



ABA Roundtable:
IP in Bankruptcy

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Intellectual Property Valuation

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Purpose of the Valuation

- Understand the specific purpose within the bankruptcy context. Illustrative purposes include:
 - To Avoid Bankruptcy
 - Avoidable Preferences
 - Fraudulent Conveyances
 - Solvency/Insolvency Analysis
 - Asset Sales / Adequate Protection
 - Secured Claims
 - Reorganization Plan
 - Collateral for DIP Financing
 - Post-Bankruptcy Monetization



Key IP Valuation Parameters for Bankruptcy

- Purpose of the valuation
- Standard of value
- Premise of value
- Valuation date



Standard of Value

- The “type” of value being utilized for a valuation
- Typically selected to match the purpose of the valuation
- Standards of value
 - Fair market value (hypothetical willing buyer/willing seller)
 - Investment value (i.e., strategic value; value to a specific party)
 - Fair value (many definitions; Bankruptcy Code Section 101(32)(A) leaves the definition up to the courts)
 - Arm’s length standard (tax concept)
 - Defined by statute (e.g., UFCA’s “Present Fair Salable Value”)
- The same asset may have vastly different values under different standards of value



Premise of Value

- Going concern
 - Assumes continued future use of the asset
- Liquidation
 - Two categories
 - Orderly (sold piece-meal over reasonable period of time)
 - Forced (time-constrained - similar to auction; i.e., “fire sale”)
 - Liquidation discounts can be as high as 90%
 - Seller’s bargaining position is disadvantaged even in an orderly liquidation or restructuring
 - Auctions typically have a negative affect on value but can be a positive if they enable competitive bids (Nortel)



Valuation Date

- All valuations only represent a snapshot in time
- Value of the same asset can change from one day to another
- Rely on information “known or knowable”



Common IP Valuation Approaches

- Cost Approach
- Market Approach
- Income Approach



Cost Approach

Definition: a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset*

Theoretical basis: No party involved in an arm's length transaction would be willing to pay more to use the property than the cost to replace the property.

* American Institute of Certified Public Accountants (AICPA), Statement on Standards for Valuation Services 1 (SSVS1), June 2007, "Valuation of a Business, Business Ownership Interest, Security, or Intangible Assets, Appendix B: International Glossary of Business Valuation Terms.



Cost Approach Observations

- Often bears little relationship to value
- Does not reflect earnings potential
- Often no true replacement asset available
- Often irrelevant to buyer/licensee
- Potential relevant applications
 - Embryonic/early-stage technology for which market applications cannot yet be defined
 - Assets that are easy to design around
 - Copyrighted software; little known trademarks
 - Assets for which other valuation approaches aren't available
 - Clinical database example



Market Approach

Definition: a general way of determining a value indication of a business, business ownership interest, security or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities or intangible assets that have been sold*

Theoretical basis: No party involved in an arm's length transaction would be willing to pay more than others have paid for similar assets; The value of an asset can be estimated by observing the value of comparable assets.

* AICPA SSVS1, Appendix B: International Glossary of Business Valuation Terms.



Market Approach Observations

- Can be very useful if an “established royalty” exists
- By definition, IP is unique
- Relatively few comps are typically available
- Most comps are related to going concerns
- More commonly used for trademarks and copyrights; more difficult for patents
 - For patents, often used to establish “ballpark” values, especially for royalty rates
- Difficult to compare deals with many terms and multiples forms of value being shared



Income Approach

Definition: a general way of determining a value indication of a business, business ownership interest, security or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.*

Theoretical basis: A buyer in an arm's-length transaction would be willing to pay some portion of its expected economic gain from using the IP.

* AICPA SSVS1, Appendix B: International Glossary of Business Valuation Terms.



Income Approach Observations

- Most commonly relied-upon approach of the three
- Most rigorous valuation approach
- Can be used in most applications where cash flows are reasonably foreseeable and quantifiable
- Trying to predict the future is always challenging
- Quality of results depends heavily on quality of inputs
- “Spectrum of value”
- Past performance may not be indicative of future performance (Kodak)
- IP damages case law may affect valuation (Kodak)



IP Valuation Best Practices

- Consider all three approaches
 - Available data
 - Purpose of the valuation
 - Try to implement more than one approach
- Determining a value
 - Each valuation approach that is implemented provides a distinct “indication of value”
 - Try to rely on more than one approach, if possible
 - Weigh results based on facts and circumstances
- Use reasonableness tests as a check
 - Brand value example re: Kodak



Contemporary Patent Valuation Issues

- Federal and state legislation
- America Invents Act (AIA) patent validity challenges
 - IPR, CBM, PGR
- Supreme Court decisions
 - Permanent Injunctions: eBay v. MercExchange
 - Patent subject-matter eligibility: Alice Corp. v. CLS Bank
 - Fee shifting: Octane Fitness v. Icon Health
- Federal Circuit case law
 - Entire Market Value Rule (EMVR)
 - Comparable agreements
 - 25% Rule and Nash Bargaining Solution
 - FRAND licensing terms for SEPs



IP Valuation Takeaways

- There is no single right answer
- Whoever does the better analysis has the best answer
- Three approaches are used to determine a “theoretical” value but, ultimately, IP is worth whatever someone will pay for it (Nortel)

Particular Issues Involving Intellectual Property Assets in Bankruptcy

Mike Annis

HUSCH BLACKWELL

Intersection of Bankruptcy and IP Laws

- Bankruptcy –
 - rehabilitate debtors and maximize value of estate for the benefit of creditors
- Intellectual Property -
 - provide protections against erosion of value and for exclusivity

Game Changer in Valuation: *Alice v. CLS Bank*

- *In Alice*, the SCOTUS set forth a 2-part test for judging whether computer implemented business methods claim patent eligible subject matter – or if the patent is seeking to claim an abstract idea.
- Since *Alice* (6/14/14), over 80% of CBM patents reviewed by the USPTO in post-grant proceedings and over 70% of patents challenged in litigation have been found invalid as claiming abstract ideas.

Impact of *Alice* on Patent Valuation

- Biotechnology --Law of nature?
- Computer technology – abstract idea?
- Substantially impacts valuation of patents directed to these fields of endeavor
- Commentators have opined that most CBM patent issued pre-*Alice* are likely valueless due to uncertainty

IP involved in Bankruptcy Proceeding

Two Critical Questions to Answer:

1. What type of asset is involved?
 - patent, copyright, trademark, trade secret?
 - each have their own unique issues in bankruptcy
2. Who “owns” the asset?
 - Debtor? Creditor? Third-party?
 - Determines which Code provisions are at issue

Licensed IP in Bankruptcy Proceeding

- Do you have an “executory contract?”
 - Most IP licenses are considered “executory”
 - Needs some future performance by both parties
 - Needs to be a “material obligation”
- Recent case law confirms most IP license agreements are “executory” in nature
 - Even if exclusive, prepaid and perpetual

Licensed IP in Bankruptcy Proceeding

- Section 365 is the key Code provision
 - Rejection (Section 356(n))
 - Can debtor treat the contract as terminated?
 - Assumption (Sections 365(a) and (c))
 - Can debtor continue on your licensee?
 - Assumption and Assignment (Same)
 - Can the debtor licensee effectively transfer its license rights to another?

Rejection –Section 365(n)

If the IP is owned by the debtor, the trustee or DIP may “reject” the license

– Big question –

- What effect does rejection have on an existing license?
- Does rejection terminate the license and allow Debtor to sell the asset free and clear?

Rejection –Section 365(n)

Answer likely depends upon the type of asset

- Trademarks are not currently defined as “IP” in the Bankruptcy Act
- Circuit split
 - 4th Circuit – Trademarks **not** subject to 365(n)
 - 7th Circuit – Trademarks **are** subject to 365(n)
- PATENT Act – amendment proposed to include TM

Rejection –Section 365(n)

Options Available to Existing Non-betor Licensee Subsequent to Court's Rejection of License

Section 365(n) basically provides the licensee two options:

1. Treat license as terminated by the rejection
-- walk away
2. Licensee can retain its rights under the license so long as it continues to pay required royalty payments

Assumption and Assignment: § 365(a)

Well-settled bankruptcy law permits debtor to assume and assign an executory contract over the objection of the owner (Sections 365(a)&(f))

- The debtor must:
 1. Cure existing defaults or give assurances
 2. Compensate for monetary losses caused by existing defaults or give assurances
 3. Adequate assurances that contract will be performed on prospective basis

Assumption and Assignment: § 365(c)

Exception to the Rule –

“...except as otherwise provided in applicable law.”

Courts will look to law of the subject matter involved in the contract to determine if that law trumps the presumption that the contract is assumable and assignable

Assumption/Assumption and Assignment: Sections 365(a) and (c) - continued

In general, if IP license is “non-exclusive,” need to look at license assignability

- to be effective, the assignment will likely need the owner’s consent

If the IP license is “exclusive,” may be assignable without Licensor’s consent

Assumption and Assignment – §365(a)

■ Patents

- Non-exclusive – no assignment w/o consent
- Exclusive – less than clear

■ Copyrights

- Non-exclusive – no assignment w/o consent
- Exclusive – usually assignable w/o consent

■ Trademarks

- Non-exclusive – not assignable w/o consent
- Exclusive – not assignable w/o consent

Other Issues to Consider

TRADE SECRETS

– Potential Problems

- Disclosure in bankruptcy proceedings without appropriate strictures may likely kill “secret” nature of Trade Secret
- May then be unable to enforce against any third parties

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INTELLECTUAL PROPERTY IN BANKRUPTCY

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CIRCUIT SPLIT REGARDING SECTION 365(c)

- “Hypothetical Test”
 - Third, Fourth, Ninth and Eleventh Circuits.
 - Could debtor assign contract to third party under non-bankruptcy law even if debtor does not currently intend to?
- “Actual Test”
 - First and Fifth Circuits.
 - Applied by bankruptcy courts in Sixth and Eighth.
 - Applies only when DIP/Trustee actually intends to assign contract to third party.

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ALTERNATIVE APPROACHES REGARDING SECTION 365(c)

- “Footstar” Test
 - *In re Footstar, Inc.*, 323 B.R. 566 (Bankr. S.D.N.Y. 2005).
 - Test based upon distinction between DIP/Debtor and Trustee.
- “Ride Through” Approach
 - Used to avoid potential harsh effects of “hypothetical test.”
 - *See .e.g., In re Hernandez*, 287 B.R. 795 (Bankr. D. Ariz. 2002).
 - *In re JZ, LLC (Diamond Z Trailer, Inc. v. JZ L.L.C.)*, 317 B.R. 412 (B.A.P. 9th Cir. 2007).

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CHAPTER 15 AND SECTION 365(n)

- *Jaffe v. Samsung Electronics Co.*, 737 F.3d 14 (4th Cir. 2013) *cert. denied*, 135 S. Ct. 66, 190 L. Ed. 2d 229 (2014)
 - Foreign debtor sought discretionary relief under Section 1521.
 - Balancing of interests under Section 1522 to apply Section 365(n).
 - At stake: \$47 million in estimated re-licensing fees for Debtor.
- Section 1506 “trump card”.
 - Applicable where discretionary relief not sought.
- Pending legislation (Innovation Act).
 - Application of Section 365(n) to Chapter 15 cases.
 - Expand Section 365(n) to include all payments, not just royalties.

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IP CREDITOR/COUNTERPARTY RISK MITIGATION TOOLS

- Good Drafting Pre-Bankruptcy.
 - Consent to assignment.
 - Subject license to Section 365(n).
 - Separate or integrate contracts.
 - Technology escrows.
 - Itemize fees and royalties for bankruptcy scenarios.
 - Lender's notice and opportunity to cure.
- Motion to Compel Assumption or Establish Deadline to Assume/Reject.
 - No specific deadline for debtors to assume IP contracts.
 - But specific deadline (120 days) to assume commercial real property leases.
 - Integrated contracts issues.
 - Require assumption of all related contracts at the same time.
 - E.g.: Franchisors who are lessors and IP licensors.
- Application for Administrative Expense Claim under Section 503(b).

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SECTION 363 SALE ISSUES

- Sales are generally “free and clear” of liens, claims, and interests.
- Can include IP licenses.
 - Section 365(n) does not trump Section 363.
 - Potential analysis under Section 365(h).
 - *See e.g., In re Dynamic Tooling Systems, Inc.*, 349 B.R. 847 (Bankr. D. Kan. 2006).
- Can exclude IP licenses.
 - Buyer gives up potentially valuable licensing fees.
 - *See e.g., Schlumberger Resource Mgmt. Servs, Inc. v. CellNet Data Sys., Inc.*, 327 F.3d 242 (3d. Cir. 2003).

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SECTION 363 SALE ISSUES

- Overview:
 - Auction is norm; however, assets can be sold without auction
 - Stalking horses are common, but not necessary
 - Timeline: Usually requires at least 60 days
 - Court approval of bidding and auction procedures proposed by Debtor
 - Submission of information by bidders to be deemed “Qualified Bidder”
 - Due diligence for “Qualified Bidders”
 - Auction if more than one “Qualified Bid”
 - Selection of “Successful Bidder” and “Backup Successful Bidder”
 - Sale hearing and court approval

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SECTION 363 SALE ISSUES

- Sale order can protect non-debtor licensees, but they must timely object.
 - 363 sale process can be fast (60 days).
 - Deadlines to object established in bidding/sale orders.
- Important Deadlines and Dates for Bidders in Bidding Procedures Orders:
 - Deadline to notify contract counterparties of proposed cure amounts
 - Deadline to notify contract counterparties if contracts will be assumed
 - Auction
 - Sale Hearing
 - Deadline to close
- Important Deadlines for Creditors and Contract Counterparties:
 - Deadline to be notified of proposed assumption/assignment and cure amounts
 - Deadline to object to proposed cure amounts
 - Deadline to object to proposed buyer and adequate assurance of future performance
 - Deadline to object to sale

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SECTION 363 SALE ISSUES

- Section 363(m) Good Faith Purchaser Protections & Mootness.
 - Sales must be stayed to be challenged.
 - If not stayed, appeal will be moot.
 - *See e.g., Matter of Ondova Limited Company (Petfinders, L.L.C. v. Chapter 11 Trustee Daniel J. Sherman)*, Case No. 13-10120, 2015 WL 4773537 (5th Cir. Aug. 14, 2015) (appeal of sale of <petfinders.com> domain name was moot because sale not stayed and challenge to buyer's good faith status not raised before bankruptcy court).

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SECTION 362 AUTOMATIC STAY ISSUES

- Upon filing, Section 362 automatically stays all collection and enforcement upon pre-bankruptcy debts.
 - Certain exceptions apply.
- Pre-bankruptcy multi-party IP litigation.
 - Stay not applicable to non-debtors.
 - Sever option.
 - May need “comfort order” from bankruptcy court.

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SECTION 362 AUTOMATIC STAY ISSUES

- Post-bankruptcy patent infringement actions may be allowed.
 - Based upon 28 U.S.C. §959(a).
 - *Voice Sys. and Servs., Inc. v. VMX, Inc.*, 26 U.S.P.Q.2d 1106 (N.D. Okla. 1992)
 - *In re Television Studio of N.Y.*, 77 B.R. 411 (Bankr. S.D.N.Y. 1987).

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SECTION 362 AUTOMATIC STAY ISSUES

- Section 362(b)(4): “Police or Regulatory Power” Exception
 - ITC Investigations and Actions.
 - *See e.g., In re Qimonda AG*, 425 B.R. 256 (Bankr. E.D. Va., July 16, 2009); *In re Spansion, Inc.* 418 B.R. 84 (Bankr. D. Del. 2009).
 - Bankruptcy courts held that exception did not apply.
 - District courts reversed or vacated decisions.
 - *U.S. Int'l Trade Comm'n v. Jaffe*, 433 B.R. 538 (E.D. Va. 2010).
 - *Samsung Electronics Co. v. Ad Hoc Consortium of Floating Rate Noteholders*, No. CIV. 09-0835, 2010 WL 2636115, at *1 (D. Del. June 29, 2010)

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GRANTING AND PERFECTING SECURITY INTERESTS

- Governed by non-bankruptcy law.
- Perfect by filing at both USPTO or U.S. Copyright Office and State levels.
- Parties must carefully draft loan and security documents and properly perfect.
 - See e.g., *CERx Pharmacy Partners, L.P. v. Provider Meds, LP et. al. v. Cary Lorimer and Stewart Stephens (In re ProviderRX of Grapevine, LLC)*, 507 B.R. 132 (Bankr. N.D. Tex. 2014).
- Lien avoidance under Sections 544 and 545.

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VALUATION ISSUES

- Potential impact of *Alice* decision on patents serving as collateral.
- Is lender over or under secured?
 - Relief from the automatic stay.
 - Cash collateral and adequate protection.
 - Post-petition interest and fees.
 - Ch. 11 plan voting.
- Is/Was Debtor Insolvent?
 - Preference and fraudulent transfer litigation under Sections 547 and 548.

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SUBJECT MATTER JURISDICTION ISSUES

- Federal Courts Usually Decide IP and Bankruptcy Issues.
- *But see, Spiro v. Vions Tech. Inc.*, No. CIV.A. 8287-VCP, 2014 WL 1245032, at *1 (Del. Ch. Mar. 24, 2014)
 - Chancery Court held it had subject matter jurisdiction to decide ownership of IP abandoned by bankruptcy trustee.

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Questions