

Pitfalls In Transacting Business With Financially Distressed Parties



Patrick Costello

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Note: This version presents the transaction scenarios and the general nature of the bankruptcy risk: my full in person presentation describes the nature of the risks in detail and discusses potential solutions

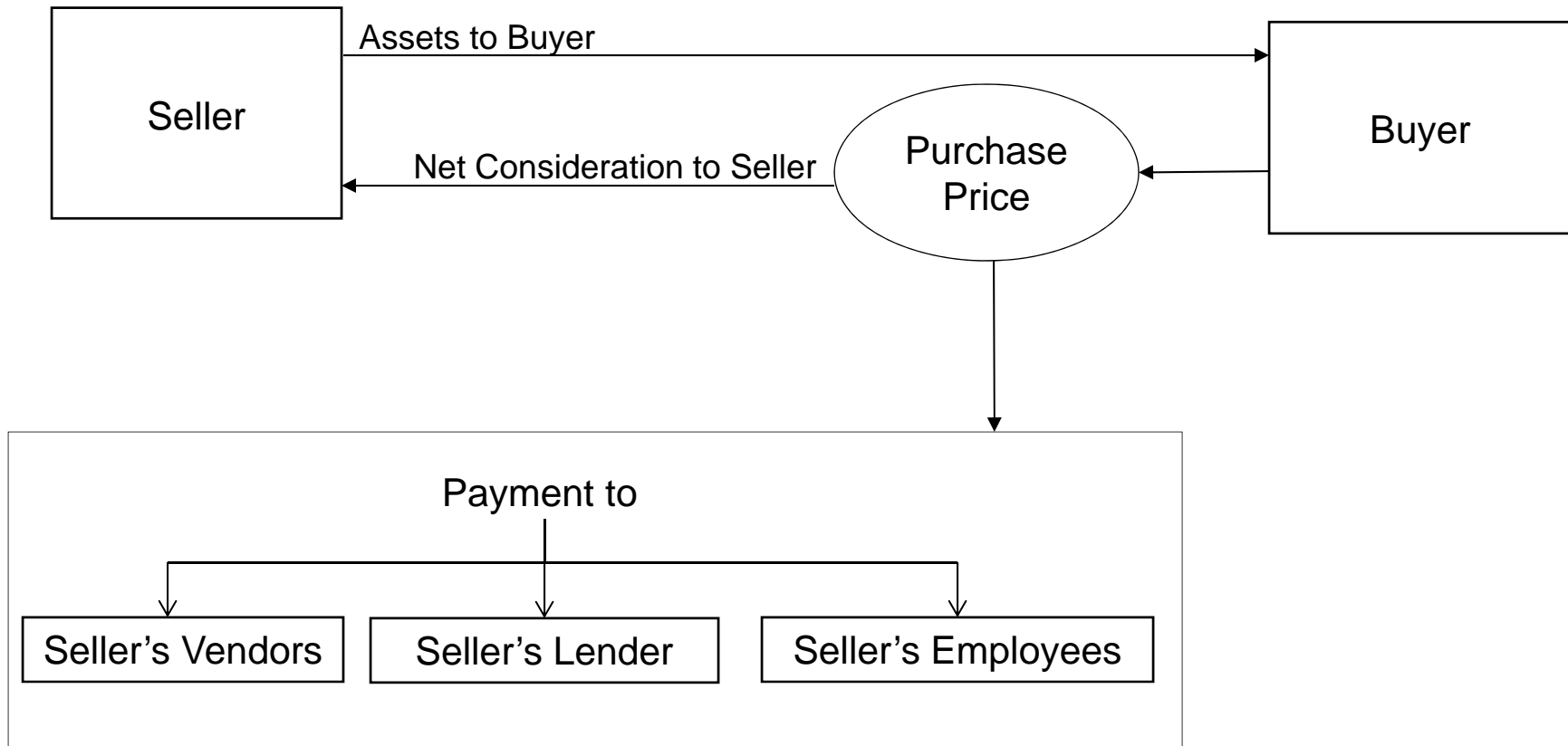
- Entering into a transaction with a financially distressed entity introduces insolvency/bankruptcy risks to which a counterparty may not be accustomed
- Vectis Law Group's objectives are threefold:
 - Identify the nature, magnitude and probability of bankruptcy risk for the decision makers
 - Formulate the changes to the transaction structure that reduce the bankruptcy risk
 - Assist decision makers in weighing bankruptcy risk against the cost of structural changes

The Pitfalls

1. Asset Purchase with Assumption of Liabilities as Consideration
2. Acquisition from a Corporate Group
3. Acquisition by Foreclosure Sale
4. Secured Loan where Priority is Achieved by a Contractual Subordination
5. The Multiple X Secured Bridge Loan
6. Secured Loans to Corporate Groups
7. The Loan Collateralized by Software/Copyright
8. License of Encumbered IP
9. The “Springing” License
10. The Developmental IP License

PITFALL #1: Asset Purchase and Assumption of Liabilities as Part of Consideration for Transfer of Assets

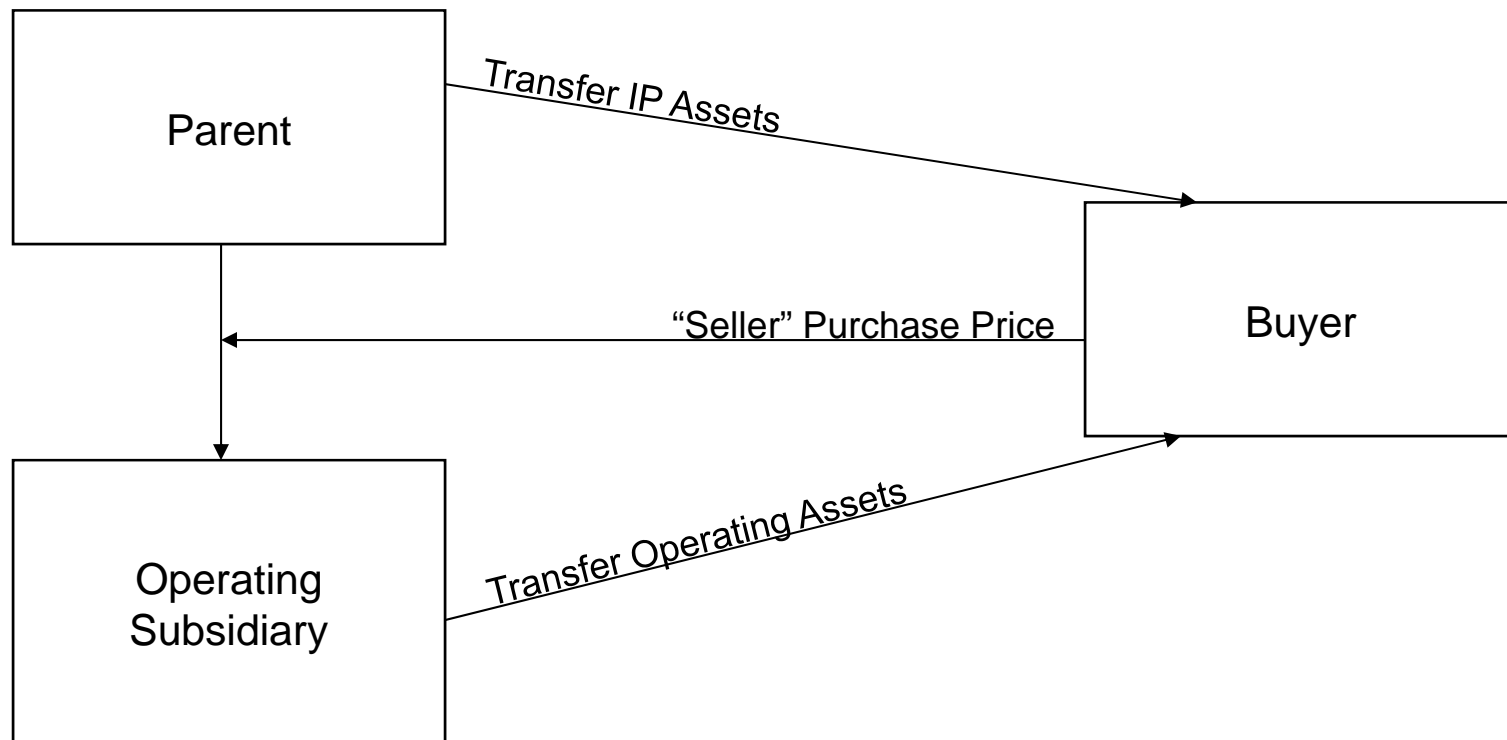
- Proposed Transaction Structure:
 - Distressed seller is selling assets to Client
 - Client proposed to pay some cash and assume certain debts (employees, key vendors, etc.) as consideration



Bankruptcy Risk: Preference

PITFALL #2: Acquisition from a Corporate Group

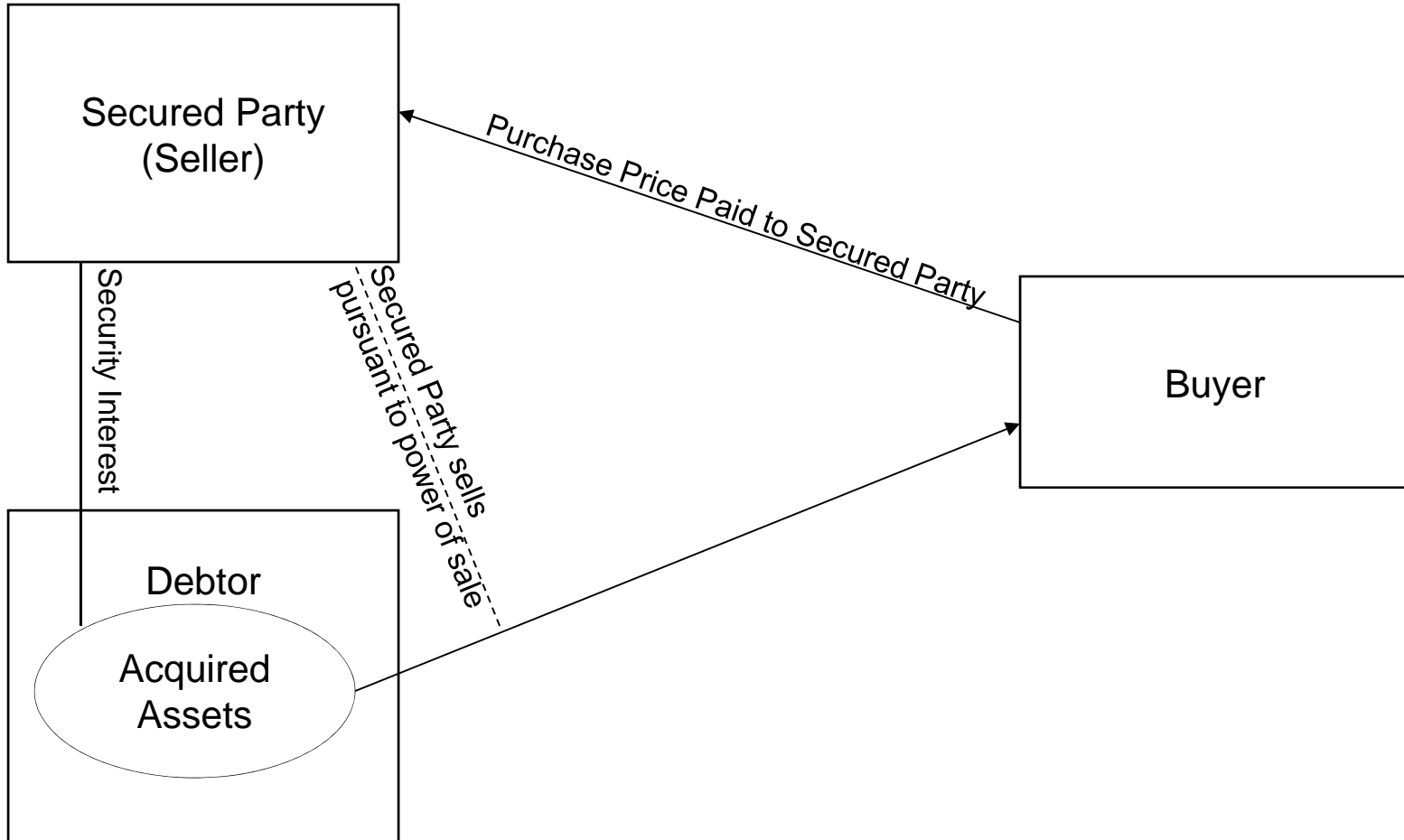
- Proposed Transaction Structure:
 - Assets to be acquired are split between parent and subsidiary (e.g.: IP is parent asset and operating assets are subsidiary assets)
 - Both parent and subsidiary are parties to APA and defined collectively as “Seller” and purchase price is to be paid to “Seller”



Bankruptcy Risk: Constructive Fraudulent Conveyance

PITFALL #3: Acquisition by Foreclosure Sale

- Proposed Transaction Structure:
 - Secured creditor of debtor sells debtor’s assets to buyer

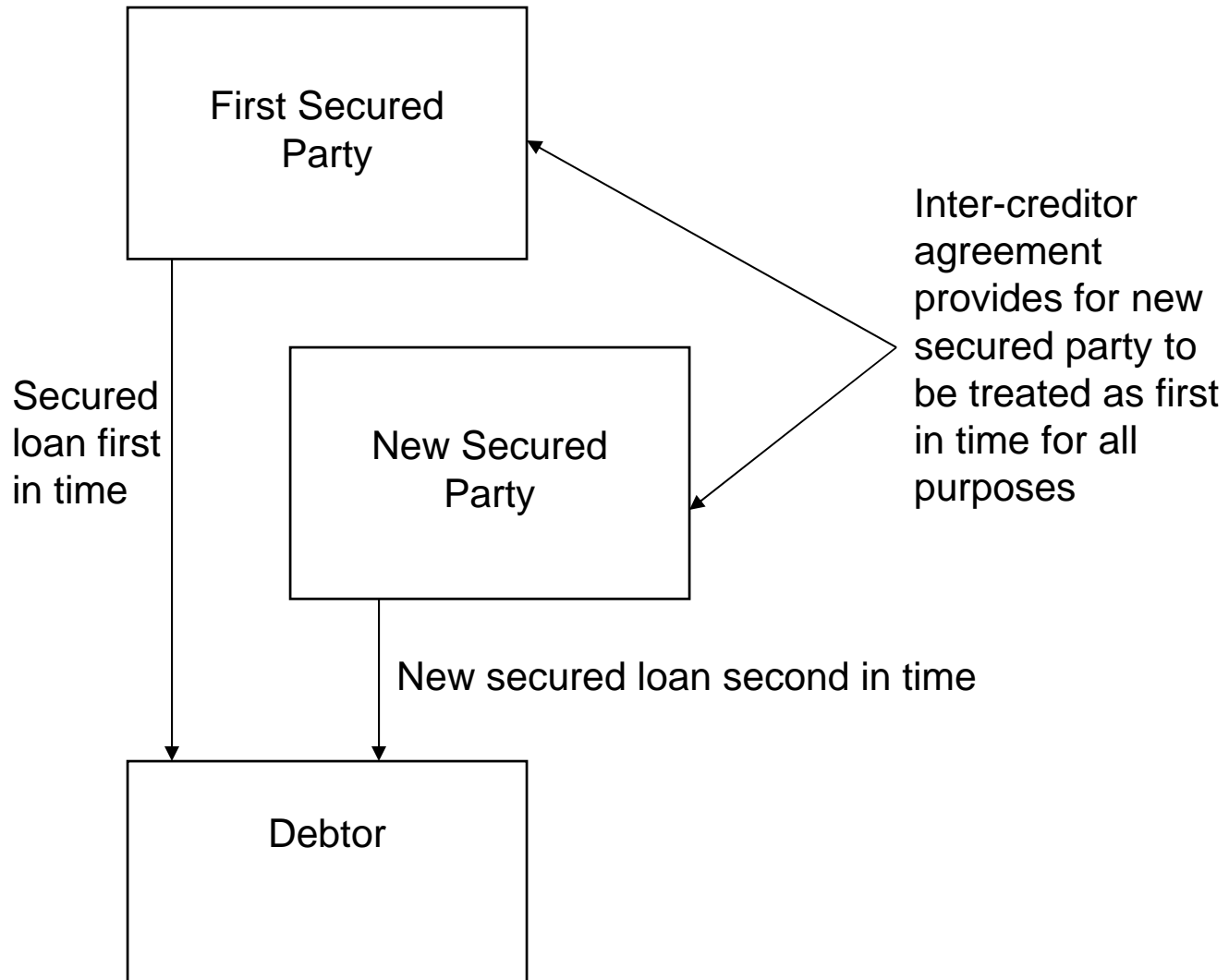


Bankruptcy Risks:

- Preference
- Fraudulent Conveyance
- Senior Encumbrance

PITFALL #4: Secured Bridge Loan Where Seniority Is Achieved By Contractual Subordination Of An Existing Security Interest

- Proposed Transaction Structure:
 - New player (e.g., bidder, supplier, investors) will make a secured loan to distressed company to bridge company to liquidity event
 - A secured loan from investors is in place
 - Seniority of new loan is to be achieved through an inter-creditor/subordination agreement



Bankruptcy Risk: Avoidance of First-In-Time Security Interest

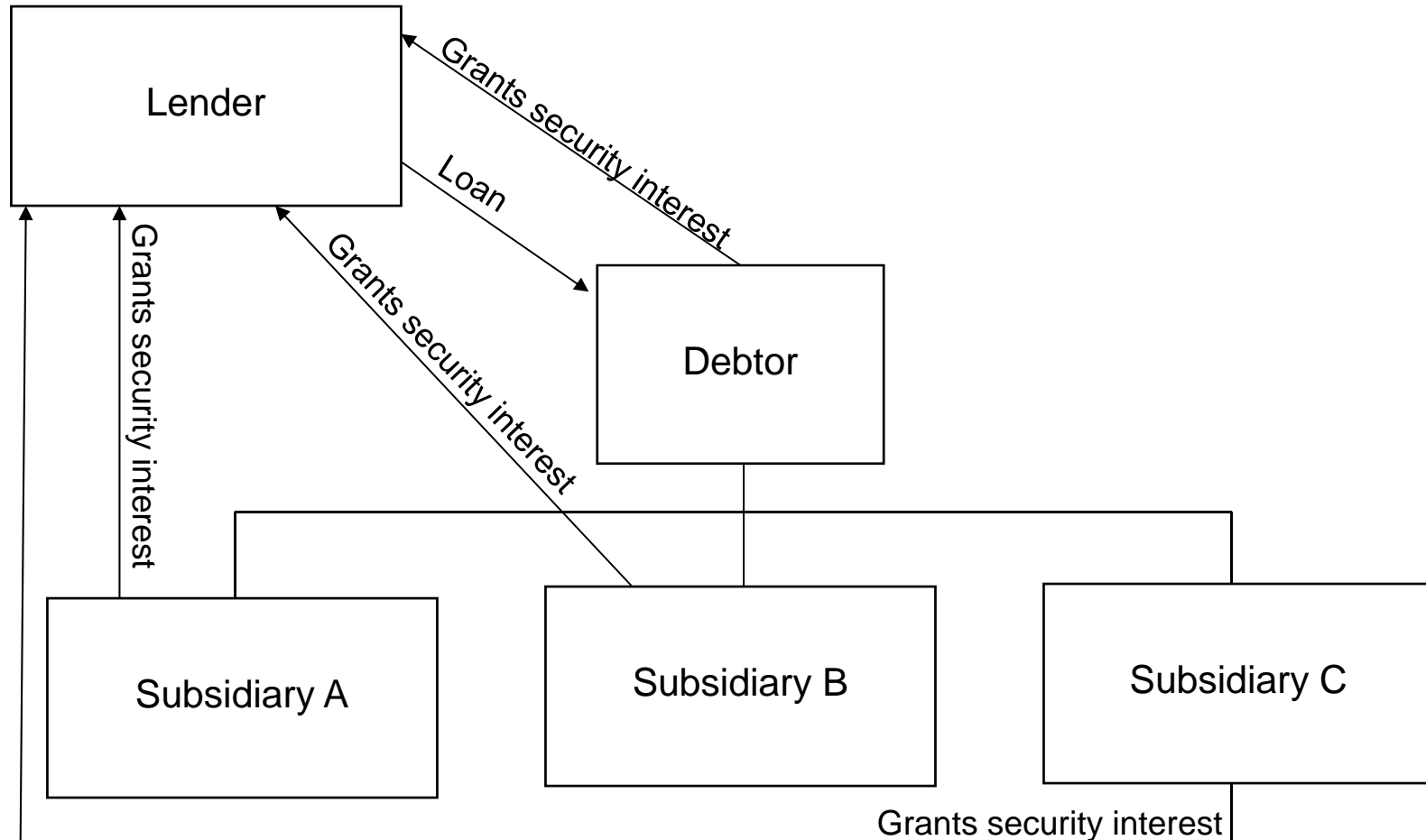
PITFALL #5: The Multiple X Bridge Loan

- Proposed Transaction Structure:
 - Investors are making a bridge loan to distressed company
 - Loan is to be secured by security interest and is entitled to a multiple x return on the sale of the Company's assets

Bankruptcy Risk: Fraudulent Conveyance

PITFALL #6: Secured Loans To Corporate Groups

- Proposed Transaction Structure:
 - Lender makes loan to corporate parent secured by blanket security interest in assets of parent and subsidiaries



Bankruptcy Risk:

- Fraudulent Conveyance
- Suretyship Defenses

PITFALL #7: The Software/Copyright Based Secured Loan

- Proposed Transaction Structure:
 - Investor/lender is making a secured loan to company
 - Credit worthiness of company is based in material part on the company's software
 - Software is protected by copyright, but company for a variety of reasons has not registered the copyright – a practice prevalent in the industry

Bankruptcy Risk: “Unperfection” and Avoidance

Licensing

PITFALL #8: IP License From Licensor Who Has Encumbered Its Intellectual Property

- Proposed Transaction Structure:
 - Client is negotiating to acquire a license to IP
 - Proposed licensor has granted a security interest in its IP to its lender

Bankruptcy Risks:

- License Rejection
- Senior Encumbrance

PITFALL #9: Taking a “Springing” License

- Proposed Transaction Structure:
 - Manufacturer or customer, insists on a license to ensure ability to manufacture and/or distribute IP-based products in the case of a default and failure to perform
 - License is to “spring” into place and becomes effective on bankruptcy, insolvency or other liquidation

Bankruptcy Risk: Void Under Ipso Facto Provisions

PITFALL #10: The Developmental IP License Agreement

- Proposed Transaction Structure:
 - Licensee enters into license agreement that requires licensee to pay substantial fees/royalties and make substantial investment toward IP/technology that requires material ongoing enhancement/development by licensor

Bankruptcy Risk: Rejection