Title: Doing Business With And Finding Value in Financially Challenged Companies
Presented by ACC's Corporate & Securities Law Committee and sponsored by DLA Piper Rudnick Gray Cary US LLP
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Moderator:
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ASSOCIATION OF CORPORATE COUNSEL

Moderator: Howard Kline
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Operator: Just a reminder, today's conference is being recorded.

Male: Go ahead, Howard.

Howard Kline: Good afternoon everybody. My name is Howard Kline. I'm the Chair of the Corporate Compliance Subcommittee of the Corporate and Securities Committee of the ACC.

I have the pleasure of being the moderator of this program, along with the panel which includes (Sara Chanich), who's a Partner in the Financial Restructuring and Bankruptcy Department; D. L. Piper; and (Stacy Snowman), who is also a Partner in the Technology, Media and Communication section.

Before I go any further, I would like to do a little housekeeping if I might since I was told I needed to do this. You'll have an opportunity at any time during the Web cast to ask questions and I would direct you to the lower right-hand corner of your Web page where it has questions. If you type in your questions and hit the send button, we'll receive the questions.

What I suggest also is that you put your name and your Web address, because we will likely get more questions than we will be able to answer during the Web cast since we will be almost exactly at one hour and that will give the panel an opportunity to answer some of the questions at a later time.

Hopefully we'll get to answer as many of the questions as we can. Also, I'd like to direct your attention to the middle box on the right-hand side, which has the Web cast slides and the Web cast evaluation form, which we request that you take a few minutes of your time and fill that out.

When you click on it, there will be a drop down menu so that you can identify the correct Web cast and if you can fill that out, we would appreciate it.

And before we start with the panel, I'm quickly going to throw in, the purpose that I had when we first talked about putting this Web cast together which was to really expand upon the idea when a bankruptcy is filed and you're dealing with a debtor in bankruptcy, either yourself as the creditor or otherwise or the company that you're representing is the creditor, that bankruptcy is not necessarily a bad word.

There are a lot of things that you can do to limit liability, limit losses, long before someone files bankruptcy or just prior to or during bankruptcy. And often you can look at someone filing bankruptcy as an opportunity, which is always a great idea that you can bring in ideas and be a revenue source for the company that you represent.

So (Sara) and (Stacy) are going to get us going on this, and hopefully, we'll key in a lot of thoughts on your part. And as I suggested, feel free to type in your questions and send them over to us.

I now hand the microphone over to (Sara), who is going to be starting the Web cast.

(Sara Chanich): Good afternoon everyone. This is (Sara Chanich).

As Howard said, we are approaching today's discussion with two premises, (1) inevitably, nearly all businesses will find themselves doing business with a troubled company, maybe not one that was troubled when they began the relationship or the financial problems were then unknown; and (2) there is money to be made in doing this with a troubled company.

And keep in mind that people usually think of troubled companies in a bankruptcy context. Most companies who experience financial problems don't file for bankruptcy, but there are problems along the way. There are delays in payment.

There are opportunities for (tax results) and to make money in and out of bankruptcy and what we're going to try to focus on today is strategies to minimize risk and maximize value and (deal with) doing business with a troubled company.

Because there are many factors and many considerations and time constraints that we have today, we can't go into any topic in great depth. Everything we discuss of course will be in the context of what applicable law requires and opportunities that it provides.

In our Power Point, we have cited to a number of pertinent statutes, but please know that in many of these areas, in fact most of these areas, there is a body of case law that should be consulted before making any major planning. And in certain areas, particularly within the bankruptcy area, the (handbook) can vary in different parts of the country.

Our focus today (as well) will largely be on U.S. laws and U.S. practices. We are living in a global economy and there are certain things you can do that protect your assets, both within the U.S. as

abroad, and in other situations, it is important to consult foreign laws because the standards and a lot of the credit issues and the restructuring issues are different.

(Stacy) will give you a couple of comments on some of the global concerns.

(Stacy Snowman): I just want to add that what's interesting is today, as (Sara) said, we're going to focus on U.S., but we're also going to touch on some global perspectives.

And there are some things, especially in the intellectual property area, which we will be interjecting a number of interesting points on where you're going to find that the limitations of many IP rights being located jurisdiction by jurisdiction, means that you do have to prepare and to look at each of these opportunities of doing business with such a company on a global perspective. So we'll touch on that item ((inaudible)) get there.

(Sara Chanich): Now, you start out with the notion that you're doing this for the company, probably before it goes into bankruptcy, as we'll get to later, there may be opportunities when you want to start a relationship or change a relationship once a company is operating under Chapter 11 protection.

The best way to eliminate credit exposure typically is to have collateral (linked) and that's usually going to be in the hands of lenders, be they banks or other financial institutions. The nature of businesses that are lending money to companies, particularly troubled companies now, is huge.

Howard Kline: (Sara), can I interrupt you for a second? Are you moving the slides?

(Sara Chanich): I did.

Howard Kline: OK. I haven't ...

(Sara Chanich): The slides should be reducing credit exposure. If that's not the case, maybe ((inaudible)) you can help us.

Howard Kline: ...for me.

(Sara Chanich): On the topic of reducing credit exposure, I do show we are on reducing credit exposure, and you don't have access to collateral or which is going to be typical, there are lots of things that people do, some of which will be familiar. One is selling on C.O.D. This is probably the most common practice in reducing credit exposure.

Now it has its obvious benefits. You know you're going to get paid for the goods you ship right at the time of that delivery. It's also helpful if you plan it well in limiting credit exposure.

People probably are generally familiar with the notion of a preference in the bankruptcy in that payments within 90 days can be returned to the estate to be distributed pro rata among creditors, assuming at the time of transfer, their transferor or the debtor, was insolvent and that the payments ((inaudible)) debt.

And there is a lot of litigation over that, but with the C.O.D., now a partial C.O.D. reducing that credit exposure you have, you are likely to get subsequent payments. You're able to create the new value defense by shipping and then getting paid and still get the opportunity itself to make money.

Another thing that's easy to do is to reduce your creditor. If you're on 60-day terms, go to 30. If you're on 30, go to 15, but pay attention. Don't' wait long to think about those things because again, you'll get into the preference problems because you'll be changing from what was ordinary to what became unordinary and you'll lose one of the best defenses to a preference action.

So look ahead, watch what's happening and still, most people are of the view, and it's well taken, that you're better off getting money now and fighting with a preference later than waiting to get sued.

Now, there are some exceptions to that where people – that usually deal with people's internal needs, ways of accounting, and needs for reserves as to when they'd rather not expose themselves to preferences, but that's ((inaudible)) business. Get advance deposits for payment.

Obviously if you get paid in advance, then sometimes you can fund money into an escrow or other similar account where their periodic payments are set and you pay over time, ((inaudible)) credit. Lots of (time) vendors don't realize that their customers may have access to letters of credit for a bank facility.

Sometimes people just don't think to ask for it. Keep that in mind. A letter of credit is probably the best thing you can have.

Howard Kline: What is that?

(Stacy Snowman): I would add also, all the things (Sara) just mentioned, you know, from a practical perspective, what you're going to want to do is not just have these ideas in your head, but as you're drafting contracts, there are provisions you can put together that say that if you feel like you're uncomfortable or they failed to make a payment, it triggers a right to be able to make it selling on C.O.D.

Or you can reduce the credit terms or now they have to make the advanced payments or they have to pop up with a letter of credit. So this is all about understanding how these mechanisms work, but getting it into the contracts is a way you can push the button and make all this happen.

(Sara Chanich): Yes, and it's later in our Power Point, UCC does provide for such provisions and I'm surprised how infrequently I see them in contracts. Another thing, that deposit is nice. People don't often luck into these facts. They do appear where you get paid re bankruptcy.

Money is in an escrow and you're owed money post-bankruptcy, but (as you're) getting relief from the bankruptcy court, you can recoup against those if it's set up right. So that's a future protection as well. If you're selling goods, most of what we talk about applies to selling services, providing services as well, consider getting a purchase money security interest.

That's where you have a lien on the goods that you are selling and it does by statute, if you jump through all the right hoops, mechanically jump ahead, ((inaudible)) existing liens, including a lien, a blanket lien a bank may have.

That being said, be careful if you want to do that because, well, if your customer is having problems, you probably don't want to put it in the position of violating its loan agreement. And the loan agreements may provide there can't be senior debt, which would include PMSI debt. ((inaudible)) all of that.

A lot of lenders will accommodate PMSI's to vendors if the vendor subordinates only to the bank. That way, you're still ahead of everybody other than the bank as opposed to being on the same level as everybody else. Junior liens are becoming more popular over recent years.

Many people may have heard about the second liens and, you know, it (is) developing a set of law and cases on how some of them work, but they are growing. Sometimes trade vendors of a particular customer get together and have a joint lien on all the inventory they sell. It can be on specific assets. That's becoming more common.

There are then typically inter-creditor agreements that are extensive with the lenders, but senior lenders are (agreeing) to these things because they want more money in and they want it to be junior. They can get – the specifics can be very complicated and there are lots of options in structuring them, but ((inaudible)), just know that right exists.

(Stacy), are you seeing second liens in IP situations at all?

(Stacy Snowman): Yes. And it's something that kind of comes and goes with the economy and in people's perspective, you can imagine in the dot com era, everybody was a bit nervous about these things.

And just to your point, just this whole idea of whether people even voice these kinds of issues and contracts are prepared to have options to escalate things in different ways, it just depends on whether they have this issue in mind when they're drafting.

(Sara Chanich): Another thing to do, and you'd just see, especially in small businesses you see it more, guarantees. If you get someone else to pay your customer's debt, that's great. But do be concerned about fraudulent transfer issues.

If the guarantor is insolvent or rendered insolvent or unable to pay its debts as they come due, at the time of the issue of the guarantee, that can be a problem. So you may want to look into the financial wherewithal of the guarantor and also pay attention to – and that's because there's a lack of value going to guarantor and granting the guarantee.

So typically, like most things there are exceptions, a downstream guarantee from a parent company to its subsidiary will work, from shareholders of a small company to the company will work. Upstream guarantees in a corporate group don't work as well.

They can depending on the nature of the transaction or if their sister company as opposed to second tier companies, so be aware of those issues. Something that doesn't happen that often, but perhaps it's more often than most of us realize, is the consignment of – a lot of people don't know.

You go into a store like Target and some of the ((inaudible)) that's being sold there will be on consignment. The advantage of consignment is the title doesn't transfer until the good is sold by the retailer to the consumer.

So if in the intervening period from shipment, the retailer before a sale to the consumer, the retailer files for bankruptcy, you can get your goods back if you're the consignor and again, you've jumped through all the right hoops ((inaudible)) UCC. We already talked about credit provisions under the UCC.

There are sale and approval contracts ((inaudible)) doesn't have until acceptance, and then when acceptance occurs, it becomes important and that can be at different times. Most agreements, of course, have the full termination ((inaudible)) provisions and think about them carefully when you're drafting agreements.

I mean, amend your agreements if you have a problem. Some of them give very long (cure) periods. It may not be necessary. You may get the other side to agree to less. You may have certain defaults that you want to provide no opportunities to (her) and they can be enforceable.

This becomes important again in the bankruptcy context because if you send a notice prior to bankruptcy of termination, that the effective date of the termination is post-bankruptcy, that will still apply.

The same thing that a (cure), though there is a 60-day extension for certain (cures) under the bankruptcy code, but once you're in bankruptcy, you can't send a determination notice or a default notice or a (cure) notice without getting relief from stay in the bankruptcy court, and particularly early in the case, that's not likely to happen.

If you're incorporating policies and procedures into invoices, as people often do, sometimes (manage it) by the Internet, send reminders, make sure the other side knows what they are, and review them. Some of these things have been around for years. It may be time to update them.

(Evergreen) clauses or the clauses in the contracts that say, this agreement will expire on a certain date, but it will be renewed for let's say a year, typically unless one of the parties of the contract gives a notice to terminate.

In bankruptcy, you can send that notice without getting relief from stay and that's particularly hard to get unless the other side, the debtor hasn't been in compliance. You may want out because it's not a good deal anymore and the debtor has been living up to its end, but if you are a bankruptcy, you could just say, (yield off). Now you can't.

Credit insurance, it costs money, you're paying a premium like other kinds of insurance, but it is available. Something that's becoming more common or almost like (put) where a creditor pays a fee to – typically it's a large financial institution.

Investment banks are doing these now. Some insurance companies may be doing these, where for a fee, you can say, if my customer files for bankruptcy, and says ((inaudible)) is insolvent, whatever the particular criteria are in your agreement, I can sell my claim to you and you must pay me X percent on the dollar.

You pay a fee to get that guaranty and if you're concerned you're going to get less, it made sense. It's similar – it works effectively like insurance. Like any other insurance premium, you're kind of hoping to never have to need it. Again, we talked about escrows a little bit.

Now, I'll ask (Stacy) to talk more specifically about technology escrows, because every businesses' technology is so important and in many industries, it becomes more important all the time.

(Stacy Snowman): Well, it's interesting because I'm sure many people who are on this call today have been involved with technology escrows in the sense of software licenses, where the source code is something you considered, whether your company was going to need that in the case of a company not performing.

And often, we don't think more broadly. But anything that you could take a license in like schematics, manufacturing, package for something that could be built or designed, maybe not because your company has expertise to build this certainly, but you can always take that to a third party and have that done.

Chemical formulas, you can imagine a number of things where the IP is important, so a tech escrow is something that allows you to put together an agreement with an escrow agent as a third party in the contract. And it's treated as a supplementary agreement.

What that means is under 365N, which we'll talk a little bit about more later, but it was a provision that substantially changed the bankruptcy laws a number of years ago with respect to IP that focuses on what's going to happen when you have a bankruptcy and you've got a licensee and they're very worried that the licensor is going to go bankrupt.

Now there's a right for the licensee to retain their rights to the IP, but more especially, it talks about retaining in the embodiment of the IP and it talks about the trustee not interfering with the right to get the IP from a third party.

So that's where the escrow agent comes in is they're a third party, there is a separate agreement, and what we typically have are some trigger events in the agreement to say if the party is bankrupt, then the ((inaudible)) can come out of the escrow.

Now there are arguments, pros and cons, as to whether anybody who gets someone's source code could ever figure out what to do with it, but if you appropriately address the scope of the license that you get in that source code and you make sure that you can use a third party to help you with it, that's a very useful thing to do.

The other thing to keep in mind is let's ignore bankruptcy for a minute and let's just say you have a company that's kind of going down the drain. And they start to divert their resources to other places because they're somewhat insolvent, the first thing that seems to go is the ability to get your questions answered and tech support and there are suddenly no updates.

So the maintenance is really flagging and you find a breach of the maintenance. You can negotiate these escrow agreements to say that if they breach their support obligations, that's when you get the source code out so you can do some self help.

And again, sometimes just having that leverage gets the attention of a somewhat insolvent company because it makes them focus their limited resources on supporting you, which is great because then you don't end up with that source code that you really don't want.

Howard Kline: Great. Let me ask you a question. If you're dealing with a company that is beginning to show these problems, are there any advantages or disadvantages in going into an involuntary bankruptcy or forcing that issue?

(Sara Chanich): Well, it can be a successful creditor tool you use very thoughtfully and carefully. If you just read the bankruptcy code, it looks very easy. If the business has more than 12 creditors, which is nearly all, you only need three creditors with unsecured debt, collectively, over $12,300 to file an involuntary bankruptcy petition.

The bankruptcy code provides that those claims cannot be subject, those bona fide disputes as the liability or amount may not be contingent as to amount. So the result is that business or person, the case may be, who does not want to in debtor bankruptcy, will create lots of fights over whether there is a bona fide dispute.

Sometimes it's not in good faith, but sometimes people manage to find, oh yes, your bill is for $1 million and you didn't really – the ((inaudible)) company wasn't really very good quality, so I shouldn't have to pay. So there is a bona fide dispute of liability and you can litigate over the question, is that bona fide or is that creative?

And there is a lot of time and a lot of money spent sometimes on these fights over whether or not the – it's called the (ledge) debtor, should become a debtor under bankruptcy. And also, where sanctions are not given out quickly by many courts, bankruptcy judges will sanction petitioning creditors if the order for release is not entered.

The order for release is what says, OK, now you're a debtor and you're subject to all the requirements of the bankruptcy code. And so if you want to do that, it's something to think about, but you want to be careful.

Most of you have probably heard there have been a lot of changes to the bankruptcy code effective October of last year. One of them has made it harder to be a petitioned creditor, so you do want to think about it, so I wouldn't think it's something to ignore in the arsenal of creditor remedy.

(Stacy Snowman): The only other thing I would say is it's interesting. There have been some cases where you get the conflagration between an involuntary bankruptcy filing and the party.

Let's say it's a licensee, wasn't in breach of the contract, and we'll talk a little more about, you know, assumption and rejection and all of that of licenses, but you can end up with these bizarre situations where sometimes there's a doctrine of ride through that kind of gets mixed up in an involuntary filing where the licensee is suddenly thinking, well, I don't think I know if I want to assume, reject.

It kind of changes all the options for people, so there is this thing called ride through where you just sort of ignore an agreement and it kind of flows through the bankruptcy and sort of pops out on the other end.

And the interesting thing there is that if that would happen and there are no protections like you would give in a bankruptcy about making payments or material breach or anything like that, so you sometimes see some interesting behavior when someone is forced into a bankruptcy.

They get very creative about how they're going to get their agreements out of this.

(Sara Chanich): Yes. Most people are probably familiar, very generally at least, with the notion of the automatic stay and the name is (telling). The decision automatically freezes all efforts to collect on debt. The ((inaudible)) provision 362 of the bankruptcy code fraud, there are exceptions, but they're not usually a debt collection.

They are things like police powers, protection of the environment, of criminal enforcement, certain kinds of liquidation and a certain kind of security, so it really applies to nearly all three petition claims. I mentioned recoupment briefly.

That's one of the exceptions, real world, people usually file a motion and ((inaudible)) to recoup so that there's no question that really recoupment is proper. But important is lawsuits are frozen. You can't send a demand letter without violating the statute and there are sanctions sometimes for consumer cases given for violations of the stay that are knowingly done.

So again, pay attention. Send your default, your termination notices quickly if that's what you want to do. Releasing the stay can be granted if granted to pursue certain collection efforts, but that's usually not to get payment.

It's usually to liquidate the claim, so if you're already in litigation in another forum over a dispute, the bankruptcy court may say, good, let the judge who knows about this case decide it. Give them an arbitration provision.

The court may say, you both chose to resolve this type of dispute and support an arbitrator, go ahead, but if you win a plan against the debtor, you just – now we know the amount to your claim and you're going to get it at the end of the case with everybody else.

A lot of people assume that if you have an arbitration provision in the contract, once you're in bankruptcy, the bankruptcy court has to rule on any dispute. Courts will give relief from stays for arbitration if it's issues like breach of contract, amounts due under a contract, pretty often.

They're not going to let you arbitrate things like should a contract be assumed to reject things that arise under the bankruptcy code. So when you're drafting, ((inaudible)) resolution provisions in

contracts, some people have a growing thought that arbitration isn't the sure cut cheaper way of resolving disputes as opposed to court, so keep this in mind in your consideration of what provisions to have (into your) resolution. Reclamation ((inaudible)).

We have here a slide on pre-petition reclamation that we're talking about bankruptcy because this is one thing that has changed significantly under the current version of the bankruptcy code. Reclamation is a concept. It does apply inside and outside of bankruptcy, but the standards are quite different.

They're set for us on these slides quite directly, but basically if ((inaudible)) goods, they were sold while the buyer was insolvent, you have to make demand if you're outside of bankruptcy within 10 days of receipt and it goes up to three months if there was a misrepresentation about solvency. And they are subject to rights of the buyers in the ordinary court.

Howard Kline: (Sara), I have a question on that. I'm going to interject because this is one of my favorite role playings here. Is this one of the strategies you can use if you're dealing with a company that you're not sure has the financial wherewithal to pay for things?

Could you make this part of the sale agreement, that they make certain representations with regard to their solvency, that they're solving, that they're not considering bankruptcy, et cetera? Can you do that and put yourself in a better position?

(Sara Chanich): Well, certainly regarding solvency, yes. Let's say that they're not considering bankruptcy on the day that they sign it and that may often be true. That could change within the next day, is that an improper representation, probably not. The situation changed.

Any agreements to say you won't file for bankruptcy or what rights you may give to somebody else in the event of bankruptcy are usually – certainly they won't file for bankruptcy and most

limits on what you would do in bankruptcy are found not to be enforceable because it becomes not only the right between the debtor and the non-debtor, but there will be other creditors rights that are impacted as well.

(Stacy Snowman): And this goes to the idea that in important transactions, you have a number of tools available. You can say that you want financial reports from the company on an annual basis.

You can say that they have to either let you, you know, give you that warranty up front and they have to reaffirm it on a regular basis or you have a right to, at your request, have them affirm the status. So those are all things you can put in the contract.

(Sara Chanich): And just one quick point of post-petition reclamation on the side, why hopefully it's self-explanatory is that this is not only about getting goods back, but you also get the administrative (expense) priority for goods sold within 20 days of the bankruptcy case, so that you may have to wait – and you typically will have to wait for the end of the case to get that kind of administrative (expense) paid.

But it gives you a higher right, so if you're doing business with a company and you think they're on the edge of bankruptcy, you may not get paid quickly, but your likelihood of getting paid ultimately is higher than it was for something you sold four months earlier. And that's, you know, again, these are all things ((inaudible)).

There are a lot of business considerations in these legal issues. I see one question that I know I've gotten a lot from clients and variations on a theme, so I'm going to interrupt from our Power Point for a moment to respond to a question that says, can you say that going forward, you won't sell unless the old debt is paid, assuming no contractual requirements to sell going forward?

If you don't have a contract that says, I'm going to supply you X goods every month for the next three years and they file for bankruptcy one year into the three years, then you're stuck. Chances are you are required to comply with your end of the agreement and the debtor is required to pay the fair value for those goods, which may not be in the contract, right?

I mean, it could be higher, you know, but it could be lower for that good. If it's an executory contract, which that kind of contract likely is, pending assumption or rejection and we'll get into the specifics on that more in a couple of moments, but if you just have a situation which is very common in that you sell goods monthly, weekly, sporadically, and you do ((inaudible)) an invoice.

And they called you up or otherwise said, I want to order this much of this much stuff and you're in disagreement of price. They send you – you send the goods, you send the invoice, you may have had a practice like that for years, that's what you're doing and there is no supply contract or similar agreement that says, I will keep selling it to you on current terms or market terms, on specified terms, you don't have to.

You can, you know, to negotiate saying, I would sell you more if you paid my old debt, that's a fair discussion. It is later in the Power Point, but ((inaudible)) on the next one, critical vendor (stat).

I mean, people may be familiar with that concept ((inaudible)) particularly in the very large bankruptcy cases, it's common for a debtor to go into the court and say, I have a bunch of vendors, not even saying who they were, and if we don't ((inaudible)) to buy without them and they're not going to sell to us unless we pay them the old debt.

And a lot of bankruptcy courts are saying, fine. Sometimes they require an identity of who these vendors were. The 7th Circuit in a K-mart case a couple of years ago said, no, you can't do that. The only way you can do it is be very specific, say, it's X,Y,Z company.

They provide us with this, it's critical because they have committed going forward to sell us more goods on these specified terms for this period of time, and based on that commitment, we now want to pay them the money we owe them prior to bankruptcy.

Those things do still happen, but they are very specifically tailored and I haven't seen any K-Mart decision debt that does not have the vendor committing to some level of delivery going forward and maybe all on C.O.D. It may be on ((inaudible)) creditor, but the point being that the debtor gets the critical product.

So that, you know, that is the way to hopefully get both – the best of both worlds. You get paid on the old money and make money on a going forward basis with little if any risk, perhaps often in that kind of situation, less risk than you might have otherwise. And that's generally an interesting point in doing business with companies operating under Chapter 11.

Once they file and have the pre-petition claim, unless you're doing the vendor arrangement that I just described, you're kind of stuck on the old claim. Now a lot of companies just say, forget it. I don't want to do business with you anymore and that's people's business decision to make.

But as a result, you can often get better credit terms, more C.O.D.'s and you have a court who can enforce, you know, you haven't gotten paid, you go to court and say, judge, the administrative expense, (pay me now). With administrative expenses, it's the highest priority of claims under the bankruptcy code.

The only thing that's senior (or jury claims) and then only to their particular collateral or claims or ((inaudible)) claims, and they get super priority administrative stat. Now that's usually limited to lenders and to professionals to a debtor, a ((inaudible)) committee, a trustee that's appointed in the case.

You can try negotiating, it's not unheard of for a more traditional vendor to get it on rare occasions. But it's important to be aware of this as well because you think your administrative priority, if you don't get paid currently, at least you're on the end, your pro rata with all the rest of them, there may be this group of administrative creditors who step between you and the secured creditors.

So be aware of that, you know, on the downside consideration as well. You can enter into new agreements post-petition with a debtor in bankruptcy. If they are out of the ordinary course, they meet with approval, (borders on) both sides, the debtor and creditor, in this kind of situation often say, yes, let's go get the court's blessing so there is no question on either side.

That's advisable. Often courts give a short time for hearings on things like this. It becomes somewhat rudimentary, but it eliminates concern that someone later is going to say, it wasn't the right price, or the debtor didn't have the authority.

We've gone through some of what's on the next slide, now we come to what can be very (stormy) issues, assumption of rejection of executory contracts and unexpired leases. A contract that expires or a lease, it's expired. Whatever the ramifications of that are, they are unchanged by the bankruptcy.

Executory contracts, the most common definition sounds pretty simple, contracts on which performance remains due to some extent on both sides. There is a huge amount of litigation over whether contracts are executory and there are two things that can happen to an executory contract. They can be assumed or they can be rejected.

(Rejection) means that the contract is being breached. A lot of people think it's terminated. This is actually a breach and the damages from breach that run happen from rejection. You know, there are in the bankruptcy code certain limits have on those damages for certain kinds of claims.

The most significant ones are for employees and for landlords and some companies, not usually a ((inaudible)) course for a bankruptcy filing, but when they had very rich executive compensation agreements and people were getting fired, it's a benefit they try to get out of a bankruptcy.

For landlords, there is a lot of litigation over how you calculate (the cash), which is in Section 502B6 in the bankruptcy code and then what happens, the landlords often are among the parties who do have security deposits, LC's, escrows, and other sources, how they get supplied.

And this is an area where the law is different in different circuits and it's evolving, so if you're someone who is involved in drafting leases, even if it's just, you know, the one lease, you know, you have a sublease in your – in your premises, if you're in the business of leasing, these issues can become important in how you structure a security deposit or LC.

It can be critical, and even whether or not you file a claim from that or there's a recent decision that says, when you file a proof of claim, if you do not file a proof of claim, this ((inaudible)) doesn't apply. So there are things to think about in rejection.

You should know courts rarely deny rejection, and I don't want to get into too many anecdotes, but a bankruptcy judge said not too long ago in a conversation, in four years on the bench, she had never denied a request (rejectively), and that's a well respected judge and I don't think she is alone on that.

Assumption – oh, and then, another point, I touched on this before, during the pendency of the time between the bankruptcy commencement and the decision to assume or reject, the debtor generally has to pay the fair value of whatever it's getting under the contract. It may not be the contract rate.

There are some exceptions in the code on this, on personal property leases and real property leases, and you need to be aware of that, but don't assume if you have a different kind of executory agreement that's pending assumption or rejection, that you'll get your contract. You might, but you should look into market conditions and do some thinking about that.

If a debtor wants to assume a contract, be it a debtor in possession or a trustee, the assumption requires (cure) of monetary default, demonstration of adequate assurances of future performance and satisfaction of ((inaudible)) typical business judgment standards.

This is a change from the old bankruptcy law because it used to be you couldn't assume if – many courts said you could not assume if there were non-monetary defaults that could not be cured, which is often the case with non-monetary ((inaudible)).

There is a lot of fighting over assumption, often the non-debtor party does not want a contract to assume – to be assumed, and then the fight becomes is there adequate assurance? Is this – and to ((inaudible)) of other credit? This is ((inaudible)) judgment (test). The debtor taking on something that's too burdensome, so there are cites on that.

And the reality of the processes along the way, there is a lot of renegotiation of agreements on both sides' interest. Now, the non-debtor party does not have to sit and wait for the debtor to get around to making a decision or take advantage of having not had to make a decision on whether or not to assume or reject.

The non-debtor party can go to court and seek an order from the court to direct the debtor to assume or reject by a date certain. And that does happen that the non-debtor party can demonstrate to the court that there are burdens in waiting and ((inaudible)) a ((inaudible)) on when the debtor makes a decision.

If you're in Chapter 11, you have until confirmation to make a decision unless otherwise ordered. Again, now a change in the law for real property leases. You have to make a decision within the first 120 days of the case. It can only be extended now for another 90 days and after that, only with the landlord's blessing.

Howard Kline: (Stacy), hopping to another issue, I know that you're going to talk a little bit about IP now and that's a totally different world with regard to standard bankruptcy matters. Why don't you kind of segue into that?

(Stacy Snowman): Well, you know, if it was a movie, it would be the collision of the world. It's an interesting area. It imports into the bankruptcy law a number of interesting principals. You've basically got the players being the patents, the copyrights, the trademarks, let's just focus on those.

And as (Sara) was saying earlier, it's very typical, and I won't go into the gory details, but it's typical that the IP licenses are executory contracts. And as (Sara) said, they can be assigned, rejected, or assumed in the ((inaudible)).

And what's interesting is you have to look to the ((inaudible)) of the law and that has gone through a lot of change and evolution over the years and I would show you sort of a matrix if I was trying to be very precise about this. So I'm going to generalize a little bit here today.

Basically speaking, you've got to understand that if you have a patent license, and I'm going to say whether it's exclusive or non-exclusive, and you are the licensee, and this is something I think people miss a lot, even when we're doing merger transactions, we have seen people going through, you know, boxes of documents and looking at assignability.

And from a corporate law standpoint, you typically figure if it's silent on assignment, then hey, you know, it could be assigned. But when you have an intellectual property license, that's not true, and if it's silent, there are a bunch of rules that govern whether it can be assigned.

And those are the rules that get dragged into the bankruptcy laws and since they are something that people don't really seem to understand anyway, then mix the rules they're not aware of with the bankruptcy law and you get quite an interesting mess.

So basically, if you've got a patent licensee, there are exclusive rights with a licensee, they cannot go assigning that without the consent of the patent holder. And I won't go into all the doctrines about that, but the idea is that that's something that's a personal license and it can't be assigned.

The same thing with copyrights, although I'll say that, you know, years ago, we thought that it was the non-inclusive copyright licenses went one way and the exclusive one another. And that's because a copyright exclusive license under the copyright law is a transfer of an interest.

So we thought, oh, well, then that means it's going to be treated like a transfer of an interest. You're an inclusive licensee, you have more rights, but there have been some recent cases that they know that's not true. So again, you cannot be assigning the copyright license. Then we've got the trademark licenses, again, exclusive or non-exclusive.

If you're a licensee of a trademark license, you can't be just going off and assigning that without the consent of the licensor. So where this gets all balled up in the bankruptcy law is that there are some tests that get applied. One is the hypothetical test and one is the actual test, and they are rather interesting.

There is a hypothetical test that says that if it could not be assigned under the applicable law, then it cannot be – it cannot be assigned in this bankruptcy setting and what's odd about that is a lot of times, it's something that the party wants to assume, but they weren't actually going to go assign it.

But the test is, if you can't assign – if you couldn't hypothetically assign it, then, you know, you can't assume it. Now the actual test says, no, you've got to really look at what's going to happen.

And those actual tests – it's the Court of Appeals that would apply the hypothetical test and it's the lower courts that seem to apply the actual test, then the lower courts had these cases where, for example, a company was going to – they wanted to assign all their shareholder interest or all their stock and they were arguing, well, we're not a different company.

I mean, we're owned now by a different set of shareholders, but we're the same entity. And that's what seems to sway the courts. So you have to understand that there is going to be some interesting outcomes when you have that kind of applicable law applied against the bankruptcy law. Now, the executory aspects, why is the IP license executory?

Well, the basic elements that the courts have looked at is they say, OK, you've got licensees. They typically have to pay royalties, keep records. They usually say that the licensor has to forebear from licensing other parties, but we realize that would only be the case in an exclusive license.

So the only thing they typically come up with for a licensor who is not exclusive is they say, well, you typically have the duty to defend an infringement suit. Now, before 365N of the bankruptcy law was put in place, the ((inaudible)) case, parties would try to argue it wasn't an executory contract, to get out of all of this, but that argument failed.

Now you've got the licensee who gets to elect to retain certain rights. This is what 365N of the bankruptcy law has given as a gift to the licensee. Your licensor is bankrupt. In the past, they were concerned that the licensor would reject the license and all they would be left with is some damages that weren't going to go anywhere.

But now they can elect to retain the license. They of course then have to perform, they have to pay the royalties and go forward. It also means there is some protection that if your licensor has given you an exclusive license, and they're bankrupt, they can't then waltz off in the bankruptcy and start licensing to others, which of course they would like to do to gain some financial benefit.

But exclusive provisions will be respected, and also, as I mentioned earlier, the right to retain the embodiment. Now, I guess the last thing I want to talk about on the IP is that there are and aren't certain things that can happen.

So for example, specific performance of affirmative duties on a licensor, those are not going to be enforced and you typically realize that the things you're looking for there are to get the support. So you're going to be on your own. You're going to have this (object) code. It may have some bugs. You can't ask any more questions.

You can't get updates. That's where the source code escrow comes in, and if there's an infringement claim and you had an indemnity, you're no longer going to get that indemnity benefit. You have to continue making the royalty payments and as (Sara) was mentioning earlier, you know, we talked about waiving the rights of set off or administrative claims.

The other thing I want to mention is that this is only going to apply to certain intellectual property rights. There is a really interesting thing that happened in the trademark law, (when B355N) was being put in, and they basically threw the trademark out.

So if you are a trademark licensee, you need to be aware of the fact that 355N is not going to do you any good when your licensor goes bankrupt. And it's also not going to help you with rights outside the U.S. because as we mentioned at the beginning of our talk, we said, you know, rights are different around the world in intellectual property.

So if you are a typical multi-national and you deal with companies who are also multi-national, and your IP licenses deal with rights all over the world, you're going to need to take a look at some other options.

And we'll talk in a few minutes just for a brief moment about bankruptcy remote entity, which is a solution for a situation where you're not going to have the benefit of the bankruptcy law of the U.S. in foreign jurisdictions.

Howard Kline: Hello? We went blank for a second there.

(Sara Chanich): Yes. (Alex), I'm stuck with my slides for a second. If you could move up ...

Operator: OK. I'm going to – I'm refreshing right now. I can ...

Howard Kline: Yes, I can't get – I'm actually pooped out on that ...

(Sara Chanich): OK. On the – OK, here we go. Another important thing trying to run through the rest of this quickly, very common provisions in contracts that the contract is not assignable period or more commonly, not assignable unless agreed to by the other side. Know that if you're in bankruptcy, those provisions with limited exceptions, are not enforceable.

Next slide please, so that if applicable non-bankruptcy law would excuse or even accept a performance from or rendering a ((inaudible)) other than the debtor, the (anti-assignment) provisions will be enforceable. Otherwise, they are not. We have listed a few examples here.

This is a fast specific analysis, not all distributorship agreements, certainly by all means, not all partnership agreements because that's probably not ((inaudible)). It will be all employment contracts, you know, or other things that are really clearly personal services.

Another common provision, next slide please, which you see an agreement and generally are not enforceable in bankruptcy or ipso facto clauses that say, in the event of a bankruptcy, usually it's part of a ((inaudible)) of a list and assignment for the benefit of the creditors, receivership, insolvency, et cetera, the agreement has been terminated, and all obligations are (accelerated) typically.

That's not enforceable unless the contract is one that's not assumable (that I just) described, or an agreement to make a loan, debt, financing or financial accommodation, there is some dispute over what does financial accommodation mean?

As you can imagine, but one thing that's clear, it does not include ordinary trade credit where you say, I'll give you credit. Pay me in 30 days, or something like that. So the one way among many that parties, the greater (frequency) are trying to protect themselves from the impact of bankruptcy.

Hopefully, we've pointed out ways where it's not all bad or there are opportunities and there are more, but you know, we haven't had the opportunity to touch on, but (with) bankruptcy remote entities, it's used a lot, but IP, which (Stacy) will talk about, but know that they are also used to hold other clients' assets, real estate commonly, among others.

(Stacy Snowman): So real estate was where a bankruptcy remote entity concept came from and it's basically the idea of being that you in a global economy, we're saying here 40 percent of your revenue in most companies are coming from other places in the world.

But you can use this as a backup licensor, either meaning that you take the license from the parent or regular entity and you also take a parallel license from the bankruptcy remote entity.

And the key here is you create this subsidiary of the party you want to take the license from because you're worried they're going to go bankrupt and you're worried there is no 365N and they're out there somewhere else in the world or they're here in the states, but they have licenses – they have IP in many other jurisdictions.

So if you go to the next slide, I've listed just a couple of elements here for you. A typical example would be, you've (made) a Delaware corporation, you'd build in ...

Howard Kline: (Stacy), can I interrupt you. My slides aren't moving forward and I just want to make sure that if anybody else is having some problems with the slides, Alice, if you can move the slides forward, that would be great.

Operator: Yes. The slides are moved forward.

Howard Kline: OK. If you're having trouble like I am, go to the right-hand side where it says links, you can download the slides and look at the slides yourself and move them along. We're currently on what slide?

(Stacy Snowman): Page 19.

Howard Kline: 19, so you can follow it on your own too just in case you're having problems.

Operator: And again, if you are having problems with your slides, you also can use the refresh button and that should refresh your screen and move to the next slide.

(Stacy Snowman): So for the benefit of those of you who may or may not be able to see the slide, the bankruptcy remote entity is something that your company, when dealing with a licensor, if you're concerned about them, you could say, OK, we want you to set up this subsidiary for your entity. We want you to put the IP into that entity.

We'd like to take a license from you because we would put in that contract the typical things, the executory things like infringement, indemnification, and all those things we want, but in the bankruptcy remote entity, it's set up so it would be highly unlikely that it would ever be involved in a bankruptcy. It wouldn't have any creditors.

It would have a separate operational legal existence. You have to be very careful to make sure it has separate facilities and there are some interesting things you can do like you would be a shareholder of it with very small ownership interest, so you had a veto right over certain transactions like initiation of bankruptcy, disposing of IP, change of control.

You'd have to have certain things in the charter documents about voting and what that would do is then it enables you to be in a situation, as long as all these rules are observed about not commingling, assets and things, to be a licensee of an entity that's never going to be bankrupt. And that's a really interesting thing that's just started to evolve.

We've been doing a few of those in the recent past, so it's kind of a neat way to take something that's a very old tradition in the real estate side of things and use that to help in our new global economy.

(Sara Chanich): Next slide please.

Howard Kline: I'd like to remind everybody, if you're asking a question and you put your name down, put in your e-mail address also. So that if we don't get to answer the questions today, (Sara) and (Stacy) can give you an answer later on.

(Stacy Snowman): Yes, we'd be happy to.

(Sara Chanich): Another way you can get value doing business with companies in Chapter 11, buying assets from them. Asset sales out of bankruptcy are common. They're a great value in terms of the buyer in getting it for the stroke of a judge's pen, all liens and other encumbrances are gone.

You don't have to go through the process of release of liens as you would typically do. Most often, but not always, sales through a bankruptcy is profit. This is true with Chapter 7 as well, if it's being done by your trustee, or auctions. Usually with an initial bidder, and then there are bids against that contract, sometimes without an initial bidder.

The initial bidder very commonly in bankruptcy do get (breakup) fees approved in advance, so that their costs in the process are reimbursed if they're not the ultimate bidder. And if you're interested in buying assets from a company in bankruptcy, and you're not getting much response from the company, sometimes companies are shopping their assets, and sometimes they're not.

But that liquidation really is the best value for creditors and management, shareholders are hoping for the contrary, being (ostriches) as they say, and creditors can become your ally. There are typically creditors ((inaudible)) in most Chapter 11 cases with any kind of meaningful assets.

You can reach out to their counsel or to the creditors directly, you know, depending on if you're the business folks. They can be an ally. There are ways to find them if you don't know who they

are. Sometimes when an asset sale is in bankruptcy, people are concerned about the ((inaudible)) of values from the time you go to contract to closing.

As you do in other acquisitions, you can usually have post-closing purchase price adjustments. The courts will readily, you know, enforce those and you have a lot of protection. We are, you know, very, very quickly, we mentioned a couple of points on preferences to highlight some things that people don't often focus on.

One of the elements of a preference, and go forward two pages please, is that at the time the transferor was insolvent, people assume that a lot in bankruptcy. It's not the case. There is a presumption in the statute, at least under the bankruptcy code, but look at that.

It may be a quick, oh, well, they were insolvent. An (analysis can assume it). I have seen a surprising number of preference actions start with (off claims) that were not entities, and that's, you know, look at that. It may not be the case.

It's often not part of the analysis of surprisingly enough plaintiffs do, where it's questionable, but if you're the defendant, you certainly want to look at it. But keep in mind that not only money can be preferences. Delivery of goods, ((inaudible)) of collateral can be preferences. Payments by non-donors are not preferential.

There may be fraudulent transfer concerns there that we discussed, with guarantors again earlier. But keep that in mind. Also know that there are preference actions and statutes in addition to the bankruptcy code. Many states have assignments that have benefited creditors to have preference statutes.

For those of you in California who are paying attention, there was a decision last year roughly saying they were enforceable in the state law. The state court ((inaudible)), said that they are,

that, you know, if you're in – or you could be anywhere and be sued by assigning California, subject to ((inaudible)) process concerns.

Also be aware that under state insurance insolvency statutes, there are preference claims and they typically, not always, do not have the ordinary course new value defenses that exist in the bankruptcy code, and most ABC statutes, ((inaudible)) to the benefit of creditor statutes, so if you're doing this as a troubled insurer, you want to be particularly careful because of a lot of the protections, at least for now.

This is subject to change and it's proposed to be changed under uniform law proposals. I just want you to be aware of that. And then there are other defenses, you know, ordinary course is now ordinary in the industry or between the parties, prior to October of last year, it was both. It's going to be easier to defend a preference action.

A good thing for anybody other than the other creditors who are unpaid, but really ((inaudible)) paid on time just on – we mentioned, you know, a couple of the highlights in fraudulent transfers. We could talk about fraudulent transfers alone for hours.

Know generally that there are two concepts with actual fraud and intent to hinder delay of defraud creditors, or constructive fraud where it's a transferor, a transfer is made when it's insolvent at the time under applicable statute, and there's a less than reasonable equivalent value, and that's where you get into a lot of fights.

Well, again, you can fight over solvency as defined in the statutes and you can be the subsequent transferee. So if you're getting money from somebody who may have been – you know where the money is coming from and you wonder whether it was a good deal, to them, pay attention to that.

We are a couple of minutes over and I apologize for giving some of these topics at short ((inaudible)), but certainly, I think that we have time now to answer some questions and certainly we can be contacted by ...

Howard Kline: Yes. I've got some questions here. I've got to get going because I've got to be running the corporate and securities committee meeting which is immediately following this.

So at least, at the very least, I'd like to thank (Sara) and (Stacy) for doing a great job and if you have any questions, please, whatever you do, fill out the valuation form. You can download the Power Point slides and certainly you can contact (Sara) and (Stacy) over at (DLA) ((inaudible)) and I'm sure that they will be more than willing to help you out.

And if anybody would like to participate in our conference, the Corporate Securities conference, the dial-in number is 888-288-9320, pass code 255544. And thank you very much. I've got to get going and I will speak to (Sara) and (Stacy) later on.

Thank you very much.

(Sara Chanich): Thanks everybody.

(Stacy Snowman): Thank you all.

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