
ACQUIRING TECHNOLOGY ASSETS FROM DISTRESSED AND BANKRUPT SELLERS
Andrew Gallo
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June 8, 2020

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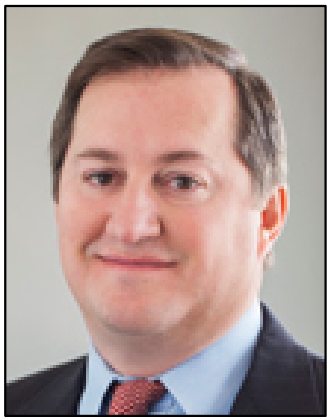

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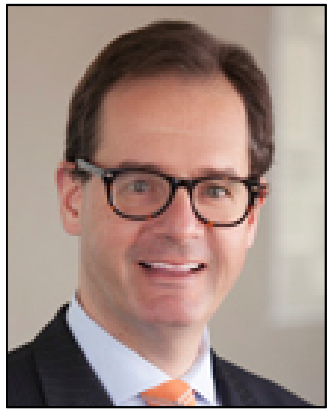

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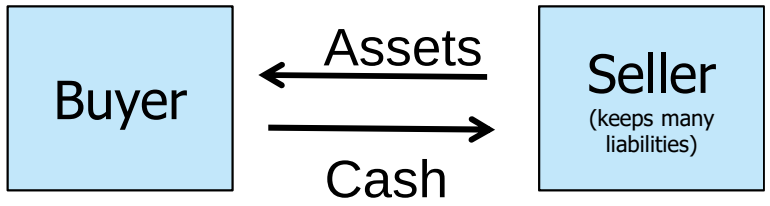
Agenda

1. Successor liability
2. Out-of-court transactions
3. 363 Sales
4. Other acquisition approaches
   - Plans of re-organization
   - Assignments for the benefit of creditors
5. Special considerations in distressed technology transactions
   - Intellectual property considerations
   - Regulatory considerations
   - Telecommunications considerations
6. Key takeaways from this session

Successor Liability

- The most common structure for the acquisition of a distressed company is for the purchaser to pay cash for the seller's assets, but not assume any of the seller's liabilities (other than the specific liabilities agreed to in the Asset Purchase Agreement ("APA")).



- As a general rule, a purchaser of assets is not liable for the liabilities of the target that are not specifically assumed. This is unlike acquisitions of stock or a merger where the target retains its liabilities.

Successor Liability

- However, there are a number of exceptions to the general rule:
  - Express or implied assumption of liabilities
  - De facto merger
    - Continuation of enterprise (e.g., continuity of management, personnel, physical location, assets, general business operations)
    - Continuity of ownership
    - Seller ceasing its business operations
    - Buyer assuming liabilities and obligations of seller that would be necessary for the uninterrupted continuation of the business
  - Fraudulent Transfers
  - Liability imposed by statute (e.g., CERCLA, tax, bulk sales laws, etc.)
- These exceptions need to be considered when structuring and documenting an acquisition


OUT-OF-COURT
TRANSACTIONS

Structuring Out-of-Court Transactions

- Out-of-court transactions of distressed companies can be structured like any other acquisition, but they are most often structured as asset acquisitions where all liabilities not specifically assumed are left with the seller.
  - Specific enumeration of assumed liabilities is typical
  - Indemnification for excluded liabilities (but consider whether there is adequate recourse)
  - Due diligence is key to assessing and pricing risk
- The goal is to leave behind many of the liabilities that resulted in the company becoming distressed.

Advantages of Out-of-Court Transactions

- Usually the fastest and cheapest option
- Buyer may be able to protect itself from successor liability through insurance
- Avoid potential negative effects of a bankruptcy on a seller's relationships with customers, suppliers, and employees
- COVID Consideration – in this environment, it may be preferable to avoid having to rely on a court's schedule, particularly in jurisdictions that are not as willing to use electronic technology

Disadvantages of Out-of-Court Transactions

- Does not convey the assets "free and clear" by court order, as a bankruptcy sale would do
- No ability to bind non-consenting creditor
- No ability to remedy agreements that are in default
- No ability to override anti-assignment clauses in leases, licenses and contracts
- No assurance that the transaction will keep the target out of bankruptcy court. Creates substantial risk of successor liability and fraudulent conveyance claims
- "Falling Knife" issue – the range of risks presented may make it very difficult to attract a buyer for a sale structured out-of-court
- There are certain instances where an out-of-court deal is not possible
  - For example: a company that needs to shed contracts or liabilities

Other Potential Considerations

- The seller may not be able to provide post-closing transition services or satisfy other post-closing obligations.
- The seller may not be able to provide post-closing indemnification.
- Even if the seller agrees to provide indemnification, post-closing agreements could be rejected in a subsequent bankruptcy of the seller or seller will not have sufficient resources to satisfy such obligations or the obligations will give rise to mere general unsecured claims receiving little or no distribution in a bankruptcy.
- The seller may have deteriorating relationships with key customers, suppliers, and employees.


363 SALES

What Is a "363 Sale"?

A "363 Sale" gets its name from Section 363 of the Bankruptcy Code, which governs the sale of property of a debtor.

Commonly refers to the sale of substantially all of the assets of a debtor in bankruptcy outside the context of a confirmed plan of reorganization.

- Purchaser takes assets free and clear of all liens and claims (subject to certain exceptions), pursuant to a bankruptcy court order.

COVID-19 Considerations: Will it be a buyers market with depressed pricing? Will there be new players in the market who were priced out before, but may not be now?

363 Sale Requirements

- Standard for approving 363 Sales:
  - There must be a "good business reason" for the proposed sale (*In re Lionel Corp.*).
  - Interested parties must be provided with adequate and reasonable notice and opportunity to object.
  - The purchaser must be acting in good faith.
  - The sale price must be fair and reasonable.
- Bankruptcy courts have concluded that the marketplace is the best indicator of the enterprise value of a debtor. Therefore, most 363 Sales occur through a public auction process in order to satisfy the "fair and reasonable" price requirement.
- COVID-19 Considerations: in this environment, parties are going to be interested in deals that are faster and cheaper.
  - What court will a company file in?
  - How will the 363 sale be structured?
  - How can the 363 process be condensed?

363 Sale Process

A 363 Sale is typically a two-phase process:

- First Phase:
  - The debtor is privately marketed to potential buyers.
  - A "stalking horse" bidder is chosen and a definitive purchase agreement is negotiated and signed.
    - As compensation for setting the initial price and terms, the stalking horse bidder receives bid protections in the event that it ultimately loses at auction, including a break-up fee (typical range is up to 3.5%) and expense reimbursement (usually capped at a fixed dollar amount).
    - Any break-up fee is typically covered by the required "overbid," or amount by which the initial counteroffer must exceed the stalking horse bid.
    - Stalking horses usually must have no remaining diligence conditions to qualify for a breakup fee.
    - Stalking horse APA is binding, but conditional on bankruptcy court approval after bidding process and auction
- COVID-19 Considerations: there may be fewer parties willing to serve as stalking horse, which could mean better than typical bid protections for those that do

363 Sale Process

- Second Phase:
  - Bid procedures are enacted by the court, which typically provide the following:
    - a diligence period, a bid deadline, rules and qualifications to become a qualified bidder, an auction date, and rules for an auction including overbid amounts
  - The stalking horse bidder may seek financing or regulatory approval during second phase.
  - An auction is held and highest and best bidder is chosen
    - Chosen by Debtors typically in consultation with key creditor constituents
  - A second hearing occurs to seek approval of the sale, at which the seller presents to the bankruptcy court the highest and best offer received, and seeks final approval to proceed with the sale.
- The transaction usually closes shortly after approval by the bankruptcy court, subject to waiver of 14-day stay period by the bankruptcy court and willingness to proceed to closing prior to expiration of appeal period.
- Note: Especially in this environment, a debtor may not be successful in getting a stalking horse, in which case the debtor will accept bids and go straight to an auction
- COVID-19 Considerations:
  - Compressed timelines and potential impact of suspensions on sale process
  - Private sales?

Advantages of 363 Sales

Protections provided under sale order, including:

- The purchaser acquires assets free and clear of all claims and liens.
- Sale orders typically contain provisions limiting successor liability claims and finding consideration fair and reasonable which precludes fraudulent transfer claims.
- Providing notice (either actual or publication notice) of the sale is critical to bind creditors to the free and clear aspects of the sale order.

Less complex and faster than the plan confirmation process

Most contracts are assignable despite non-assignment clauses

Ability to "cherry-pick" assets and liabilities

Secured creditors can credit bid their debt

May generate more value for a seller than an out-of-court transaction because the buyer has less risk on a number of issues

Certain liabilities may follow the assets notwithstanding the bankruptcy court's free & clear order, e.g., certain ERISA/COBRA obligations

Disadvantages of 363 Sales

A public auction is generally necessary

Transfer taxes and HSR Act requirements cannot be avoided

- But note accelerated HSR waiting period for 363 transactions

Debtors typically prefer a plan because of ability to get releases.

Certain tax attributes may be lost, e.g.:

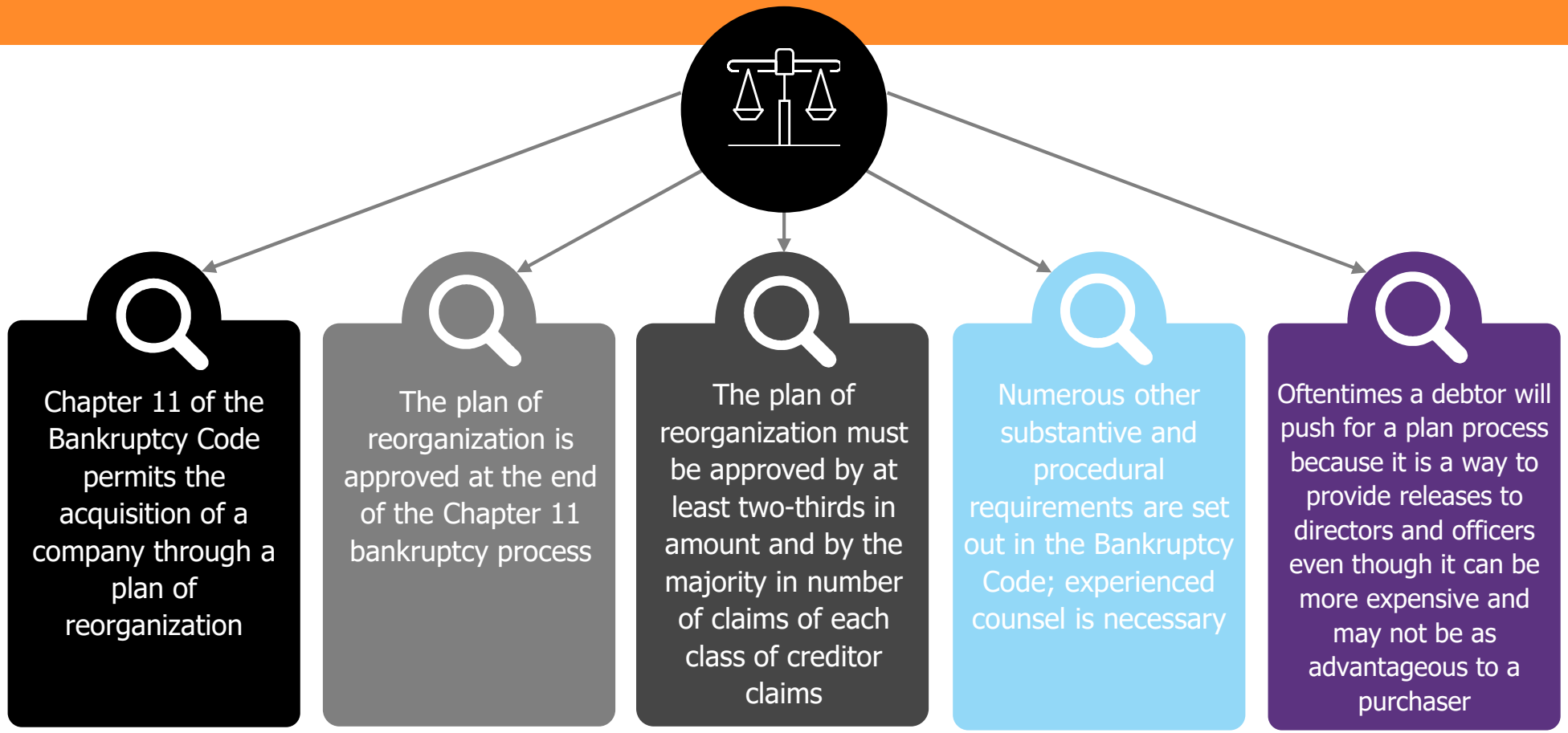
- NOLs
- Capital gains on assets being sold may impact distribution waterfall, cutting out entire classes of stakeholders

As compared to out-of-court transactions:

- Sale must be approved by the bankruptcy court
- Notice must be provided to all interested parties
- Sale is subject to objections
- Can be more expensive and time consuming (typically 60-90 days but can be shortened for "cause")


OTHER ACQUISITION
APPROACHES

Acquiring a Debtor through its Chapter 11 Plan



Advantages of Confirmed Plan

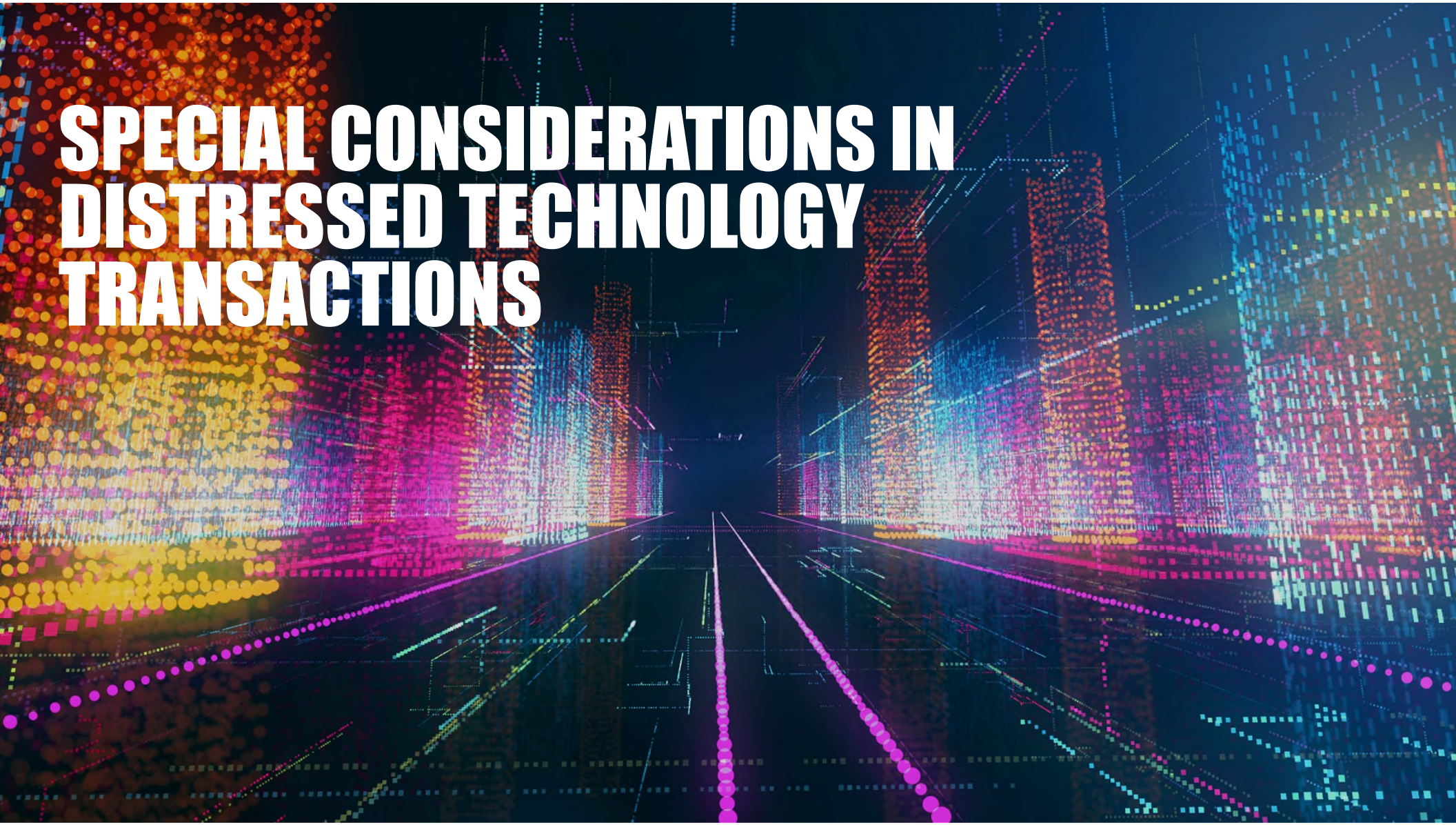
- Can be a very flexible option in terms of structuring the entirety of the acquired business
- Broad releases of liabilities and obligations
- Public auction may not be required
- Exemption from transfer taxes
- Exemption from registration for securities issued under a plan
- Exemption from HSR Act
- Tax attributes (e.g., NOLs) may be preserved in certain circumstances
- Other potential tax reasons

Disadvantages of Confirmed Plan

- Process can be lengthy and expensive (typically 90-120 days)
- Debtor estate must be financed throughout the process
- Creditors get to vote on the Plan (unlike a 363 sale)
- Risk of failing to line up all necessary constituencies to achieve plan confirmation
- Lengthy bankruptcy may destroy much of the value of the debtor and its relationships with customers, suppliers, etc.
- COVID Consideration: potential for 363 sale combined with a liquidating plan

Assignment for the Benefit of Creditors (ABC)

- Liquidation of assets under state law by assigning all of the seller's assets to an "assignee" or trustee under a trust agreement.
- Some states require court oversight and others do not.
- Process begins very quickly
  - Simple Board resolution needed
  - Assignment document is relatively simple and straightforward
  - Equivalent of "tossing the keys" to the Assignee
- The assignee serves as a fiduciary for purposes of liquidating the assets and distributing the proceeds to creditors.
- Since the debtor is out of the picture, due diligence can be difficult, and trustee will not generally stand behind the assets.
- Leases/licenses/contracts are not assignable without consent where anti-assignment clauses exist.
- Assets cannot be assigned free and clear of liens, thus secured lender consent is required.


SPECIAL CONSIDERATIONS IN
DISTRESSED TECHNOLOGY
TRANSACTIONS

Treatment of IP In Bankruptcy

- IP Acquired through bankruptcy is not acquired "free and clear" of all prior encumbrances
  - IP is still subject to previously granted licenses
  - IP is still subject to previously made "FRAND" commitments to standards bodies, such as ANSI, ITU, etc.
  - It can nevertheless be attractively priced and valuable for many IP buyers.
- Bankruptcy Code Section 365(n) protects licenses of IP affected by Bankruptcy
  - Not all IP is afforded 365(n) protections, and notably trademarks are excluded
  - Patents, patent applications, inventions, trade secrets, copyrights and mask works are included.
- For licenses rejected by a bankrupt licensor, the licensee can:
  - (i) treat the license as terminated and seek damages like other creditors; or
  - (ii) elect to have the IP license continue for as long as the licensee continues to pay royalties or other fees due according to the term of the original license and any extensions of the term. Licensee cannot force the debtor to honor any other affirmative commitments in licenses after rejection of the license.

Treatment of IP In Bankruptcy

- Licensees that are debtors in Bankruptcy can:
  - Assume or reject IP licenses according to established time periods; and
  - Attempt to sell IP licenses that are assumed.
  - However, section 365(c) of the Bankruptcy Code provides that when applicable non-bankruptcy law prohibits a contract's assignment, it may not be assumed or assigned by a debtor without the permission of the non-debtor counterparty to the contract.
    - Generally, courts have allowed assignment and assumption of exclusive IP licenses even without consent of the counterparty in most jurisdictions, except California, because exclusive licenses are more like property.
    - Non-exclusive IP licenses generally require consent of the counterparty where assignment is prohibited.

Why Technology Companies Need to Consider CFIUS

- US technology companies considering capital raise or acquisition rais from foreign persons may be subject to CFIUS review before (or after) the transaction closes. If you have "critical technology" or if a significant investor is considered "foreign government-controlled" the transaction may be subject to mandatory CFIUS clearance before it closes. Even if no mandatory CFIUS clearance is required if you are operating in certain areas (eg., have sensitive personal data) you may be subject to a post-closing review.
- US technology companies need to understand early on:
  - if there technology is controlled for US export purposes;
  - if it constitutes "critical technology" for CFIUS purposes, or
  - if an investor is considered foreign or foreign government controlled.
- Even when investment is being made by US person these questions are being raised as it could impact potential buyer, future financing or exit upside.
- Applicability can add delay or risk to closing a transaction or investment.

Overview of CFIUS Today

- US has a long history of reviewing cross-border investment and M&A (FDI) to assess the national security implications of these transactions. Most transactions occur outside of U.S. Government review.
- Congress amended CFIUS process in 1988, 1993, 2007 and 2018. In 2018 in rare bipartisan effort, Congress passed and the President signed the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA).
- Treasury issued final regulations effective in February 2020. Whereas CFIUS filings had previously been voluntary where a foreign investor exercised control over a US entity - FIRRMA and the regulations established the first mandatory filing requirements for FDI and outlined additional requirements for mandatory filings in certain real estate transactions, non-controlling investments and critical infrastructure deals.

Special Concerns for Technology Companies

FIRRMA Creates new focus on foreign investments in so-called TID businesses. These are businesses that involve certain Technology, Infrastructure or Data.

Critical Technology

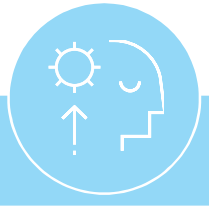
Certain defined or export controlled technologies with additional scrutiny if technology utilized in connection with certain industries (eg: biotechnology, computing, optical instruments and others)

Infrastructure

Certain critical systems (eg. telecommunications, energy, rail, water, telecom and information networks)

Sensitive Personal Data

Companies that have certain collections of non-public sensitive or identifiable data (geolocation, biometric, messaging)



Emerging and Foundational Technology

Treasury expected to expand scrutiny

Considerations for Non-Mandatory Filings

Assuming a transaction is not covered by mandatory filing requirements and it is a covered transaction how does one assess the pros and cons for filing a voluntary notice? What are the factors that should be considered when deciding whether to file a short form voluntary Declaration or a full Joint Voluntary Notice?

Pro Factors	Con Factors
• Whether filing party's nation is of potential concern • Parties previously vetted • If acquirer/investor is a foreign government-controlled or fiduciary entity • If the target is geographically proximate to installations of security concern	• Time and expense of filing • Closing delay • Investment uncertainty • Potential for mitigation restrictions

M&A Considerations

- Consider CFIUS issues in when considering investment and sale or other triggering transactions.
- Certain bona fide changes such as eliminating an equity investment, board or observer rights, access to material non-public technical information relating to "critical technologies" or other limitations on investor rights may be done so that the transaction is no longer subject to mandatory requirements or be a covered transaction.
- It is expected that CFIUS will further increase its review of non-notified covered transactions. Unclear to what extent and where it's focus may lie. Could create divestment or mitigation risk for buyers that fail to make voluntary filings.

Key Takeaways From This Session

- Focus early on IP
- Out-of-Court Transactions may be preferred – but risks remain
- Don't get "tripped up" on regulatory issues
- Speed will be at a premium for 363 Sale Process
  (May impact where cases are filed)
- In current environment, parties will be looking to complete sales quickly and at low cost as funds may not be available to fund a longer, more expensive process
- Debtors will be focused on wrapping up cases quickly through plan process that provides releases

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Andrew Gallo is both an accomplished trial lawyer and bankruptcy attorney. Andrew counsels secured and unsecured creditors, equity holders, and investors in complex Chapter 11 cases and out of court restructurings. He also litigates creditors' rights cases in state and federal (including bankruptcy) courts, with specific experience in fraudulent transfer and lender liability cases. Andrew has also had multiple engagements representing creditors and other parties-in-interest in distressed situations relating to the oil & gas industry. He serves as deputy leader of the firm's bankruptcy and restructuring practice and as co-leader of the firm's energy industry team.

Previously, Andrew was a law clerk for Judge Sidney H. Stein, United States District Court for the Southern District of New York. Before joining Morgan Lewis, Andrew was a partner in the financial restructuring practice at another international law firm, where he helped run the training programs for litigation associates.

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Andrew Ray is the leader of the firm's interdisciplinary corporate practice in Washington, DC, where he represents public and private companies, financial sponsors, and management teams in a broad range of industries, including technology, financial services, life sciences, real estate, and the not-for-profit sector. Various industry publications recognize Andy as a leader in both M&A and in technology, media, and communications law, among other fields. He led the team representing Oculus VR in its $2 billion sale to Facebook, which was named the M&A Advisor M&A Deal of the Year.

Andy writes and speaks frequently on topics that include corporate finance, private equity, technology, M&A, corporate governance, and cross-border deals.

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Rob Bertin is a partner in the Intellectual Property practice group. He has nearly 20 years of experience litigating patent, trademark, trade secret and copyright cases throughout the United States, counseling clients on intellectual property (IP) and negotiating transactions involving IP. He has represented clients at the center of some of the largest patent portfolio sale and licensing events in the high tech industry, including the Nortel and Kodak transactions. Rob leverages a technical background to represent large and small companies primarily in high technology industries.

From his base in Washington, DC , Rob represents large and small clients in IP litigation through trial and appeal in the federal courts and the US International Trade Commission. He also advises clients on patent infringement and validity; conducts IP due diligence; drafts and negotiates license agreements and the IP provisions of M & A transactions; advises on licensing strategies and cultivating patent portfolios and on various other patent, trademark, copyright, and trade secret issues.

Rob's IP practice has been recognized in Super Lawyers (2013–2016) and he is a past chair of the patent, trademark and copyright section of the Bar Association of DC. Involving an array of technologies, Rob's practice includes representing clients with IP issues in wireless telecommunications devices, systems, and services; landline telecommunications devices, systems, and services; computer technology, including software, hardware, Internet, microprocessors, memory, digital signal processors, encryption, data compression, MPEG, object oriented programming, circuit design, and semiconductor technology; electronic commerce, including electronic selling, buying, advertising, billing, auctioning, reservation, and other online businesses; medical devices, including biopsy needles, catheters, flow control devices, balloon technologies, and arterial stents; and various other technologies.

Prior to practicing law, Rob was an electrical engineer with IBM Corporation's Federal Systems Division, where he designed circuits and packaging for logic, memory, and microprocessor chips. He also wrote proposals and technical studies regarding satellite systems and radiation-induced failure mechanisms in semiconductor devices. Rob has published papers and has been awarded two US patents for his work in these areas.

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Bill Wilhelm is a partner in the Telecomm Media and Technology practice group. He advises technology companies on policy, state, and federal regulation and commercial transactions and disputes related to the development and deployment of new communications applications, voice and video services, digital media, and broadband wireless and wireline networks. His clients frequently offer products and services that leverage unique intellectual property, computer technology, or broadband networks.

Clients frequently seek Bill's counsel on new or novel legal issues related to technology. For example, Bill represented a leading Internet telephony provider to obtain a landmark federal court and federal agency decision pre-empting state utility commissions from regulating their service.

Bill's clients include leading technology innovators, venture-backed startups, and established Fortune 500 companies. He advises domestic and international telecommunications companies, intellectual property telephony and video providers, financial institutions, online exchanges, Internet service providers, insurance companies, equipment manufacturers, software developers, email and Internet marketing companies, and broadband and wireless companies, as well as film and Internet content distribution companies.

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