

Searching for IP Value in Bankruptcy

IP Law & Business

[By Jennifer Alvey](#)

November 3, 2008

That patents are liquid assets capable of being monetized is a fervent, if still somewhat novel, tenet of belief in the IP community. Patent-holding companies, auctioneers, venture capitalists and patent brokers have all set up shop to realize that vision.

But have corporate and bankruptcy lawyers caught on?

That's a hot question, given the wave of bankruptcies expected as a result of the banking crisis. IP lawyer Jeffery Norman of Kirkland & Ellis was a bankruptcy attorney during the S&L crisis of the early 1990s, and he expects that now, as then, there will be three waves of bankruptcy: financial companies first, then retailers that depend on financial companies to fund their operations, and finally those who supply those retailers.

While there is relatively little IP in the first wave, there's more in the second wave involving retailers. The third category — the companies that make goods or license know-how — is where most IP resides. When manufacturers and suppliers start to fail, corporate IP attorneys are going to get busy, Norman says. Ed Black, a transactional IP lawyer at Ropes & Gray, says already "there's definitely an uptick around debt-related issues — for instance, a licensee wanting to make sure it is protected if the licensor declares bankruptcy."

But if history is any guide, says Ron Epstein, CEO at IPotential, a Silicon Valley-based patent broker, "a lot of value will be lost for creditors" in bankruptcy. That's because corporate and bankruptcy attorneys are trained to keep their eyes on the balance sheet, where IP rarely appears at its market value. That didn't matter so much during tough times in the past.

"In 1982, 62 percent of corporate value was tangible — real estate, machinery and the like," points out Darren Collins, an IP partner at Sonnenschein, Nath & Rosenthal in Dallas. "Now U.S. companies' assets are mostly intangible — 62 percent of value is either intangibles, or a mix of tangible with intangible rights, such as selling licensed T-shirts."

But the sophistication of investors, creditors and their lawyers hasn't kept pace with the change, at least according to Epstein. "Liquidators still throw patents in the toilet," he says. So he is busy trying to market IPotential's services to the bankruptcy bar and to venture capitalists.

The VC community, which depends on blockbuster winners, tends to want just to sweep away their mistakes. Epstein tells the tale of two patents that belonged to a failed Silicon Valley voice-over-Internet start-up. "The venture capitalists in charge got two offers to buy the patents for \$2 million," Epstein recalls. "They said, 'Gee, that sounds like enough.' But then a minority investor got involved and got them to hire me. We ended up getting \$5.5 million. The VCs were happy."

Meanwhile, in-house IP attorneys would be wise to think the unthinkable — what would maximize the value of their company's IP if it had to file for bankruptcy. "It would be shortsighted not to do that," says Kirkland's Norman. Companies that are licensors should be evaluating whether their existing deals didn't demand enough money, or had too few obligations attached to it, and whether they should try to terminate the license in bankruptcy.

Basic housekeeping such as IP inventories can prevent headaches down the road, says Collins. Because corporate lawyers are calling the shots, the time for valuing IP assets often is very short — maybe a week — once a bankruptcy is about to be filed. He recalls a telecommunications client that was about to file for a reorganization. The deal was almost derailed by a company that supplied and serviced the software on the troubled company's servers; it refused to continue to provide support. "These were not core patents," Collins says.

The telecom company had to relicense the software at an increased price. Even though copyright and patent licenses cannot be automatically terminated in a bankrupt estate by statute, licensees are only entitled to the naked license, and licensors can terminate any support and service obligations.

One big issue for IP in U.S. bankruptcies is the different treatment that trademarks receive, says Lori Lesser, a partner at Simpson Thacher & Bartlett. Licensors in bankruptcy can revoke trademark licenses. The time therefore to deal with the potential of bankruptcy in a trademark deal is when the deal is struck, says Black. In many circumstances, licensees can persuade licensors to place their marks in a "bankruptcy-remote" holding company.

With copyright and patents, Norman recommends that licensors insist on a provision to get their license back if the licensee runs into financial strain. Similarly for licensees, "if you've got a bad deal, you're stuck with it," says Black, "once the licensor's bankruptcy petition is filed."

Licensor companies often want to help out troubled suppliers by letting royalty payments slide. That's a mistake. "You're better off being hard-nosed, unfortunately," says Norman. Allowing late payments could endanger the licensor's priority in any later bankruptcy proceedings, making it harder or impossible to recover royalty payments owed. Bankruptcy courts look not only at late payments, but also at the payment history.

"If you've always let your licensee pay three days late and continue to do that," you likely won't endanger priority. "But if you start letting that slide to five or eight days, you'll definitely have a problem," says Norman. It's a rough world out there.

Jennifer Alvey is a reporter for IP Law & Business, a Recorder affiliate based in New York.