for retaining the employees with the experience and knowledge to help extract value from the IP, along with strategies for maintaining confidentiality.

Obtaining All The Debtor's Essential IP Contract Rights

As with any acquisition, careful diligence is needed about the seller's rights. Because indemnification rights against a distressed seller are unlikely to have any value and in some cases the seller will offer few representations and warranties, the diligence phase is especially important.

A buyer of IP assets will also want to ensure that it can have assigned to it all relevant contracts that govern the IP it desires to acquire. Outside of bankruptcy, this will entail the seller arranging the assignment of the relevant contracts including seeking any consent necessary.

Sales in bankruptcy benefit from special rules that govern the treatment of contracts. The Bankruptcy Code's special provisions relate to "executory contracts" - contracts requiring per-

formance to some extent by both sides. A contract that has been terminated or that has expired before the commencement of a bankruptcy case is not executory. The Code nullifies any provision in a contract that allows a non-debtor to terminate the contract on the grounds of the insolvency or bankruptcy filing of the debtor.

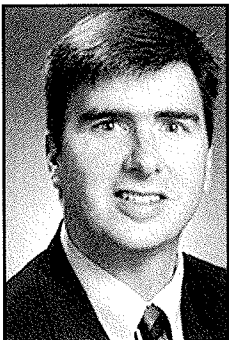
In some jurisdictions, licensors have prevented not only a debtor's assignment of their IP licenses, but also mere assumption by the debtor. The majority of the federal Circuit Courts that have considered the issue, as well as the U.S. Bankruptcy Court for the district of Delaware, have concluded that a debtor that has no ability to assign an IP contract also lacks the ability to assume such a contract.

These decisions place incredible leverage in the hands of licensors by allowing them to seek to obtain control of the license once a licensee files. Other courts - most notably the 1st U.S. Circuit Court of Appeals - have rejected that approach and instead allow a debtor to assume an IP license if it has no actual intent to assign but instead will continue to perform itself.

An IP asset buyer should carefully review the assignment provisions. The Bankruptcy Code prohibits enforcement of most anti-assignment clauses.

Yet such clauses in copyright licenses can be enforced by the non-debtor licensor. Careful licensors will prohib-

Business Law



John Loughnane, a partner at the law firm of Gadsby Hannah LLP, has represented numerous buyers and sellers of assets from distressed situations, as well as third parties such as licensors and licensees whose rights have been affected by such sales.

He can be reached at jloughnane@ghlaw.com.

it assignment or limit it to very specific conditions to demonstrate why a particular licensee was approved to receive the license and may include a provision that upon an acquisition or change in control, the license is automatically terminated.

An IP asset buyer should also carefully review termination rights. As with anti-assignment clauses, the right to terminate on account of a bankruptcy filing (an "ipso facto" clause) is also generally held to be unenforceable.

Licensors sometimes enhance termination clauses to include other measures of impending financial difficulty such as the departure of key executives, or the licensee's failure to meet certain milestones. Buyers should be careful to review such clauses to ensure the contract is still in full force and effect.

And an IP asset buyer should analyze the length of an agreement. A licensee is only able to assume and assign those contracts in effect as of the petition date. Annual automatic renewal clauses, unless notice of non-renewal has been given, are one way to limit term. Be sure the key contracts

you need can be extended for the periods of time necessary for you to accomplish your business objectives.

Keep The People – And The Secrets

Buyers recognize that it can be essential when buying IP assets to also ensure the employees most knowledgeable about the IP agree to work for the buyer. Serving as the stalking horse bidder in a bankruptcy asset sale is often instrumental in learning about the people and putting in place devices to ensure the people follow the assets.

The buyer can condition its deal on obtaining the services of certain employees on specified terms. Alternatively, the buyer may try to "lock up" key former employees by signing them to agreements in advance of a sale closing.

Just as important as the people are the secrets that underlie the company and the IP. All bidders need to understand the public nature of a bankruptcy case and the ease with which sensitive information may become public.

For example, it is not uncommon for a debtor to seek court authority to

pay any pre-petition wages that may be owing to certain employees. In some cases, debtors file too much detail with such a pleading allowing interested parties to learn who earns what. Similarly, another filing required in bankruptcy cases is a list of all the company's receivables – essentially a customer list. Depending on the industry, disclosure of that information may be very prejudicial to the company or to the interests of potential buyers. Similarly, schedules to an asset purchase agreement may be filed that may contain sensitive company information.

In addition, IP-specific confidentiality must be guarded. Procedures should be put in place to ensure that all interested buyers sign a strict confidentiality agreement and that interested parties demonstrate their seriousness through some level of financial commitment and wherewithal to actually consummate a deal. Finally, the successful buyer should insist that confidentiality agreements entered into between the company and other parties are assigned to the winning bidder at closing.