DETERMINING AND PRESERVING THE ASSETS OF DOT-COMS

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ABSTRACT

The dot-com company is not your father's hard asset wielding company. Typical "old economy" or "brick and mortar" companies possess hard or tangible assets like equipment, fixtures, and inventory. Dot-com companies, on the other hand, possess less tangible, but not necessarily less valuable, assets like customer lists, data, software technology, trademarks, copyrights, patents, domain names, and other intellectual property. As long as the company remains profitable, so does the company's intellectual and intangible property.

What comes up, however, must inevitably come down. As the dot-com surge has come tumbling down, many dot-com companies, like their sister "brick and mortar" companies, have sought protection in bankruptcy. Because a dot-com's primary assets are intangible, however, the value of its primary asset tends to decline with the company. In addition, the Revised U.C.C. Article 9 has changed the rules for perfecting security interests in intellectual property. This article presents the problem of determining what assets a dot-com company has at bankruptcy, how to preserve the value of those assets, and who under the Revised Article 9 has a perfected security interest in the assets.

I. INTRODUCTION

The key for struggling companies looking to reorganize under Chapter 11 of the Bankruptcy Code, with few exceptions, is to have a profitable base of core assets available to restructure the business. When an "old economy" company fails,1 there is typically a significant body of tangible assets available to convert into cash. This conversion to cash can

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1"Old economy," used in this sense, refers to traditional "bricks and mortar" companies with hard assets.
provide either a foundation for a restructured company to go forward, or money to repay some portion of the failed company's debt. Having hard (or tangible) assets will likely result in a bankruptcy filing that gives debt holders a comfortable process of asset conversion.

Dot-com companies, however, rarely possess any meaningful base of hard assets. Most dot-com, or "new economy," companies possess few hard assets and instead leverage off the inventory of others. Dot-com companies rarely have any real estate value, or value in the leaseholds, because the majority of dot-coms have only been in existence for a few years. Dot-coms also tend to lack measurable amounts of furniture, fixtures, or equipment of value because their computer systems tend to be leased, not owned. Consequently, the bulk of dot-com companies' asset value exists in intangible assets, including: intellectual property (i.e., copyrights, trademarks and patents); proprietary software or technology; Internet addresses or domain names; licensing agreements; brand name(s); customer lists and data; and key employees.2

"New economy" assets, along with the dot-com industry, are currently undergoing a major transition. Dot-com companies are running out of cash at an ever-increasing rate and cannot absorb operating losses for future growth or profits. Venture capital firms and individual investors are no longer providing an endless stream of funds to dot-coms. Moreover, traditional asset-based lenders are loathe to finance a failing dot-com unless its credit is secured. "[T]he slide into insolvency [for dot-coms] can be abrupt because of the lack of tangible and intangible assets, and . . . financing."3 "Internet casualties are beginning to pile up from the shakeout in electronic commerce, and financial experts are finding that it is easier to liquidate a factory than a Web page."4 The fate of a failing dot-com largely depends on whether the "idea" is worth salvaging.

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2 Intellectual property assets usually have a very limited value outside of the business because of the specificity of the intellectual property to the company. Roger G. Schwartz & Shelly C. Chapman, Does one size fit all?, NAT'L J., Feb. 12, 2001, at B9. Key employees of declining dot-com companies are also very hard to retain, and they cannot be easily replaced because of their specialized knowledge of the company's technology. Id.

3 Scott Blakeley, Red Flags That May Signal Your Dot-com Customer Is Falling from Cyberspace and into Insolvency, 103 BUS. CREDIT 33, Jan. 1, 2001 (indicating that the red flags of a dot-com sliding into insolvency are: (1) Excess cash burn rate; (2) Source of financing stalled; (3) Management and key employee departure; (4) Stock price decline; (5) Fat advertising and marketing budgets; (6) Patented technology; (7) Profits in near future are dim; (8) Key customer has financial difficulties; (9) Using tax money to pay the bills; (10) Ignoring phone calls and emails; (11) Vulture investors circling).

4 What'll you bid for this failed 'dot-com'?, REUTERS, June 12, 2000, available at http://news.zdnet.co.uk/story/0,,2698-s2079495,00.html.
Given the nature of dot-com assets and the infancy of the industry, what process will companies utilize to deal with the financial crisis and impending insolvency? This article answers this question by evaluating the type and value of dot-com assets. More specifically, Part II of this article discusses the disposition and preservation of dot-com assets when financial crisis strikes. Part III continues the discussion by identifying and addressing the issues surrounding a dot-com company's assets and the determination of the legal rights in those assets. Finally, Part IV addresses the difficulties faced when valuing those assets.

II. WHEN FINANCIAL CRISIS STRIKES

A dot-com company has several choices for the disposition of assets when financial crisis strikes, including: Chapter 11 reorganization or liquidation bankruptcy; Chapter 7 liquidation bankruptcy; merger and acquisition; asset sales or liquidation outside of bankruptcy; or cessation of operations and abandonment of the business. While a number of factors must be evaluated to make this determination, the most important factor is the nature and value of the company's assets.

Chapter 11 is the traditional refuge for companies that wish to continue operations but need the protection of the automatic stay provision in the Bankruptcy Code while they shed debt and reorganize. Chapter 11, however, may not be the best means available to dispose of assets in the early stages of financial crisis for dot-com companies. Whether a dot-com intends to enter Chapter 11 to reorganize or liquidate, two main problems may prevent a successful result. First, dot-coms often do not have sufficient cash to fund bankruptcy proceedings because they wait until the eleventh hour for an infusion of cash from an investor or lender, but find little secured value on which to provide debtor-in-possession financing. Second, the value of any assets that do exist depreciate at an alarming rate. Typically, start-up dot-coms have not realized a profit, making it nearly impossible to reorganize. Many dot-com entrepreneurs will simply move on to new businesses instead of working through bankruptcy proceedings.

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7 As one attorney noted, "Hope springs eternal from the breast of debtors . . . . They tend to try to keep away from bankruptcy . . . as long as possible, and it becomes a self-fulfilling proposition because reality does not set in until the company is completely out of cash. They are completely out of options by the time they come to your doorstep." James R. Grube et al., Hi-Tech and Telcom in Financial Distress Roundtable, 8 AM. BANKR. INST. L. REV. 205, 213-14 (2000) (statement of Bill Weintraub).
As the dot-com industry matures and asset bases are solidified, Chapter 11 may eventually become the dot-com's standard process for orderly reorganization or disposal of assets. Moreover, Chapter 11 may become the process of choice for dot-coms once it becomes easier to identify intangible assets, once the law regarding intellectual property rights in the industry stabilizes, and once the valuation of intangible assets becomes more reliable and standardized. Bankruptcy attorneys who have kept current on the fluctuations involving "new economy" assets will have a decided advantage.

The recent period of stock market re-pricing has presented another type of wealth creation activity in merger and acquisition (M&A) transactions. The stock market is identifying struggling dot-coms and, accordingly, setting the price of their stock. At the same time, relatively solid dot-coms are acquiring unsuccessful dot-com companies at record setting rates. More than $200 billion in Internet M&A transactions occurred in the first quarter of 2000, and there were fourteen Internet M&As in the second quarter of more than $1 billion each. Through M&As, even some unsuccessful dot-com entrepreneurs have become wealthy.

Highly profitable M&A transactions, however, are more the exception than the rule. A more typical disposition of dot-com assets in the current environment is the M&A of British retailer Boo.com. Boo.com devoured $135 million in investor cash, boarded up its doors, and hired KPMG LLP to liquidate. Bright Station, a British information technology firm, bought its technology for a mere $368,800, and the website was sold for an undisclosed amount to fashionmall.com.

Other dot-coms have been even less fortunate. Some dot-coms have called specialized liquidators to buy and sell assets including websites, software, intellectual property, domain names, chat rooms, customer lists, and graphics. The dot-coms expect to find buyers from other dot-coms looking to grow through acquisitions or from "old economy" companies looking to expand into Internet commerce. Other dot-coms simply shut down operations and walk away after deciding that selling some office

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furniture and a domain name (if possible) is not worth the effort.11 Regardless of the methods chosen, assets will need to be identified, legal rights determined, and a valuation rendered.

III. IDENTIFYING DOT-COM ASSETS AND THEIR LEGAL RIGHTS

Determining the assets owned by a dot-com company entails a two-step process. The first step is to separate and identify the specified tangible and intangible assets. As previously stated, due to the nature of dot-com assets, intangible assets are likely to be the primary assets of a dot-com company.

The second step is to determine and analyze the bundle of legal rights subject to appraisal.12 According to the bundle of rights theory, complete intangible asset ownership, or title in fee, consists of a group of distinct legal rights. Each of these legal rights can be separated from the bundle and conveyed by the fee owner to other parties either in perpetuity or for a limited period of time. When a right is separated from the bundle and transferred, a partial or fractional property interest results. It is possible to examine property interests in [individual] intangible assets from several points of view... because the legal, economic and financial aspects of ownership of intangible assets overlap... Different economic values [will] attach to the different ownership interests.13

As a prelude to the discussion of dot-com assets, it is interesting to note one commentator's statement that "[i]t's amazing to see a startup get $100 million in financing and then when the robe gets taken off, there's nothing... What do you have...? The domain name, a little bit of capital, and the crown jewel: the customer database."14

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11 A domain name could be a very valuable asset in bankruptcy if, among other things, the name is familiar or popular. Wine.com founder, David Harmon, in 1999, sold the domain name for $3.5 million. Conor O'Clery, Bankruptcy auction turns Napa Valley's Wine.com e-tailing dream to vinegar, IR TIMES, June 25, 2001. Although, the majority of domain names that were valued in the millions before are now going for only $10,000 to $20,000. Sally McGrane, The Crash's Silver Lining, FORBES, Sept. 10, 2001, at 26.

12 Reilly, suspra note 8, at *4.

13 Id.

A. Customer Lists and Data

The national debate developing over the sale of confidential customer data by dot-coms has illustrated the sharp contrast between constitutional privacy rights and the basic bankruptcy goal of maintaining value to creditors. "The databases contain not only customer names, addresses, credit card information and phone numbers, but often shopping histories and Web-surfing habits." In the frenzy to pay irate creditors, companies try to sell any assets they may have, including information purported to be confidential. A New York Law Journal article noted that:

never before has the accumulation of personal information been so important to businesses as it now is to many internet businesses. Indeed, the ease of accumulation and transfer of personal information is one of the greatest marketing claims of Internet companies. In many respects, in markets where the barriers to entry are low, as they are in many Internet businesses, the ability to collect personal information, and the advantage of being the competitor with the most or best information, is one of the attributes that ... drives many of the high market valuations of Internet companies.17

The economic value of customer information has persuaded some companies, even those not in financial crisis, not to adhere to the privacy policies they advertise. These promises will be worth even less once a company begins to slide into insolvency. "Authorities, however, typically can step in only if the e-tailer [(an internet-based retailer)] has a policy on its Web site promising not to sell personal information . . . ." However, unless such sales are brought into a public forum, such as bankruptcy, agencies have a very difficult time monitoring them.19

The central question is whether bankruptcy will make it possible for an Internet company that has collected data under privacy policies to sell the data it has accumulated. It appears possible, but the debate is still

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15These privacy rights typically arise from statutory or contractual privacy rights—either from the posted privacy policy of the business or from consumer laws.
18Davidson, supra note 16, at E2.
19Id.
ranging. The United States appears to be promoting a "self-regulation" paradigm through the contractual obligations of voluntary privacy policies put forth by dot-com companies as an alternative to stronger informational privacy rights statutes for individuals. Despite this general policy, members of Congress, the Federal Trade Commission (FTC), and various state legislatures are beginning to craft a more uniform policy regarding the use of customer data collected under an advertised privacy policy. Additionally, on July 12, 2000, the Privacy Policy Enforcement in Bankruptcy Act, S. 2857, was introduced in the Senate. The bill would amend section 541 of the Bankruptcy Code to exclude confidential customer data from the bankrupt estate. In contrast, the European Union has already issued a directive barring companies from exchanging personal consumer data with entities located in countries outside its jurisdiction that do not offer comparable data privacy protection. Consequently, the prevailing state of the law in this area is unclear.

The seminal case on the above issue is In re Toysmart. Toysmart. com was an e-tailer of toys that teach, of which Walt Disney Company was a majority shareholder. Like many e-tailers, Toysmart.com posted a privacy statement on its website that provided, in part that "[w]hen you register with Toysmart.com, you can rest assured that your information will never be shared by a third party." The company ceased operations on May 19, 2000. On June 9, 2000, creditors filed an involuntary bankruptcy petition against the company. Not long afterwards, Toysmart.com moved for express authority from the bankruptcy court to sell its assets, including its inventory, warehouse fixtures, equipment, domain name, website source code, business plan, and customer lists and databases. The intent was to sell these assets by public auction, free and clear of liens, claims and encumbrances under section 363 of the Bankruptcy Code.

Subsequently, the FTC filed a complaint against Toysmart.com, charging that the sale of the customer data violated section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a), which prohibits unfair

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20Id.
21Larry M. Nashelsky, On-line Privacy Collides With Bankruptcy Creditors; Potential Resolutions for the Competing Concerns, Highlighted by, Unresolved Toysmart Case, N.Y. L.J. Aug. 28, 2000, at S2.
22Id.
23Id.
24Id.
26Id.
27Id.
28Id.
or deceptive acts or practices in or affecting commerce. The FTC complaint sought a permanent injunction to bar the sale of the customer data. At the same time, attorney generals in forty states, as well as TRUSTe, the non-profit agency that certifies the privacy policies of online retailers, also objected to the Toysmart.com sale motion.

On July 21, 2000, the FTC announced an agreed settlement with Toysmart.com which prohibited Toysmart.com from selling the customer data as a standalone asset, but which permitted it to sell the data in connection with the sale of the entire website to a "qualified buyer." According to the settlement, a "qualified buyer" was an entity that operated in a related market and agreed to be bound by the terms of Toysmart.com's privacy statement, unless customers affirmatively consented to changes in policy. The Massachusetts Attorney General and TRUSTe continued to oppose the sale of the customer data. Ultimately, BV, a subsidiary of Walt Disney, bought the customer data for $50,000 on terms that it would destroy or cause the data to be destroyed without disclosing its contents to BV or any other person or entity.

Several other defunct e-tailers, including eToys, Living.com, and More.com, have either agreed not to sell their customer lists or to do so under tight constraints. Living.com entered into a settlement with the Texas Attorney General regarding the sale of its customer data. The settlement permitted the sale of customer data if the customers had an opportunity to opt-out of the transfer of data. A similar agreement with the Maryland Attorney General was reached in e-Toys. "There will be an opt-in notice sent to the customers . . . no credit card information will be given to KB Toys [the purchaser]." More.com, after selling its customer

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30Id.
31Nashelsky, supra note 21, at 52.
32See id.
33See id.
35Texas Settles Privacy Case with On-Line Retailer, National Association of Attorneys General, Bankruptcy Bulletin, at 3, Sept. 2000. The Texas Attorney General, before settlement, alleged that the sale of the list would violate the Texas Deceptive Trade Practices Act because the privacy rights of the customers placed limits on the property interests held by the trustee and precluded the sale of information free and clear of those rights through a sale under section 363 of the Bankruptcy Code. Id. Additionally, if approved by the bankruptcy court, the agreement provided that social security and credit card numbers would be destroyed by a trustee of the court. Id.
36Id.
lists to HealthCentral.com, gave former customers a chance to opt-out through an email sent by HealthCentral. Other dot-coms are letting third parties own and manage their customer data to ease these data privacy concerns.

In addition to the legal issues already discussed, it is conceivable that the customer data could be deemed estate property, and if so sold free and clear of a customer's privacy interest. Alternatively, it is also conceivable that the dot-com's promise not to sell customer data or its agreement with TRUSTe could be an executory contract and rejected under section 365 of the Bankruptcy Code. A company may also choose to breach the agreement, giving the customer a prepetition claim subject to discharge in bankruptcy. It is, however, unlikely that any of these theories would prevail. If any of these arguments were to survive a court's legal scrutiny, the court could—and probably would—exercise its equitable powers to either refuse the rejection of the sale of data, or condition them on similar terms as in the aforementioned cases.

The Toysmart.com case will certainly cause secured lenders to question the value of any dot-com collateral. After all, if a dot-com's customer data cannot be effectively sold, it becomes almost worthless as collateral. Given the uncertainty in this area, dot-coms are probably giving serious thought to their privacy policies. Many have reworked them to provide the flexibility to sell such data in certain circumstances. After the Toysmart.com controversy, Amazon.com revamped its privacy policy by emailing 23 million customers and prominently advertising on its website that "in the unlikely event that Amazon.com, Inc., or substantially all of its assets are acquired, customer information will of course be one of the transferred assets."

B. Domain Names

A domain name operates as a dot-com company's business address on the Internet. Each entity maintaining a presence on the Internet is assigned a domain name consisting of a unique set of words, often separated by dots or other symbols. As corporate names, a domain name will often indicate the nature and content of the dot-com's businesses and website. Domain names share many similarities with trademarks and are

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treated as possessing an inherent intellectual property right. As such, many companies have assumed that domain names could be transferred freely.

Prepetition security interests in domain names and other intellectual property (including the copyrights, patents, trademarks, software and license agreements discussed in detail in the following section) may be subject to avoidance under section 544(a)(1) of the Bankruptcy Code.\textsuperscript{40} The Bankruptcy Code essentially allows a bankruptcy trustee or debtor-in-possession to act as a hypothetical judicial lien creditor in certain circumstances.\textsuperscript{41} Section 544(a)(1) provides that a trustee may avoid any transfer that, as of the commencement of the case, is voidable by a creditor holding a judicial lien on all property of the debtor subject to a judicial lien.\textsuperscript{42} Because an unperfected security interest is subordinate to a judicial lien, it is commonly said that, under section 544(a)(1), the trustee or debtor-in-possession may "avoid" a security interest that is unperfected as of commencement of the bankruptcy case.\textsuperscript{43}

Courts have been called upon to determine whether a domain name can be levied upon and sold by a judicial lien creditor. If a domain name can be levied upon and sold, then it would be treated as a general intangible and a security interest could be perfected accordingly. Furthermore, a bankruptcy trustee could sell it as a separable asset, apart from the business as a whole, and a creditor could obtain and enforce a security interest in the domain name. Two opinions on point, however, suggest that this is not the case.

In \textit{Dorer v. Ariel},\textsuperscript{44} the Federal District Court examined the issue of defining a domain name as a property right. It held that the value of a domain name, like corporate good will, is inextricably intertwined with the user's business.\textsuperscript{45} The court stated, "[I]f the only value that comes from the transfer of the domain name is from value added by the user, it is inappropriate to consider that an element subject to execution."\textsuperscript{46} In \textit{dicta}, the court suggested that a domain name is not personal property subject to a judicial lien, but instead represents trademark and contract rights, which derive from the contract with the domain name registrar.\textsuperscript{47}

\textsuperscript{40}11 U.S.C. § 544(a) (2000).
\textsuperscript{41}Id.
\textsuperscript{42}Id.
\textsuperscript{43}Id.
\textsuperscript{44}60 F. Supp. 2d 558 (E.D. Va. 1999).
\textsuperscript{45}See id. at 561.
\textsuperscript{46}Id.
\textsuperscript{47}Id. at 560-61.
The Virginia Supreme Court reached a similar conclusion in *Network Solutions, Inc. v. Umbro International, Inc.* Umbro obtained a default judgment against the defendant and sought to levy thirty-eight internet domain names that the defendant had registered with Network Solutions. Umbro asked Network Solutions to "place [the] domain names on hold and to deposit control of them into the registry of the circuit court so that the domain names could be advertised and sold to the highest bidder." Network Solutions argued that its registration agreements with the judgment debtor were contracts for services and thus not subject to garnishment. The lower court held that the domain name registrations were valuable intangible property subject to garnishment, and that domain names were a "new form of intellectual property" subject to being sold at a sheriff's sale. The Virginia Supreme Court reversed, finding that although a domain name is an intangible asset, it is limited to the rights held under the contract for services between the holder and registrar of the domain name. The court further explained:

>[t]hat contractual right is inextricably bound to the domain name services that [Network Solutions] provides. In other words, whatever contractual rights the judgment debtor has in the domain names at issue in this appeal, those rights do not exist separate and apart from [Network Solutions'] services that make the domain names operational Internet addresses.

The court voiced its concern that allowing the garnishment of the registry services could open the door for similar treatment of practically any service, including the registry of corporate names by the Secretary of State. These early decisions on the issue of domain name interests limit the rights of domain name holders and, as a result, reduce the value of the

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48529 S.E.2d 80 (Va. 2000).
49*Id.* at 81.
50*Id.*
51*Id.*
53*Network Solutions*, 529 S.E.2d at 86. But see Kremen v. Cohen, 99 F. Supp. 2d 1168, 1173 n.2 (N.D. Cal. 2000) (rejecting the *Network Solution* majority opinion and holding that domain names are separate and apart from services provided).
54*Id.*
55*Id.* at 87.
domain names. If the law continues to follow this precedent, domain names will not be assets that a bankruptcy trustee could sell apart from the company as a whole. Thus, a creditor could not obtain and enforce a security interest in the domain name. Despite Network Solutions' legal position and the terms of its domain name services agreement, Network Solutions cooperated in the transfer of its domain names, particularly when such transfers occurred in the bankruptcy process.

C. Copyrights, Patents, and Trademarks

Many of the legal battles that emanate from copyright, patent and trademark assets involve questions of the perfection of security interests. The perfection of a security interest in "new economy" assets requires an understanding of former Article 9 of the Uniform Commercial Code (the U.C.C.); as well as an understanding of the changes that have occurred under revised Article 9. It is also critical to understand and evaluate the interaction between Article 9, federal intellectual property law and the Bankruptcy Code since the policies behind the different sets of laws can be directly at odds.

The Bankruptcy Code is designed to give a debtor breathing room to reorganize and to maximize payments to creditors in an organized and equitable manner. Section 362 of the Bankruptcy Code imposes an automatic stay on a number of actions against the debtor while a bankruptcy case is pending, including, but not limited to, the continuation or commencement of lawsuits based on pre-bankruptcy acts of the debtor or "any act to obtain possession" and "exercise control over property" of the debtor's estate. On the other hand, intellectual property laws are meant to provide a means of judicial recourse for entities with perfected rights in intellectual property against entities who violate those rights, i.e., to seek damages for past infringement and to seek injunctive relief against future infringement.

As a result of the conflicting policies, when a debtor

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56 Note that revised article 9 has been adopted by all of the states, and therefore, this Chapter uses the term "former Article 9" to reference Article 9 prior to the July 1, 2001 revision. 11 U.S.C. § 362(a)(1)-(3) (2000).
57 The copyright owner enjoys a monopoly on the exploitation of its copyright because "[i]t is intended to motivate the creative activity of authors and inventors by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired." Madlyn G. Primoff & Erica G. Weinberger, E-Commerce and Dot-com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts, Including Intellectual Property Agreements, and Related Issues Under Section 365(e), 365(e) and 365(n) of the Bankruptcy Code, 8 AM. BANKR. INST. L. REV. 307, 325 (2000) (quoting In re Patient Educ. Media, Inc., 210 B.R. 237, 240 (Bankr. S.D.N.Y. 1997)) (quoting Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984)).
in bankruptcy violates another party’s intellectual property rights, a judge must often weigh competing policies.

1. Perfection of Security Interests in Intellectual Property Assets

Under former Article 9, the law governing perfection was determined by applying section 9-103 of the U.C.C.\(^5^9\) Intellectual property rights, which include copyrights, patents, and trademarks, were classified under section 9-106 as "general intangibles."\(^6^0\) The Official Comment to this section provided that the term "general intangibles" incorporated "miscellaneous types of contractual rights and other personal property . . . examples are goodwill, literary rights and rights to performance. Other examples are copyrights, trademarks and patents" or intangible collateral.\(^6^1\) Former section 9-103(3)(d) provided that in most situations, "[a] debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence."\(^6^2\) The effect of perfection and non-perfection were, therefore, governed by the law of the jurisdiction where the debtor was deemed located. Consequently, the only way to perfect a security interest in a general intangible asset was to file a financing statement (to the extent that the question is determined by Article 9), in any jurisdiction that might conceivably contain the debtor's chief executive office.

Several critical changes were made in the revised Article 9, which went into effect on July 1, 2001.\(^6^3\) For instance, describing collateral as a general intangible will no longer be adequate since revised section 9-102(a)(1) describes the right to payment under a license as an account.\(^6^4\) Additionally, the rules for determining where the debtor is located are quite different under revised Article 9. Under revised U.C.C. section 9-307(e), the baseline rule for debtors that are not corporations, limited partnerships, or similar "registered organizations" remains the same.\(^6^5\) Revised section 9-307(e), however, provides that "[a] registered organization that is

\(^{62}\)Note that a security interest perfected by filing under former Article 9 generally remains effective under revised Article 9 until the expiration of the 5-year period of validity of the financing statement even if Revised Article 9 provides for filing in a different jurisdiction. Furthermore, since state law governs the U.C.C., revised Article 9 will affect the relevant state when that state adopts Revised Article 9 or their version of the revised Article 9.
\(^{64}\)See U.C.C. rev. § 9-307(b) (2001).
organized under the law of a State is located in that State.\textsuperscript{66} Thus, according to revised Article 9, a corporate debtor or other entity registered by the state, is located in the registering or incorporating state.\textsuperscript{67}

The filing of a U.C.C.-1 financing statement perfects a security interest in general intangibles.\textsuperscript{68} Revised Article 9 of the U.C.C., however, will not apply to that perfected if "a statute, regulation, or treaty of the United States preempts [it].\textsuperscript{69} Even more profound, the revised section 9-310(b)(3) provides that "[t]he filing of a financial statement is not necessary to perfect a security interest . . . in property subject to a statute, regulation, or treaty . . ."\textsuperscript{70} Revised Article 9 of the U.C.C. continues to provide that "[c]ompliance with the regulations of a statute, regulation, or treaty is equivalent to the filing of a financial statement under this article."\textsuperscript{71}

Consequently, the U.C.C. filing is unnecessary and ineffective to perfect a security interest if federal law governs registration of a security interest.

\textsuperscript{66}See U.C.C. rev. \S\ 9-307(e) (2001).

\textsuperscript{67}If, however, the debtor is not a U.S. corporation, the "chief-executive-office" test will still apply. U.C.C. rev. \S\ 9-307 (2001). If such a debtor's chief executive office is outside the United States in a jurisdiction that does not provide for the perfection of the security interest by filing or recording in that jurisdiction, the debtor will be deemed to be located in the District of Columbia. \emph{Id.}

\textsuperscript{68}See U.C.C. \S\ 9-310(a) (2001).

\textsuperscript{69}U.C.C. rev. \S\ 9-109(c)(1) (2001). U.C.C. rev. \S\ 9-109(c)(1) attempts to address the misinterpretations surrounding U.C.C. \S\ 9-104(A) (1995), which states that Article 9 of the U.C.C. will not apply "to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." Revised Article 9 intends to clarify that Article 9 of the U.C.C. is not superceded whenever federal law provides any rule, but rather, only when federal law preempts it. \textit{Cf.} Nat'l Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n. (\textit{In re} Peregrine Entm't Ltd.), 116 B.R. 194, 202 (C.D. Cal. 1990). Therefore, U.C.C. rev. \S\ 9-109(c)(1) (2001) provides that Article 9 of the U.C.C. governs security interests in intellectual property to the extent that federal law does not preempt state law in that area.

\textsuperscript{70}U.C.C. rev. \S\ 9-310(b)(3) (2001). See generally U.C.C. 9-302(3) to (4) (1995) which states that:

\begin{enumerate}
  \item The filing of a financing statement otherwise required by this Article is not necessary or effective to perfect a security interest in property subject to a statute or treaty of the United States which provides for a national or international . . . certificate of title or which specifies a place of filing different from that specified in this Article for filing of the security interest . . .
  \item Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this Article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 9-103 on multiple state transactions . . .
\end{enumerate}

\textsuperscript{71}U.C.C. rev. \S\ 9-311(b)(2001).
Properly perfecting a security interest is critical in the bankruptcy context. As previously noted, section 544(a)(1) of the Bankruptcy Code gives the trustee or debtor-in-possession the status of a hypothetical judicial lien creditor holding a lien on all the debtor's property as of the date the bankruptcy petition was filed. Therefore, when section 544(a)(1) is invoked, the security interest will only be valid as against the judicial lien creditor if it was perfected as of the petition date (i.e., the date the debtor filed for bankruptcy).

A few other considerations pertaining to the differences between the former and revised Article 9 are worthy of mention. Under the former version of Article 9, a financing statement perfected a security interest for a five-year period from the date of filing. The security interest would be deemed ineffective if a continuation statement was not filed within six months prior to the expiration of the security interest. The security interest, however, if properly perfected on the filing of bankruptcy, would be tolled until sixty days after the insolvency proceeding. On the other hand, revised Article 9 eliminates the tolling period, requiring "that continuation statements be filed 'only within six months before the expiration of the five-year period.'" Additionally, under revised Article 9, the retroactive effect of lapse deletes the words "lien creditor," which has the effect of deeming the security interest "never to have been perfected as against a purchaser of the collateral for value." Thus, in jurisdictions that adopt revised Article 9, the secured creditor must be aware of the expiration date of the financing statement.

2. Copyright Perfection

The United States Copyright Act (Copyright Act) states: "[A]ny transfer of copyright ownership or other document pertaining to a copyright may be recorded in the [United States] Copyright Office . . . ." Section 205(d) of the Copyright Act governs priorities among transferees. It provides:

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73 Id.
74 Id. § 9-403(2) to (3).
75 G. Ray Warner, Continuing Perfection During Bankruptcy under Revised Article 9, AM. BANKR. INST. J., Apr. 2001, at 22 (citing U.C.C. rev. § 9-515(d) (2001)).
76 Id. at 22-23 (citing U.C.C. rev. § 9-515(c) (2001)).
As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice under subsection (c), within one month after its execution in the United States or within two months after its execution outside the United States, or at any time before recordation . . . of the later transfer. Otherwise the later transfer prevails if recorded first in such manner, and if taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.79

Furthermore, the Copyright Office defines a document pertaining to a copyright as any that "has a direct or indirect relationship to the existence, scope, duration, or identification of a copyright, or to the ownership, division, allocation, licensing, transfer, or exercise of rights under a copyright. That relationship may be past, present, future or potential."80 "A transfer of copyright ownership is an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright . . . but not . . . a nonexclusive license."81 Lastly, the Copyright Act provides that "[t]he ownership of a copyright may be transferred in whole or in part by any means of conveyance or by operation of law."82

The prevailing case law in the copyright area indicates the federal Copyright Act's recording provisions preempt the U.C.C.'s provisions.83 The California District Court held that to prevail over the rights of a judicial lien creditor, a security agreement with the Copyright Office must be filed to perfect a security interest in a copyright.84 In the seminal case on this point, In re Peregrine,85 the debtor's primary assets were a compilation of copyrights, distribution rights, and licenses to 145 motion pictures.86 A bank issued a $6 million line of credit to the debtor that was secured by the debtor's film assets.87 The bank filed a security agreement and a U.C.C.-1 financing statement describing the collateral as "[a]ll

79Id. § 205(d).
84Id.
85Id.
86Id. at 197.
87In re Peregrine Entm't Ltd., 116 B.R. at 197.
inventory consisting of films and all accounts, contract rights, chattel paper, general intangibles, instruments, equipment, and documents related to such inventory, now owned or hereafter acquired by the Debtor."88 The bank never recorded its security interest in the Copyright Office, but filed a U.C.C.-1 financing statement in several states.89 The debtor subsequently filed a Chapter 11 bankruptcy petition and brought an action to avoid the bank's security interest in the copyrights, under section 544(a)(1) of the Bankruptcy Code.90 The judge held that, as a hypothetical lien creditor, the debtor's interest in the copyrights prevailed over the bank's security interest.91 The judge pointed out that filing a U.C.C. financing statement is not "necessary or effective to perfect a security interest," when the Copyright Act specifies that a filing should occur in the Copyright Office.92

A line of cases, including Official Unsecured Creditors' Committee v. Zenith Products, Inc. (In re AEG Acquisition Corp.),93 have reached the same conclusion. AEG filed under Chapter 11 and, as debtor-in-possession, also set out to invoke Bankruptcy Code section 544(a)(1) to avoid security interests in three motion picture copyrights.94 The prepetition security interest was given to Zenith Productions, Ltd. (Zenith).95 Zenith filed a copyright registration and the security agreement prior to the petition date for the movie, Patty Hearst.96 For the other movies, For Queen and Country and The Wolves of Willoughby Chase, Zenith had filed the security agreements, but not the copyright registra-

88Id. at 197-98.
89Id. at 198.
90Id.
91In re Peregrine Entm't Ltd., 116 B.R. at 198.
92Id. at 202. When structuring credit transactions involving intellectual property, the distinction between a security interest in a copyright and the physical embodiments of the copyrighted work must be kept in mind. A creditor who claims an interest in the ownership of a work, including the right to license, reproduce, or distribute it, is claiming an interest in an intangible, but a creditor who claims an interest in the physical embodiment of the work, whether a CD-Rom, recorded tape, inventory of books, or copy of a source code, is claiming an interest in tangible goods. The fact that the distinction is sometimes blurred is another good reason to perfect under both systems. See, e.g., In re Bedford Computer Corp., 62 B.R. 555 (Bankr. D. N.H. 1986) (discussing the distinction between the tangible and intangible aspects of computer technology for bankruptcy purposes); Raymond T. Nimmer & Patricia A. Krauthaus, Secured Financing and Information Property Rights, 2 HIGH TECH. L.J. 190, 208 (1988) (illustrating the "great uncertainty" in patent security interests).
94Id. at 37.
95Id.
96Id. at 38.
Recordation of a document in the Copyright Office gives everyone constructive notice of the facts stated in the recorded document, if:

1. The document, or material attached to it, specifically identifies the work so that, after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title or registration number of the work; and
2. Registration has been made for the work.

As a result, the court found that perfection of the security interest in a copyright requires that the work is both registered and recorded with the Copyright Office.

Aerocon Engineering Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.), followed the holding in AEG. In Aerocon, the debtor designed and sold aircraft products, of which one was copyrighted, but unregistered. The court held that a U.C.C.-1 financing statement was the only way to perfect the security interest. The difference between the cases was that the debtor in Aerocon, unlike AEG, never registered the copyright with the Copyright Office. The debtor granted a security interest in the copyright to a bank to secure a loan. The bank filed a U.C.C.-1 financing statement with the California Secretary of State, but did not record the security agreement or the financing statement with the Copyright Office. The trustee sought to avoid the bank's security interest under section 544(a)(1) of the Bankruptcy Code, arguing that it was unperfected because it had not been recorded with the Copyright Office. The court concluded that the transfer was not avoidable. The debtor had not registered the copyright with the Copyright Office; therefore, filing a U.C.C.-1 financing statement with the Secretary of State was the only way to perfect the security interest in the unregistered copyright.

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97 In re AEG Acquisition Corp., 127 B.R. at 38.
98 Id. at 41 n.6 (citing 17 U.S.C.A. § 205(e) (West 1977)).
99 In re AEG Acquisition Corp., 127 B.R. at 42.
100 244 B.R. 149 (Bankr. N.D. Cal. 1999), aff’d, 303 F.3d 1120 (9th Cir. 2002).
101 Id. at 150.
102 Id. at 156.
103 Id. at 150.
104 In re World Auxiliary Power Co., 244 B.R. at 150.
105 Id.
106 Id.
107 Id. at 156.
Notably, the court stated that a security interest in an unregistered copyright is still "vulnerable to invalidation if a copyright were later registered and a competing security interest in the copyright had been recorded in the Copyright Office." Accordingly, the court suggested that "a prudent secured creditor would record its security agreement in the Copyright Office at the same time it filed the U.C.C.-1 financing statement in the U.C.C. Office."

Not surprisingly, it may be difficult to perfect a security interest in frequently updated software and website "pages" with any degree of confidence. Moreover, even if the security interest is properly perfected prepetition, section 552(a) of the Bankruptcy Code casts doubt on whether a security interest in web pages can continue postpetition because of the ever-changing nature of a web page. Section 552(a) provides that a prepetition security interest does not extend to property acquired by the debtor postpetition, except to the extent that the security interest includes after acquired property. It is likely that many debtors-in-possession seeking to reorganize will expend substantial resources to revise a web page because it might be considered after-acquired property or its proceeds may not be subject to the security interest.

Finally, under section 364(c)(2) of the Bankruptcy Code, a bankruptcy court has the authority to alleviate some of the uncertainty surrounding the perfections of security interests in copyrights and other kinds of intellectual property for credit extended postpetition, rather than prepetition. Section 364(c)(2) provides that the court may authorize a trustee or debtor-in-possession to incur postpetition credit secured by a lien of estate property. The order authorizing such borrowing typically provides that the lien is deemed perfected without the necessity of filing a financing statement or taking any other action.

3. Patent Perfection

The case law regarding the interplay between patent law and the U.C.C. suggests that although filing in the Patent Office is necessary to
protect a secured creditor from claims of other secured creditors and purchasers, either a federal filing or a U.C.C. filing will protect against claims of judicial lien creditors and bankruptcy trustees. The Patent Act provides that "[a]n assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage."\(^{115}\) In *Moldo v. Matsco (In re Cybernetic Services, Inc.)*,\(^{116}\) the Ninth Circuit Bankruptcy Appellate Panel (BAP) held that a U.C.C. filing will suffice to perfect a security interest in a patent.\(^{117}\) The debtor owned a patent for a video signal data collection device.\(^{118}\) Matsco held a security interest in all of the debtor's assets, including "general intangibles."\(^{119}\) Matsco filed a U.C.C.-1 financing statement with the Secretary of State, but did not file anything with the Patent Office.\(^{120}\) When Matsco moved for relief from the automatic stay to enforce its security interest, the trustee argued that Matsco's security interest was voidable under section 544(a)(1) of the Bankruptcy Code because it had not been properly perfected by filing with the Patent Office prior to bankruptcy by filing.\(^{121}\) The court focused on whether the federal patent registration system preempted state law or excluded the perfection of security interests in patents from the U.C.C.\(^{122}\) The BAP reasoned that:

A security interest is not an "assignment, grant or conveyance" of a patent. Patent law adheres to strict concepts of title, in order to protect the ownership of new inventions. It therefore distinguishes "assignments" of patents (of which "grants" and "conveyances" are specific types) from all other transfers (which are called "licenses.").\(^{123}\)

Additionally, the court contrasted the Patent Act and Section 101 of the Copyright Act, which defines "transfer of copyright ownership" broadly to include not only an "assignment" but also a "mortgage... or hypothecation

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\(^{116}\) 239 B.R. 917 (B.A.P. 9th Cir. 1999), aff'd, 252 F.3d 1039 (9th Cir. 2001).
\(^{117}\) Id. at 923.
\(^{118}\) Id. at 918.
\(^{119}\) Id.
\(^{120}\) *In re Cybernetic*, 239 B.R. at 918.
\(^{121}\) Id. at 919.
\(^{122}\) Id.
\(^{123}\) Id. at 921 (quoting WILLIAM C. HILMAN, DOCUMENTING SECURED TRANSACTION 2-19 to 2-20 (1998)).
Consequently, the BAP held that "Article 9 of the U.C.C. controls the perfection of a security interest in a patent," and that Matsco had properly perfected its security interest in the patent by filing a U.C.C.-1 with the Secretary of State. Thus, the trustee could not avoid the security interest.

The BAP cautioned that, although a U.C.C. filing would protect the security interest from the claims of competing lien creditors and bankruptcy trustees, it would not provide protection from a bona fide purchaser who records with the Patent Office, because the Patent Act governs transfers of title. As such, even a secured creditor who files with the Patent Office and the office designated by the U.C.C. may find its lien subject to the claims of a bona fide purchaser. The court suggested that the best way to protect a security interest from subsequent purchasers, as well as from lien creditors, might be to structure the transaction as an assignment of the patent to the creditor with a license back to the debtor.

In the earlier case of City Bank & Trust v. Otto Fabric, Inc., a bankruptcy trustee sought to avoid the transfer of security interests in three patents as preferences. The trustee argued that the transfers occurred when a notice of assignment was recorded with the Patent and Trademark Office, which "occurred within the 90-day preference period." The secured creditor asserted that the transfer had been perfected outside of the ninety-day preference period, when the U.C.C.-1 financing statements had been filed. Under section 547(e)(1)(B) of the Bankruptcy Code, perfection of a transfer of personal property is deemed to occur "when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." Thus, the court reasoned that the issue was whether recording the transfer with the Patent and Trademark Office was necessary to cut off the rights of a judicial lien creditor. Here, as in In re Cyberneteic, the court concluded that federal registration was only.

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124 In re Cybernetic, 239 B.R. at 921.
125 Id. at 920.
126 Id. at 923-24.
127 Id. at 920 n.8.
128 In re Cybernetic, 239 B.R. at 929 n.8.
129 Id. at 921. See also In re Transp. Design & Tech., Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985) (discussing the effectiveness of recording a mortgage with the Patent Office against bona fide purchasers).
131 Id. at 781.
132 Id.
134 See Otto Fabric, 83 B.R. at 781.
necessary to preclude the rights of "any subsequent purchaser or mortgagee."\textsuperscript{135} It found further that the Patent Act left open the question of perfection for the purpose of precluding the rights of lien creditors.\textsuperscript{136} The court concluded that federal recording, at least for this purpose, was not necessary, and that the U.C.C. filing was adequate.\textsuperscript{137}

Alternatively, the court held that federal recording was not required to perfect the security interest because section 261 of the Patent Act "does not expressly state that one must file an assignment with the Patent and Trademark Office to perfect a security interest."\textsuperscript{138} Finally, the court reasoned that section 261 of the Patent Act only requires federal recording of an "absolute assignment," such as a transfer of title, because it refers only to transfers by "assignment, grant or conveyance."\textsuperscript{139} Since the transfer of a security interest does not divest the transferor of title, the court concluded that the U.C.C., rather than the Patent Act, governed.\textsuperscript{140}

4. Trademark Perfection

The law relating to perfection of security interests in trademarks is more certain than patents or copyrights. Courts have unanimously held that perfection is accomplished in a federally registered trademark by filing a U.C.C. financing statement. Section 10 of the Lanham Act, however, does provide for the federal filing of "assignments."\textsuperscript{141} Section 1060(a), pertaining to perfection, provides that:

[a] registered mark or a mark for which an application to register has been filed shall be assignable with the good will of the business in which the mark is used, or with that part of the good will of the business connected with the use of and symbolized by the mark. Notwithstanding the preceding sentence, no application to register a mark under section 1051(b) of this title shall be assignable . . . except for an assignment to a successor to the business of the applicant, or portion thereof, to which the mark pertains, if that business is ongoing and existing. In any assignment authorized by this

\textsuperscript{135}Id. at 782; In re Cybernetic. 239 B.R. at 920.
\textsuperscript{136}Otto Fabric, 83 B.R. at 782.
\textsuperscript{137}Id. at 784.
\textsuperscript{138}Id. at 782.
\textsuperscript{139}See id. at 783.
\textsuperscript{140}Otto Fabrics, 83 B.R. at 783.
section, it shall not be necessary to include the good will of the business connected with the use of and symbolized by any other mark used in the business or by the name or style under which the business is conducted. Assignments shall be by instruments in writing duly executed. Acknowledgement shall be prima facie evidence of the execution of an assignment, and when the prescribed information reporting the assignment is recorded in the Patent and Trademark Office, the record shall be prima facie evidence of execution. An assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the Patent and Trademark Office within 3 months after the date of the assignment or prior to the assignment.\footnote{142}

The most prominent case on point is Roman Cleanser Co. v. National Acceptance Co. of America (In re Roman Cleanser Co.)\footnote{143} Roman Cleanser, a household cleanser manufacturer, granted National Acceptance Company of America (NAC) a security interest "in and to all of Roman Cleanser's then owned and thereafter acquired goods, equipment, and general intangibles."\footnote{144} NAC filed a U.C.C. financing statement.\footnote{145} After Roman Cleanser's 1984 Chapter 11 filing, the case was converted to a Chapter 7 liquidation.\footnote{146} The bankruptcy trustee sought to avoid NAC's security interest.\footnote{147} The trustee's chief argument was that to perfect a security interest in a federally registered trademark, NAC was required to file "a conditional assignment" with the Patent and Trademark Office, not a U.C.C. financing statement.\footnote{148} The court disagreed, drawing an important distinction, similar to that of the patent cases, between an assignment and the transfer of a security interest:

An "assignment" of a trademark is an absolute transfer of the entire right, title and interest to the trademark . . . . The grant of a security interest is not such a transfer. It is merely what the term suggests—a device to secure an indebtedness. It is

\footnotesize\begin{itemize}
\item \footnotemark[144] Id. at 942.
\item \footnotemark[145] Id.
\item \footnotemark[146] Id.
\item \footnotemark[147] Id.
\item \footnotemark[148] In re Roman Cleanser, 43 B.R. at 942.
\item \footnotemark[149] Id.
\end{itemize}
a mere agreement to assign in the event of a default by the debtor . . . . Since a security interest in a trademark is not equivalent to an assignment, the filing of a security interest is not covered by the Lanham Act. Accordingly, the manner of perfecting a security interest in trademarks is governed by Article 9 and not by the Lanham Act.\footnote{Id. at 944. See also, e.g., In re 199Z, Inc., 137 B.R. 778, 782 (Bankr. C.D. Cal. 1992) (quoting verbatim In re Roman Cleaner); In re Together Dev. Corp., 227 B.R. 439 (Bankr. D. Mass. 1998) (presenting "the question of the proper method of perfecting a security interest in trademarks").}

Additionally, the \textit{In re Roman Cleanser} opinion noted that the use of the phrase "general intangibles" in the security agreement and financing statement will extend the security interest to intellectual property, such as trademarks, whether specifically described or not.\footnote{In re Roman Cleanser, 43 B.R. at 944-45.} Similarly the court seemed to assume that the phrase "general intangibles" also extends to the goodwill associated with the trademark.\footnote{Id. at 945.}

\section*{D. Intellectual Property Licenses}

The intersection of federal laws relating to intellectual property licenses with the Bankruptcy Code has also created a number of controversial and unsettled issues that have been the subject of disparate treatment by the courts. Today, an understanding of a client's assets cannot be complete without assessing the importance of intellectual property licenses to a client's business, either in terms of expected royalty for the licensor or the continued use of critical technology by a licensee. Equally important is structuring a business transaction while being fully cognizant of the potential consequences of such license rights if one party subsequently files for bankruptcy.

\subsection*{1. The Assumption and Assignment of Intellectual Property Licenses}

Bankruptcy law generally deems a license to be an executory contract that a trustee may assume or assume and assign under section 365(c) of the Bankruptcy Code without consent of the other party to the contract. Patent law, however, generally prohibits the assignment of a patent license without the assignor's consent due to the patentee's exclusive
right to control the use of the invention.\textsuperscript{152} The patent owner's preclusion of the use of the patent can frustrate bankruptcy process objectives because the patent license may be one of the debtor's most valuable assets. On the other hand, if the case were reversed, the license may fall into the hands of one of the patent owner's primary competitors.

The first inquiry involves an evaluation of whether the licensing agreement was effectively terminated prior to the Chapter 11 filing. A contract that has been validly terminated due to the debtor's default, or rescinded, or that by its terms has expired prior to the commencement of a bankruptcy case is no longer executory for the purposes of section 365 of the Bankruptcy Code.\textsuperscript{153} Thus, there is nothing to assume or reject. "Filing a Chapter 11 petition will not resuscitate a contract that has already been terminated."\textsuperscript{154} The steps required to terminate the contract, however, must be complete as of the time the bankruptcy filing and not subject to reversal under nonbankruptcy law.\textsuperscript{155} Therefore, where notice of termination is not

\textsuperscript{152}\textit{In re Access Beyond Tech.}, 237 B.R. 32, 45 (Bankr. D. Del. 1999) (citing Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972), \textit{cert. denied}, 410 U.S. 929 (1973)). The "longstanding federal rule of law with respect to the assignability of patent license agreements provides that these agreements are personal to the licensee and not assignable unless expressly made so in the agreement." \textit{Id.} See also \textit{Tap Publ'ns v. Chinese Yellow Pages} (New York), 925 F. Supp. 212, 218 (S.D.N.Y. 1996) (holding that in New York a trademark license is not assignable without the consent of the trademark owner). The court in \textit{In re Access} also held that "where provisions of a patent license are silent on the question of assignability, the license is nontransferable" without the licensor's consent. \textit{In re Access}, 237 B.R. at 46.

\textsuperscript{153}\textit{In re Triangle Labs., Inc.}, 663 F.2d 463, 467-68 (3d Cir. 1981). The Third Circuit has held a contract, once terminated, cannot be revived in bankruptcy:

If the contract or lease has expired by its own terms or has been terminated prior to the commencement of the bankruptcy case, then there is nothing left for the trustee to assume or assign . . . .

This interpretation of section 365(e)(1) is consistent with the recognized principle of bankruptcy law that an executory contract or lease validly terminated prior to the institution of bankruptcy proceedings is not resurrected by the filing of the petition in bankruptcy, and cannot therefore be included among the debtor's assets. When a debtor's legal and equitable interests in property are terminated prior to the filing of the petition with the Bankruptcy Court that was intended to preserve the debtor's interest in such property, the Bankruptcy Court cannot then cultivate rights where none can grow. \textit{Id.} (citations omitted). \textit{See also In re Tudor Motor Lodge Assoc., L.P.}, 102 B.R. 936 (Bankr. D. N.J. 1989).

\textsuperscript{154}\textit{In re Best Film \\& Video Corp.}, 46 B.R. 861, 869 (Bankr. E.D.N.Y. 1985). \textit{See also In re Anne Cara Oil Co., Inc.}, 32 B.R. 643, 647 (Bankr. D. Mass. 1983) (holding that "[a]t the time of the filing of the Chapter 11 petition, the franchise relationship was executory . . . . As of the day after the petition was filed, the franchise agreement ceased to be executory and without some activity by the debtor could not therefore be assumed.").

\textsuperscript{155}\textit{See Comp III, Inc. v. Computerland Corp. (In re Comp III, Inc.)}, 136 B.R. 636, 639 (Bankr. S.D.N.Y. 1992) (holding that "[w]here an executory contract has been terminated prior to bankruptcy, [even] section 365(e)(1) does not authorize a bankruptcy court to reach beyond the veil of the petition to reinstate the contract").
effective until received by the debtor and notice is not received until after commencement of the case, the contract is executory at the time of filing and the debtor may be given the opportunity to cure defaults and assume.156

2. Conflicting Laws regarding Assumption and Assignment

The conflict of laws related to the assumption and assignment of leases and contracts is well characterized in In re Lil' Things, Inc.,157 which states that:

[p]ursuant to §§ 365(a) and (f) [of the Bankruptcy Code] a debtor's contracts and leases are generally assumable and assignable, because these are some of the most valuable assets of most bankruptcy estates. If this were not the rule, it would thwart one of the Code's basic underlying goals of maximizing value for the creditors of the bankruptcy estate. However, § 365(c)(1)(A) acts to balance the rights of third parties who contracted with the debtor and whose rights may be prejudiced by having the contract or lease performed by an entity with which they did not enter into the agreement.158

The significant power given to a trustee or debtor-in-possession under section 365(f)(1) of the Bankruptcy Code allows for assumption and assignment, regardless of contrary contractual clauses of nonbankruptcy law.159 The limitation in section 365(c)(1) provides that a trustee may not assume or assign an executory contract if applicable nonbankruptcy rules excuse the non-debtor party to the contract from accepting performance from, or rendering it, to someone other than the debtor or debtor-in-possession.160 This provision is often said to bar the assumption and assignment of personal services contracts that are not assignable as a matter of state law. The section 365(c)(1) exception, however, is not limited to personal services contracts.161

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158Id. at 591.
Courts are split on whether certain intellectual property licenses are assignable because of the existing conflicts between bankruptcy law and federal law related to the particular licensing agreements. In *In re Alltech Plastics, Inc.*, the court concluded that the trustee "[did] not have the power to assign the patent license absent consent from the licensor." The court manufactured plastic containers using a patented procedure under a license from the patent holder. The trustee sought to assume the license and assign it to another manufacturer. The court found that "federal common law classifies patent licenses as personal in nature and not assignable unless expressly made so."

More recently, *Everex Systems, Inc. v. Cadrak Corp. (In re CFLC, Inc.)*, the Ninth Circuit joined the Sixth and Seventh Circuits by holding that, under federal patent law, the assignability of non-exclusive patent licenses is prohibited if the patent owner objects to the assignment. The court stated that fundamental policy of the patent system is to "encourag[e] the creation and disclosure of new, useful, and non-obvious advances in technology and design" by granting the inventor the reward of "the exclusive right to practice the invention for a period of years." Allowing free assignability . . . of non-exclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensor would become a potential competitor with the licensor-patent holder in the market for licenses under the patents.

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162 Section 365(n) of the Bankruptcy Code (discussed infra text accompanying Part III.D.4) provides that when the debtor is the licensor, a non-bankrupt licensee may utilize the intellectual property, under the terms of the license, and enforce certain negative covenants on the license against the debtor-licensor. Marjorie Chertok & Warren Agin, *Restart.com: Identifying, Securing and Maximizing the Liquidation Value of Cyber-Assets in Bankruptcy Proceedings*, 8 AM. BANKR. INST. L. REV. 255, 282 (2000).


164 *Id.* at 689.

165 *Id.* at 687.

166 *Id.*

167 *In re Alltech*, 71 B.R. at 689.

168 89 F.3d 673 (9th Cir. 1996).

169 *Id.* at 680.

170 *Id.* at 679 (quoting Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 150-51 (1989)).
The rationale of Alltech and CFLC has been applied with equal force to other kinds of intellectual property licenses, including copyright licenses.\textsuperscript{171} Thus, absent the licensor's consent, neither a trustee nor a debtor-in-possession will be able to attain any value for the estate by assigning the debtor's intellectual property licenses.\textsuperscript{172}

Several jurisdictions have allowed the assumption, without assignment, of intellectual property licenses. They have concluded that section 365(c)(1) should not bar a debtor-in-possession from assuming a contract merely because it is not assignable under nonbankruptcy law.\textsuperscript{173} The First Circuit held that a patentee's objection would not prevent the debtor from assuming a patent license in conjunction with the sale of stock to the patentee's major competitor.\textsuperscript{174} The \textit{Institut Pasteur} court applied an actual performance standard in applying the contract assumption provisions of the Bankruptcy Code.\textsuperscript{175} Under this standard, the assumption is not prohibited where the patentee could not establish that it would receive less than the benefit of its bargain.\textsuperscript{176} Since the stock transfer did not change the corporate entity that operated prepetition, the patentee could not use section 365(c)(1) to accept performance.\textsuperscript{177} The court distinguished between a sale of stock and an outright transfer of the license, as was contemplated in the CFLC case.\textsuperscript{178}

Consistent with CLFC, but under a similar federal scenario to \textit{Institut Pasteur}, the Ninth Circuit rejected the "actual performance" standard for a "hypothetical test."\textsuperscript{179} In \textit{In re Catapult}, the debtor sought in its reorganization plan to assume nonexclusive patent licenses for online video game technology.\textsuperscript{180} Perlman, the patent owner, objected on grounds that

\textsuperscript{172}Id.
\textsuperscript{174}See \textit{Institut Pasteur} v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir. 1997), \textit{overruled on other grounds by} Hardemon v. City of Boston, 144 F.3d 24 (1st Cir. 1998).
\textsuperscript{175}Id. at 493. \textit{See also Cajun Elec. Members Comm. v. Mabey (In re Cajun Elec. Power Coop., Inc.), 230 B.R. 693, 705 (Bankr. M.D. La. 1999) (rejecting the "hypothetical test").}
\textsuperscript{176}\textit{Institut Pasteur}, 104 F.3d at 493.
\textsuperscript{177}Id. at 494.
\textsuperscript{178}Id.
\textsuperscript{180}\textit{In re Catapult}, 165 F.3d at 748.
the licenses were not assumable under federal patent law. The debtor argued that Congress never intended section 365(c)(1) to bar debtors-in-possession from assuming their own contracts. The Ninth Circuit held that, regardless of whether or not the debtor intended to assign the license to a third party, it could not assume the license if nonbankruptcy law prohibited assignment. In other words, if a contract could not be assigned to a hypothetical third party under nonbankruptcy law, it could not be assumed under the Bankruptcy Code even if the debtor had no intention of assigning it. The Third, Fourth, and Eleventh Circuits have also employed this rationale. Following such logic, these jurisdictions effectively held that patent law excuses a patent licensor from accepting performance from a hypothetical assignee and, consequently, the patent license is per se non-assumable, regardless of any contemplation of assignment.

In a Chapter 7 case, if a contract is not timely assumed, it is automatically rejected. In a Chapter 11 case, a trustee or debtor-in-possession may assume or reject most kinds of contracts at any time prior to the confirmation of a reorganization plan. If a contract is neither expressly assumed nor rejected prior to plan confirmation, the contract will "ride through" the case and remain an obligation of the reorganized entity. Some commentators have suggested that a debtor can avoid the result by simply continuing to perform their obligations under the contract and exercising the "ride through" option. Additionally, the Bankruptcy Reform Act of 1999 (H.R. 833) contained an amendment to section 365 that would have clarified that a debtor-in-possession may assume a contract even if the contract is non-assignable. The amendment, however, did not appear in the Senate Bill (S.625), nor does it appear in the current House version.

While contractual clauses prohibiting assignment will have little effect in the bankruptcy context, they raise significant Article 9 questions. Former Article 9 was silent on the enforceability of such a clause, so the

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181 Id.
182 Id. at 751.
183 Id. at 749.
184 City of Jamestown v. James Cable Partners, L.P. (In re James Cable Partners, L.P.), 27 F.3d 534 (11th Cir. 1994); In re West Elects., Inc., 852 F.2d at 84 (Higginbotham Jr., J., concurring in part and dissenting in part); Breedon v. Catron (In re Catron), 158 B.R. 629 (E.D. Va. 1993), aff'd, 25 F.3d 1038 (4th Cir. 1994).
186 Id. § 365(d)(2).
187 See Grube et al., supra note 7, at 230-31.
188 Id. at 230.
issue would be governed by the common law of contracts. State law, however, is not uniform. According to the *Restatement (Second) of Contracts*, the general rule is that non-assignment clauses are enforceable, but do not prevent the assignment of a claim for payment when the assignor has fully performed its obligations under the contract. Thus, under the *Restatement* at least, this type of clause would be enforceable. Revised Article 9, however, contains a provision specifically addressing the issue. Revised U.C.C. section 9-408 provides that a non-assignment clause in a license is ineffective to the extent that it applies to the creation, attachment, or perfection of a security interest. Section 9-408 makes clear that such a security interest does not require the licensor to recognize the secured party as the licensee or entitle the secured party to enforce the security interest. Furthermore, under the former Article 9, the right to receive royalties was a "general intangible," but under the revised Article 9 it is an account. This has obvious implications for the description of the collateral in a financing statement, but also means that the rules in revised Article 9 would govern an outright sale of these payment rights as well as the creation of a security interest in them. Therefore, to perfect an assignment of the right to receive royalty payments, it will be necessary and sufficient to file an Article 9 financing statement. Moreover, revised Article 9 gives secured parties the right to collect accounts directly in the event of default.

3. Performance Pending Assumption or Rejection of a Licensee

In bankruptcy, a debtor-in-possession has a statutory period in which it is permitted to assume or reject contracts. Under a license agreement for software, for instance, the debtor may profit from the license during this period. Often, the fees that accrue during this period of limbo will be

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189 *Restatement (Second) of Contracts* § 338 (1979).
190 See id.
194 U.S.C. § 365(d)(1) (2000). In a Chapter 7 case, a trustee must assume an executory contract within 60 days of the order for relief, unless the time is extended by the court. Id. If the trustee fails to assume within that period, the contract is deemed rejected. Id. In a Chapter 11 case, a trustee or debtor-in-possession may assume or reject contracts (other than a lease for nonresidential real estate) at any time before the confirmation of a plan, although the court may order the debtor to fish or cut bait earlier. Id. § 365(d)(2).
195 See Microsoft Corp. v. Dak Indus. (*In re* Dak Indus., Inc.), 66 F.3d 1091 (9th Cir. 1995).
characterized as priority administrative claims. In In re Dak Industries, Inc., however, the court held otherwise. Microsoft sold Dak a license to load Microsoft Word software onto computers that Dak sold to its customers. The agreement provided that Dak would pay $55 per copy of Word that it distributed. It also obligated Dak to make a minimum royalty payment of $2,750,000 in five installments over a nine-month period. Dak had made two installment payments prior to filing for bankruptcy protection.

Between the filing of the petition and rejection of the contract. Dak sold 7,600 copies of Word. The court found that if the debt had arisen or if Microsoft had provided consideration after the petition was filed, the debt would have been entitled to priority. The court, however, determined that the entire debt had arisen prepetition, that Microsoft had not provided anything postpetition, and that Dak had accepted no modifications or upgrades postpetition. Accordingly, the court held that the debt should be treated as a general unsecured claim.

4. Rejection or Termination of an Intellectual Property License

A debtor in bankruptcy generally has the ability to reject executory contracts under section 365(a) of the Bankruptcy Code. This is a very powerful bankruptcy tool for the debtor to escape contracts, particularly long-term contracts that are no longer favorable, or to gain leverage to renegotiate contracts. The Fourth Circuit, in Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., affirmed the bankruptcy court's determination that the decision to reject was based upon the sound business judgment of the debtor. The court found that a license to use a metal

196 Id.
197 Id. at 1096-97.
198 Id. at 1092.
199 In re Dak Indus., Inc., 66 F.3d at 1092.
200 Id.
201 Id.
202 Id. at 1093.
203 In re Dak Indus., Inc., 66 F.3d at 1095.
204 Id.
205 Id.
206 See id. at 1096.
208 56 F.2d 1043 (4th Cir. 1985).
209 Id. at 1047.
coating technology was an executory contract because it was materially unperformed on both sides.\textsuperscript{210} The debtor-licensor, Richmond, had a continuing duty to give Lubrizol, the licensee, notice of any other licenses, to adjust the licensee's royalty payments accordingly, to notify the licensee of infringement suits and to defend them, and to indemnify the licensee.\textsuperscript{211} Lubrizol owed Richmond a continuing duty to account for and pay royalties.\textsuperscript{212} The metal coating process was Richmond's principal asset, however, continued adherence to the terms of the Lubrizol contract would have frustrated the debtor's ability to successfully reorganize because the contract restricted Richmond's ability to license the technology to others.\textsuperscript{213} Finally, although rejection of an executory contract did not constitute rescission of the contract, the court concluded that rejection in this case would terminate Lubrizol's license and would only give a claim for damages.\textsuperscript{214}

On the other hand, in \textit{In re Petur U.S.A. Instrument Co.},\textsuperscript{215} the court refused to permit rejection of a patent license where the damage to the licensee was "grossly disproportionate" to the benefit of the estate.\textsuperscript{216} The court held that, particularly where a successful reorganization was questionable, equity would not allow the "ruination of an otherwise profitable, successful and ongoing business."\textsuperscript{217}

Subsequently, as a response to the harsh effect of the Lubrizol decision, and the uncertainty resulting from equitable decisions like \textit{In re Petur}, Congress enacted the Intellectual Property Protection Act, codified in sections 365(n) and 101(35A) of the Bankruptcy Code.\textsuperscript{218} Section 365(n) provides that if a trustee or debtor-in-possession rejects an executory contract, under which the debtor is a licensor of a right to intellectual property, the licensee has two possible choices.\textsuperscript{219} Section 365(n)(1)(A) provides that the licensee may elect to treat the agreement as terminated if rejection "amounts to such a [material] breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another

\textsuperscript{210}Id. at 1045.
\textsuperscript{211}Id.
\textsuperscript{212}Lubrizol, 756 F.2d at 1045.
\textsuperscript{213}Id. at 1047.
\textsuperscript{214}Id. at 1048.
\textsuperscript{216}Id. at 563.
\textsuperscript{217}Id. at 564.
\textsuperscript{219}Id. § 365(n)(1).
entity."\textsuperscript{220} The licensee would then have a prepetition claim for damages under section 502(g).\textsuperscript{221} Alternatively, section 365(n)(1)(B) allows the licensee to elect, for the duration of the agreement and any extensions thereof, to retain its rights to the intellectual property and any embodiment thereof under the license agreement and any supplemental agreements.\textsuperscript{222} The rights retained are "such rights [that] existed immediately before the case commenced."\textsuperscript{223} In other words, section 365(n) avoids the rescissionary effect of \textit{Lubrizol}, but does not permit the licensee to compel specific performance of the debtor-licensor's affirmative duties under the rejected license. For example, the debtor cannot be compelled to maintain, enhance or upgrade technology.\textsuperscript{224} Additionally, if the licensee elects to retain its rights to the property, it must continue to pay royalties at the contract rate.\textsuperscript{225}

The Bankruptcy Code does not define royalties; however, at least one court has concluded that even though payments were described as "license fees," they were "royalties in the sense of section 365(n)."\textsuperscript{226} In \textit{In re Prize Frize}, the debtor had licensed the manufacture, use, and sale of its patented french fry vending machine to Encino in exchange for payments described as "license fees."\textsuperscript{227} Prize Frize filed for bankruptcy and rejected the license.\textsuperscript{228} The lower court held that the license fees were "royalty payments" within the meaning of 365(n), and that the licensee was obligated to pay them to retain its rights under the licensing agreement.\textsuperscript{229} Encino argued on appeal that some of the fees were allocable to other obligations undertaken by the debtor unrelated to the intellectual property.

\begin{itemize}
\item \textsuperscript{220} Id. § 365(n)(1)(A).
\item \textsuperscript{221} 11 U.S.C. § 502(g) (2000); \textit{In re El Int'l} 123 B.R. 64 (Bankr. D. Idaho 1991) (stating generally a licensee's options under section 365(n)).
\item \textsuperscript{222} 11 U.S.C. § 365(n)(1)(B).
\item \textsuperscript{223} Id.
\item \textsuperscript{225} See Schlumberger Res. Mgmt. Serv., Inc. v. Cellnet Data Sys., Inc. (\textit{In re Cellnet Data Sys., Inc}.), 227 B.R. 588, 595 (D. Del. 2002), \textit{aff'd}, 327 F.3d 242, 249-52 (3d Cir. 2003) (concluding, in a case of first impression, that if a Debtor rejects a license agreement but the licensee elects to retain its rights under § 365(n)(2)(B) of the Bankruptcy Code, any renewed royalty payments "are the property of the licensor, even though the licensor may have transferred its intellectual property assets during the bankruptcy" since the royalties are linked to the rejected contract and not the intellectual property itself).
\item \textsuperscript{226} Encino Bus. Mgmt. Inc. v. Prize Frize, Inc. (\textit{In re Prize Frize}, Inc.), 32 F.3d 426, 429 (9th Cir. 1994).
\item \textsuperscript{227} Id. at 427.
\item \textsuperscript{228} Id.
\item \textsuperscript{229} Id. at 428.
\end{itemize}
license. The court agreed, in dictum, that to the extent that the fees were consideration for other unperformed obligations, they might indeed abate, however, because the licensee failed to raise the issue below, it could not be raised on appeal. The lesson learned from In re Prize Frize is that in drafting intellectual property licenses, licensees should take pains to clearly delineate the extent to which they are compensation for the use of the intellectual property and the extent to which the licenses are compensation for other obligations of the licensor.

E. Key Employees

Key employees are critical to upholding the value of a struggling company. The flight of key employees can present almost insurmountable problems in the bankruptcy of a traditional "brick and mortar" company, and will almost certainly sound the death knell for a failing dot-com. The best method to prevent employee disloyalty or flight is preemptive action. Unfortunately, there is not a simple answer to the problem of keeping employees from severing affiliations with the debtor. Indeed, competitors who are aware of the weak financial condition of a debtor are apt to lure critical employees with better offers and more security. A company with a good working relationship with its staff, however, will generally find that their loyalty and interest will survive troubling financial times if they are confident that the problems can be remedied. In the context of a sale, dot-coms should proceed to sell assets expeditiously to retain the help of key employees to integrate and upgrade technology. In fact, the intellectual property is often virtually worthless unless these employees go along with it.

1. Assumption, Assignment, and Rejection of Personal Services Contracts

There is a split among courts regarding the assumption of personal services contracts. Several courts have held that, despite the language of section 365(c)(1) of the Bankruptcy Code, a debtor-in-possession may assume a personal services or other nonassignable contract if its performance will be the same as if a bankruptcy petition had not been

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230 In re Prize Frize, 32 F.3d at 428.
231 Id. at 429.
filed.\textsuperscript{232} This view was rejected in \textit{Breedon v. Catron (In re Catron)},\textsuperscript{233} where the court found that the debtor-in-possession, as a separate legal entity, could not assume a personal services contract.

State law uniformly prohibits the assignment of personal services contracts. Moreover, section 365(c) of the Bankruptcy Code excludes personal services contracts from the free assignability of executory contracts under section 365(f) of the Bankruptcy Code.\textsuperscript{234} The presence or absence of a clause prohibiting or restricting assignment of rights or delegation of duties is irrelevant in the bankruptcy context because state law excuses the other party from performance.\textsuperscript{235} "Rare genius and extraordinary skill are not transferable, and contracts for their employment are therefore personal, and cannot be assigned."\textsuperscript{236} Of course, an assignment would be valid if the other party consents.\textsuperscript{237}

2. Non-Compete Clauses

Covenants not to compete are commonly incorporated in contracts with key employees. The ability to enforce such contract provisions may be of particular importance for dot-com debtors, whose employees have specialized and valuable skills eagerly sought by competitors. Such a "covenant is generally valid under state law so long as its time period, geographical area and covered activities go no further than what is reasonably necessary to protect the other's business and goodwill."\textsuperscript{238} These clauses are often validly written to restrict competition by time, area and scope of activity.\textsuperscript{239} The non-compete provision is not separable from the contract as a whole. Thus, the effect of the clause depends on whether the contract is assumed or rejected by the debtor, or breached by another party.

\textsuperscript{232}See Weaver v. Nizny (\textit{In re Nizny}), 175 B.R. 934, 937 (Bankr. S.D. Ohio 1994) (finding that if performance remains the same, section 365(c) does not preclude the assumption of an executory contract, including a partnership agreement); \textit{In re Cardinal Indus., Inc.}, 116 B.R. 964, 982 (Bankr. S.D. Ohio 1990) (same).


\textsuperscript{235}See id. § 365(c).

\textsuperscript{236}Taylor v. Palmer, 31 Cal. 240, 247 (Cal. 1866), 1866 Cal. LEXIS 201 (Oct. 1866).


\textsuperscript{239}Id. at 708.
IV. VALUING DOT-COM ASSETS

If valuations of "old economy" companies are described as a guess compounded by an estimate, then valuations of "new economy" companies would be described more appropriately as simply a guess.\textsuperscript{240} Nevertheless, for most companies there are some accepted yardsticks, including the book value, discounted cash flow, and capitalization of future earnings methods. The value of a typical dot-com's intellectual capital in today's information-based economy can easily exceed the stock book value of tangible assets by several times. But what valuation methods are appropriate for the dot-com industry that is growing so quickly and moving in so many different directions? According to a classic finance text:

Unreasoned companies in new fields of activity . . . provide no sound basis for the determination of intrinsic value . . . . Analysts serve their discipline best by identifying such companies as highly speculative and not attempting to value them . . . . The buyer of such securities is not making an investment, but a bet on a new technology, a new market, a new service . . . . Winning bets on such situations can produce very rich rewards, but they are in an odds setting rather than a valuation process.\textsuperscript{241}

Nevertheless, valuation is a necessity and several different methods are being tested.

To add insult to injury, valuing the assets of a dot-com company in crisis must happen quickly because "[m]any of the key assets of dot-com companies, from websites to proprietary software to computer equipment . . . are goods that depreciate quite rapidly."\textsuperscript{242} As the number of dot-com companies going bankrupt expands, the pressure to cut deals almost as soon

\textsuperscript{240}See Geoffrey Colvin, Buying Net Stocks? Read this First, FORTUNE, Jan. 1, 2000. Based on current valuations of internet companies as of January 1999: AOL was worth more than GM, Ford and the entire American steel industry combined. Yahoo was worth more than all of America's railroads combined. Amazon.com was worth more than Sears, Kmart, J.C. Penny, Saks, and Neiman Marcus combined. Ebay was worth about the same as the New York Times Co., Dow Jones, and the Washington Post Co. combined.

\textsuperscript{241}Benjamin Graham et al., Securities Analysis: Principles and Technique 4 (1939).

as the company closes its doors is immense. Whereas the traditional bricks and mortar company might receive ten to twenty cents on the dollar for their assets, dot-com assets that cost millions to build are being sold at bargain basement prices. 243 When Pets.com went bankrupt in 2000, the company put a number of assets up for sale, including the company's heavily marketed puppet mascot, the domain name and other content. Out of the more than fifty prospects contacted for the sale of these assets, only eight were prepared to visit the company. 244 After Pets.com sold its domain name and fifty-nine other addresses to Petsmart.com Inc. for a mere $375,000, the coordinator of the Petsmart website joked that "$375,000 is a small rounding error in our budget." 245

Intangible assets tend to be the largest base of market value in dot-com businesses. The market, however, has difficulty valuing these assets and as such, "irrational market valuations of dot-coms often result." 246 Dot-com intangibles require individual valuation procedures and analysts "familiar with current industry trends, empirical data, and procedures derived from dot-com transactions and industry participants [to] perform them." 247

The first decision such analysts must make is whether to value assets individually or to weigh the value of the company as a whole. Once the basic valuation method is chosen, the specific procedures and techniques of the economic analysis must be chosen. There are basically three general industry-recognized categories of economic analysis: the cost approach, the market or sales comparison approach, and the income or discounted cash flow approach. 248

Appraisers, typically use the "income or discounted cash flow approach" in valuing intellectual property. 249 They ask what investors would be willing to pay for an asset with a given income stream in the future, adjusted for perceived risk. Certainly this requires a credible projection of future income or cash flow. The reorganization of Zenith Electronics is an interesting case on point. The debtor placed its going

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243 Patrick Byrne, CEO of Overstock.com, once stated that "[a] company might buy something for $1 million one day, but if they go under the next day, it's worth bupkes." Arlene Weintraub, E-Assets for Sale—Dirt Cheap, Business Week Online, May 14, 2001, available at http://www.businessweek.com/magazine/content/01_20/b3732716.htm.
244 Weintraub, supra note 243.
245 Id., supra note 8, at *7.
246 Id.
247 Id. at *5.
concern value at $310 million. The equity committee maintained the
going concern value was $1.05 billion. The difference was attributable
to their respective experts' valuation of the debtor's patented technology for
airwave transmission of digital television signals. All parties agreed that
the discounted cash flow method was the appropriate method by which to
value the technology. The parties disagreed over the appropriate
discount rate to be used to determine the then-present value. The debtor's
experts chose a discount rate of 25%, which was based on the middle of
the range of rates for venture funds and hedge funds. The debtor analogized
its status to that of start-up biotechnology firms that have a new product
nearing regulatory approval, but no sales track record. The equity
committee's expert chose a discount rate of 17%, analogizing the debtor's
status to that of Microsoft. The court concluded that the debtor's
discount rate of 25% was more reliable. The court found that the tech-
nology being assessed was new and untried in the market and that
significant risks were inherent in its future.

Analysts tend to abandon the single focus approach for the
combination of all three approaches. The resulting multidimensional
perspective stems from the final value estimate which is "usually based on
a synthesis, or reconciliation, of the various value indications." Since the
"marketplace actually determines the value of dot-com intangible assets,"
the final value estimate should be derived from the analyst's reasoning and
judgment regarding all of the relevant factors and all of the available
market data and evidence. This gives either the court or the corporation
a reasonable basis for a total asset valuation and allocation.

250 Id. at 103.
251 Id.
252 Id.
254 Id.
255 Id.
256 Id.
257 Id.
258 Id.
259 Id.
260 Id.
261 Id.
262 Id.
V. CONCLUSION

A core asset base is critical to a Chapter 11 reorganization. The first wave of dot-com insolvencies has shown that these "new economy" companies are lacking this core asset base. Importantly, cash reserves tend to be alarmingly low and the primary assets of these companies are intangibles. Experience has also demonstrated that intangible assets depreciate rapidly upon financial crisis. Due to the nature of dot-com assets and the infancy of the industry, it is unlikely that a substantial number of Chapter 11 reorganizations will result. For this reason, bankruptcy law will progress to meet the needs of the "new economy" and bankruptcy attorneys should do the same.