

Strafford

presents

M&A Transactions: Capitalizing on Intellectual Property Assets

Structuring Deals to Leverage IP Value and Minimize Legal Risk

A Live 90-Minute Audio Conference with Interactive Q&A

Today's panel features:

Edward G. Black, Partner, **Ropes & Gray**, Boston

Jeffery S. Norman, Partner, **Kirkland & Ellis**, Chicago

Steven Hoffman, President and CEO, **ThinkFire**, Boston

David M. Klein, Partner, Paul Hastings **Janofsky & Walker**, New York

Tuesday, September 8, 2009

The conference begins at:

1 pm Eastern



12 pm Central

11 am Mountain

10 am Pacific

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M&A Transactions: Capitalizing on IP Assets

**Ed Black, *Ropes & Gray*
Jeff Norman, *Kirkland & Ellis***

Structuring the Role of IP in an M&A Transaction

- Traditionally, IP analyzed “as it stands” regarding both liabilities and benefits
- Current trend toward more aggressively structured transactions
- IP ownership is restructured to improve the *financial* business case, *strategic* business case, or both

Financial Structuring of IP

- **IP in Asset Backed Lending**
- **Structuring IP income performance**
 - Internal: Hold Co.
 - External: Securitization, conversion of products to services, or products and services to licenses
- **IP structured for Tax & Accounting Optimization**
- **IP structured to support immediate post-transaction sale or license to “de-lever”**
- **IP issues arising in “going private” transactions**

Strategic Structuring of IP

- **Spin-out of under valued IP assets into new business. (e.g. life sciences)**
- **Restructuring IP to enable restructured business or “break up” post-transaction**
- **IP as the business: IP focused spin out**

IP Diligence/Drafting

Supporting IP

Structuring

Asset Backed Lending

- **Relevant IP Assets: Assets in which security interests can be perfected**
 - “Registered” IP: Patents and reg’d TMs, copyrights, domain names, industrial designs, selected rights of publicity
 - Software products (licensed to borrower and owned by borrower, including unreg’d copyrights)
 - Recorded licenses and transaction rights/royalty streams
- **Perfection of ownership in the borrower**
 - Record owner searches
 - Transfers to borrower
 - Lien search and clearance
- **Security Agreement**
 - IP management and scope business control tied to the IP
 - Pre-foreclosure rights to lender in IP
 - IP foreclosure
- **Perfection of the Security Interest**
 - Record, record, record
 - Often involves asset transfers
 - May be expensive
 - Perfection of foreign IP rights may require long periods of time (years in some cases)
- **Valuation: *Later***

IP in the Business Spin Out

- **Relevant IP Assets: IP that enables the spin out**
 - Identifying question is not “is it qualified collateral?” but “is it used?”
 - In addition to “Registered” IP, now add trade secrets, know how, unrecorded licenses, rights of privacy and publicity, and unregistered copyrights, TMs, and designs
- **Need to identify nature of the use and confirm post transaction availability of that intended use**
 - Research is directed at FTO, not merely ownership
- **Common key IP diligence issues:**
 - TMs in a new territory (diligence = public record searching and analysis)
 - Restricted licenses (diligence plus consents or re-negotiation of terms)
 - Licenses needed by both seller and spin out businesses (splitting license, sublicense or obtain new license; often involves renegotiation regardless)
 - Private data (firewalls and policy compliance)
 - Carry forward of defensive protections such as cross licenses and defensive portfolios
 - System for joint management and maintenance, especially regarding infringers and future improvements
 - System for knowledge transfer
 - Shared IP between seller and spin out business
 - ***Seller retained rights***
 - Valuation: *Later*

Preparing to “De-Lever”

- **Relevant IP assets:** Those that are positioned to be licensed, sold, or otherwise spun out in order to generate “new” cash
- **Common Key IP Diligence Issues**
 - Similar to spin out, *except:*
 - Now without seller cooperation
 - Heightened emphasis on restrictions imposed by current deal structure
 - Lien releases in relevant assets
 - asset disposition buckets and limitations
 - lender consent
 - post-default rights may be different

Establishing an IP Holding Company

Why relevant to M&A?

- Tax optimization
- Accounting & administrative optimization
- Joint control in multi-entity or multi-company deal
- Trademark licensing & Section 365(n)

IP Holding Co. Diligence

- **Relevant IP Assets? Depends on purpose:**
 - Almost always limited to “registered” IP
 - Trademarks and patents are most common
 - IP holding company as bankruptcy “remote” vehicle may be less attractive in light of recent case law
- **Common Key IP Diligence Issues**
 - Perfection of ownership in the hold co.
 - System for joint management and maintenance
 - Re infringers (standing)
 - Re future improvements, new IP
 - Re support and management of the IP business as such
 - Re trademark quality control , usage and policing
 - Independence of the hold co and the licensed businesses
 - Tax
 - Patent litigation: standing to receive injunction, vulnerability to countersuit, effect on damages
 - Enablement requirements in licenses back (see “spin outs”)
 - Valuation: *Later*



Valuation and Monetization of IP Assets

*Presented by Steven Hoffman, CEO, ThinkFire
September 8, 2009*



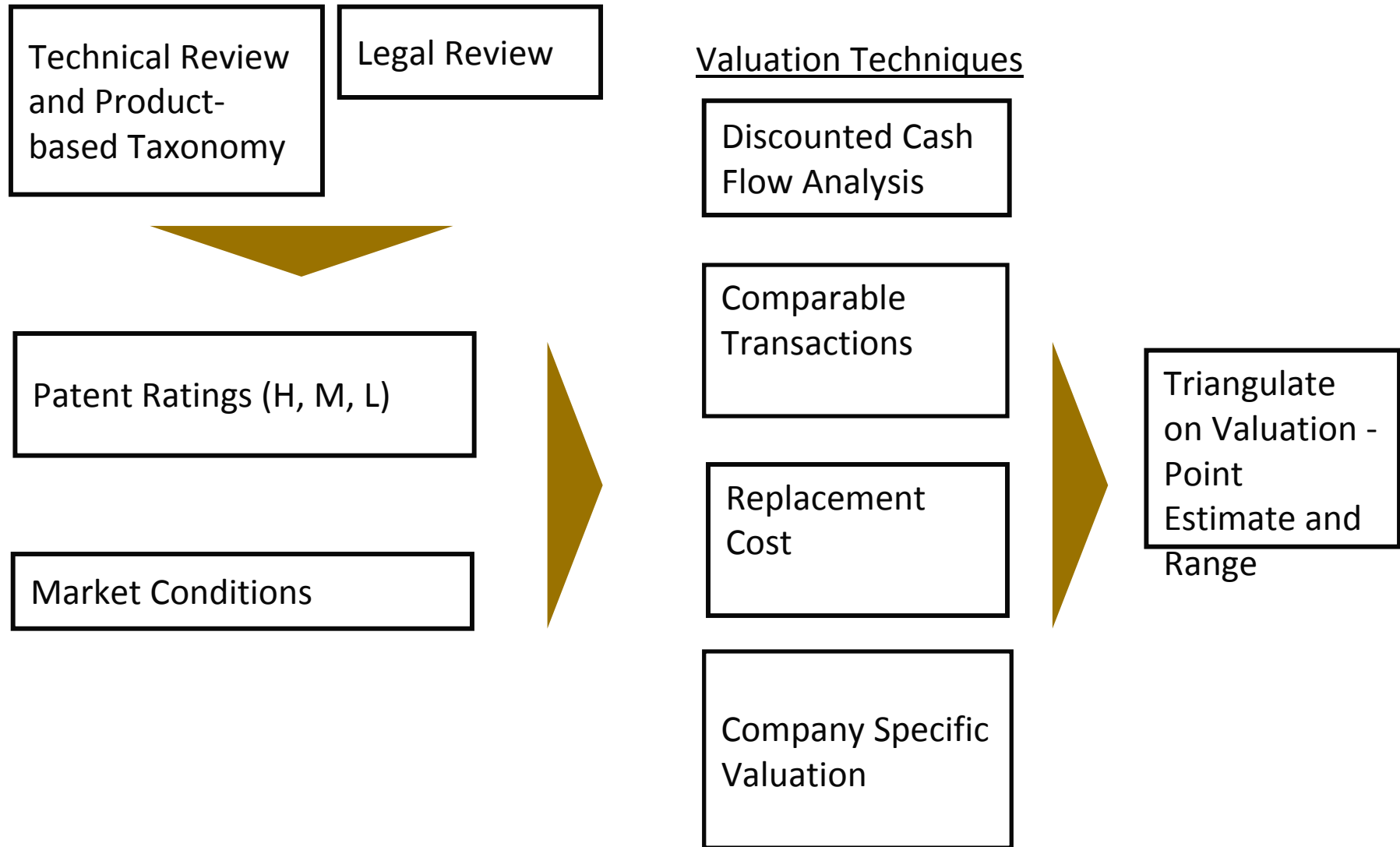
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Agenda

- Valuation Basics
- Approaches to Resolving Valuation Differences
- Current Trends and Strategies in IP Transactions

Portfolio and Patent Valuation

— Methodology —



Patent Quality Rating

Multiple factors determine the quality of a patent for sale or licensing

	Rating	Criteria
Technical Factors	Detectability	Ability to detect infringement in products
	Vulnerability	Intensity of R&D in the space preceding and simultaneous with the invention
Legal Factors	Claim Structure	Breadth and strength of claims
	Avoidability	Availability of practical alternatives
Market Factors	Standards	Impact upon industry standards (essential?)
	Maturity	Impact on current vs. past or future products
	Commercialization	Significance of the invention in the market

Approaches to Resolving Valuation Differences

- Independent Third Party Evaluations
- Success Fees
- Shared Future Royalty Streams
- Carve - outs

Current Trends and Strategies in IP Transactions

- Current Market Conditions
 - Many motivated sellers
 - Fewer buyers
 - Operating Companies
 - Non-operating Entities
 - Flight to Quality
 - Steep Discounts from Expected NPV

Current Trends and Strategies in IP Transactions (Continued)

- As a result of current market conditions
 - Some sophisticated sellers have temporarily exited the market
 - Some sellers are putting bigger and better packages up for sale
 - New buyers are (contemplating) entering the market
 - New transaction structures are being utilized
 - Spun-out licensing entities, with or without in-place management teams
 - Corporate acquisition with subsequent spin-out of operating company
 - Lots of activity, but few deals (yet)
 - Unrealistic expectations on the part of sellers
 - IP “naiveté” and risk aversion on the part of new buyers

Paul Hastings

**M&A Transactions: Capitalizing on
Intellectual Property Assets**

**Intellectual Property Issues in
Bankruptcy**

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- ▶ Intellectual Property in Bankruptcy
- ▶ Assignment & Assumption of Intellectual Property Agreements
- ▶ Rejection of Intellectual Property Licenses in Bankruptcy
- ▶ Perfection of a Security Interest in Intellectual Property

Intellectual Property in Bankruptcy

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- ▶ §365(c) Transactions are similar to other types of M&A transactions
- ▶ Representations and warranties do not generally survive
- ▶ Due diligence may be more limited
- ▶ Many title and other issues are more easily resolved
- ▶ Auction transactions have interesting dynamic

▶ Assignment & Assumption of Intellectual Property Agreements

Assignment & Assumption of Intellectual Property Agreements

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- ▶ General rule - A bankruptcy trustee or debtor in possession may freely assume, assign, or reject executory agreements
- ▶ A contract is executory if each party to the agreement has material obligations that still require performance
- ▶ General presumption in favor of assumption and assignment
- ▶ Non-assignment clauses do not present obstacles to assignment in bankruptcy

Assignment & Assumption of Intellectual Property Agreements PaulHastings

- ▶ §365(c) - Prohibits trustee from assigning or assuming executory contract if applicable law excuses parties from accepting (or rendering) performance from (or to) a party other than the debtor.
- ▶ Courts are split over how to interpret §365(c)

Assignment & Assumption of Intellectual Property Agreements

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- ▶ A trustee may not “assume or assign” if “applicable law excuses a party, other than the debtor . . . from accepting performance from or rendering performance to an entity other than the debtor” without the non-debtor party’s consent
- ▶ Trademark licenses are generally considered personal to and non-assignable by the licensee.
- ▶ Nonexclusive patent and copyright licenses are generally considered personal to and non-assignable by the licensee

Assignment & Assumption of Intellectual Property Agreements PaulHastings

- ▶ Courts are split between a “hypothetical” and an “actual”
- ▶ Recently, federal bankruptcy courts have postulated a third test - the “*Footstar* approach”
- ▶ Justices Kennedy and Breyer issued an odd statement in conjunction with denying certiorari to a recent case, explicitly expressing their desire to unify these divergent interpretations of §365(c) when a suitable case arises

Assignment & Assumption of Intellectual Property Agreements PaulHastings

- ▶ “Hypothetical Test” (Third, Fourth, and Ninth Circuits)
 - Strict interpretation of the Bankruptcy Code
 - Rejection of any agreement where applicable law restricts assignment, whether or not there is an actual intent to assign the agreement
 - Plain language of §365(c) prohibits the trustee from assuming or assigning any non-assignable contract

Assignment & Assumption of Intellectual Property Agreements

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- ▶ “Actual Test” (First Circuit)
 - Allow assumption of non-assignable executory agreements unless there is an actual intent to assign the contract, in which case the trustee must reject the agreement
 - §365(c)’s phrase “may not assume *or* assign” should be read to mean “may not assume *and* assign”
 - Reading is necessary to maximize property of the estate while avoiding clear injustice

Assignment & Assumption of Intellectual Property Agreements

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▶ “*Footstar* approach”

- Advocates a middle road
- Allows debtor in possession to assume executory contracts, but prohibits the trustee from doing so
- Chapter 11 reorganization may usually proceed without the appointment of a trustee
- Bankruptcy district courts within the Second Circuit were first to advocate the use of the *Footstar* approach
- Recently a bankruptcy court in the Tenth Circuit followed their lead

Assignment & Assumption of Intellectual Property Agreements

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Test:	Actual	Hypothetical	<i>Footstar</i>
Approach:	Trustee/DIP may assume unless there is an actual intent to assign	Trustee/DIP may not assume even if there is no intent to assign	Trustee may not assume even if there is no intent to assign DIP may assume unless there is an intent to assign
Reasoning:	Literal reading of § 365(c) defies sound bankruptcy policy Text of §365(c) may be drafting error	Courts must apply literal language of § 365(c)	This interpretation follows the literal reading of § 365(c) without defying bankruptcy policy
Jurisdictions Clearly Following:	First Circuit Vast majority of lower courts	Third Circuit Fourth Circuit Ninth Circuit	Bankr. S.D.N.Y. Bankr. D.N.M.
Jurisdictions Inclined to Follow:	Fifth Circuit Eighth Circuit	Eleventh Circuit	Second Circuit Tenth Circuit
Special Notes:	<ul style="list-style-type: none"> A bankruptcy court in the Sixth Circuit explicitly rejected the hypothetical test, but the Sixth Circuit has not directly addressed the issue. There is no evidence of an inclination towards any of the three approaches in the Seventh Circuit. 		

▶ Rejection of Intellectual Property Licenses in Bankruptcy

Rejection of Intellectual Property Licenses in Bankruptcy

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- ▶ Prior to 1988, debtors could reject all IP licenses in bankruptcy
- ▶ Terminate non-debtor licensee's continuing rights to use intellectual property
- ▶ Congress modified §365(n) to enable licensee of intellectual property to avoid a trustee's rejection of their license

Rejection of Intellectual Property Licenses in Bankruptcy

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- ▶ Options under §365(n)
 - Licensee may treat a rejected license as terminated
 - Licensee may retain its rights to intellectual property by fulfilling its obligations under the agreement (including royalty payments)

Rejection of Intellectual Property Licenses in Bankruptcy

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- ▶ Covers patents, copyrights and trade secrets
- ▶ No §365(n) protection for trademark licensees
- ▶ A trademark license is terminated upon rejection and the licensee is left only with a claim for damages
- ▶ Equitable concerns, if strong enough, may allow reversal of a bankruptcy order to reject a specific license in a specific instance

Rejection of Intellectual Property Licenses in Bankruptcy

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- ▶ §365(n) may not completely protect intellectual property licensees
- ▶ Trustee could possibly exterminate licensee rights via a §363 sale
- ▶ Under §363, a trustee or debtor in possession may sell property of the estate free of any interest in the property
- ▶ If a trustee bypasses rejection and directly sells an executory intellectual property license in a §363 sale, the licensee would likely not be afforded protection under §365(n), which is only applicable where the trustee rejects the executory license
- ▶ Seventh Circuit and the Bankruptcy Court for the Southern District of New York would allow §363 sales to overpower § 365(n) under these circumstances

▶ Perfection of a Security Interest in Intellectual Property

Perfection of a Security Interest in Intellectual Property

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- ▶ Security Interest - an interest in personal property created to secure payment or performance of an obligation
- ▶ Secured creditor typically takes a security interest in Intellectual Property
- ▶ If debtor goes bankrupt, the secured creditor may enforce its security interest against the collateral to recover its debt
- ▶ Secured creditors take precedence over unsecured creditors on liquidation

Perfection of a Security Interest in Intellectual Property

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- ▶ To enjoy the full benefit of a security interest, secured creditors must “perfect” the security interest
- ▶ Determining whether a security interest in Intellectual Property is perfected is not always an easy task
- ▶ Intellectual property rights are governed by both federal and state law
- ▶ Competing recordation systems cause confusion regarding the proper way to perfect

Perfection of a Security Interest in Intellectual Property

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- ▶ Article 9 of the UCC regulates the perfection of a security interest in personal property
- ▶ UCC includes intellectual property such as copyrights, trademarks, and patents in the definition of “general intangible,” which is a subcategory of personal property
- ▶ Filing generally has to be made in either the Secretary of State’s Office where the debtor is located or in the county clerk’s office.
- ▶ UCC filing system does not apply where a system of federal filing has been established under federal law and preempts state law

Perfection of a Security Interest in Intellectual Property

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- ▶ When such a system exists, perfection can be achieved only through compliance with that system
- ▶ Federal statutes providing filing systems for copyrights, trademarks and patents
- ▶ Whether UCC is preempted by federal filing systems has been controversial issue
- ▶ Languages of the federal statutes is not always clear about whether they preempt UCC

- ▶ Federal Law: The Copyright Act of 1976
- ▶ Majority view: Copyright law preempts Article 9 of the UCC
- ▶ Federal filing is required at least for registered copyrights
- ▶ With regard to the unregistered copyrights, there is a circuit split
- ▶ Dual filing with the USPTO under the UCC may be advisable for unregistered copyrights

- ▶ Federal Law: The Lanham Act
- ▶ Majority view: Lanham Act does not preempt filing requirements under Article 9
- ▶ To perfect a security interest in a trademark, one *must* file a UCC-1 financing statement
- ▶ Most lawyers both record with the USPTO and file under the UCC

- ▶ Federal Law: The United States Patent Act
- ▶ Majority view: The Patent Act does not preempt Article 9 of the UCC
- ▶ To perfect a security interest in a patent, one *must* file a UCC-1 financing statement
- ▶ Most lawyers both record with the USPTO and file under the UCC