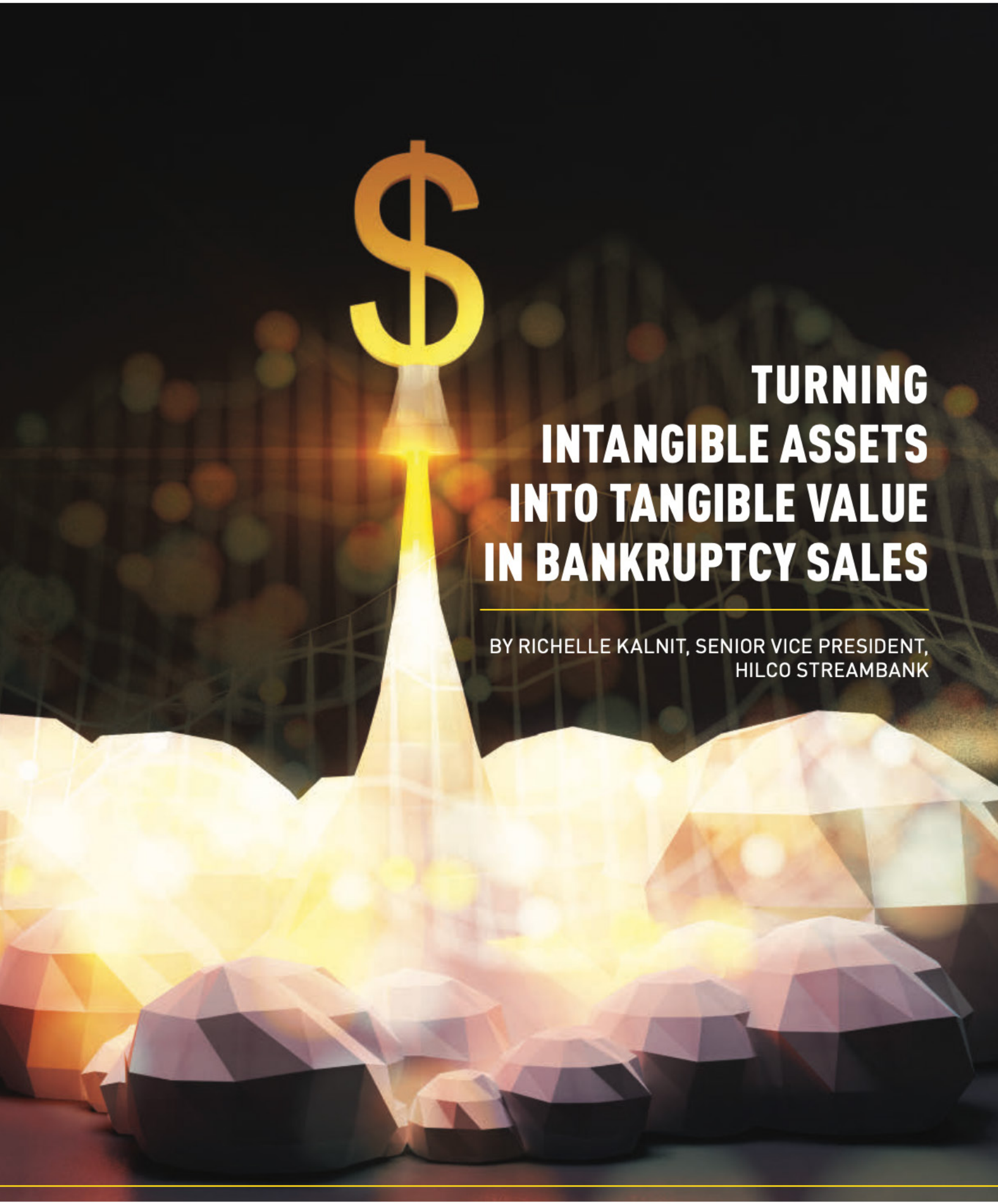
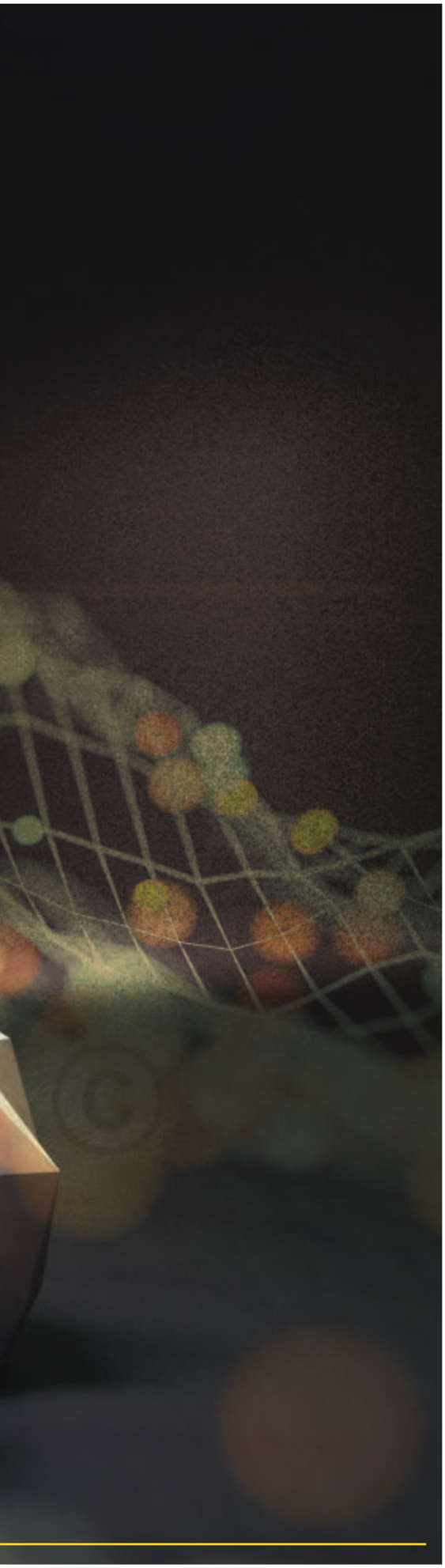


TURNING INTANGIBLE ASSETS INTO TANGIBLE VALUE IN BANKRUPTCY SALES

BY RICHELLE KALNIT, SENIOR VICE PRESIDENT, HILCO STREAMBANK



The stand-alone sale in bankruptcy of certain forms of intellectual property, namely trademarks, is now well-established. Since the dot-com bust, when website companies had few, if any, tangible assets to sell, restructuring professionals have grown accustomed to disposing of intangible assets in bankruptcy.

Debtors may sell intangible assets for any number of reasons, including, most obviously, in a liquidation, but they may also sell them in a going concern sale or plan process when a buyer or plan sponsor is not interested in continuing to fund, operate, or maintain certain non-core intangible assets. This article explores a handful of types of intangible assets that can be monetized on a stand-alone basis (or a quasi-stand-alone basis, in the case of customer data) and strategies used by sellers to maximize value in stand-alone sales of those assets under Section 363 of the U.S. Bankruptcy Code.

Class-Action Claims

Class-action claims[1] recently have become an asset class of interest in liquidating cases, as well as sales and restructuring cases, when creditors' committees work to extract value for their constituents from prepetition lenders, whose liens against such claims are often not perfected; plan sponsors; and purchasers. The most commonly traded class-actions claims in bankruptcy cases are those held by debtors against Visa, MasterCard, and various other defendants in the "interchange fee litigation."

While it has been reported that the defendants are close to settling the 13-year-old lawsuit, appeals of such a case can take years. In fact, a previously approved settlement took more than three years to work through the appeals process, only to be overturned and remanded to the district court. Accordingly, the market for claims in this class-action case—one of the largest of its kind—is likely to continue for at least a few more years.

Depending on the nature of its business, a debtor may be entitled to participate in other class-action cases—most of which are based on alleged antitrust violations—something which many case constituents focus on less frequently.

For example, there currently is significant disruption in the grocery space, and the fallout from Amazon's purchase of Whole Foods has not yet been fully realized. Over the past few years, numerous supermarkets have filed for bankruptcy, including A&P, which owned Pathmark, Food Emporium, and Waldbaum's, among others; Southeastern Grocers, which owns Winn-Dixie and Bi-Lo; Tops Friendly Markets; Marsh Supermarkets; Fresh & Easy; and Central Grocers. Supermarket chains would be well-served to analyze the large class-action cases in which they could have claims, including price-fixing cases involving food products.

Likewise, electronics retailers may be eligible to participate in class-action cases based on the nature of the products they sell, including claims related to component parts of computers and/or televisions. For example, hhgregg, an appliance, consumer electronics, and home products retailer, sold its rights in three such class-action cases for cash plus a share of amounts recovered by the purchaser above a certain threshold.

Moreover, in that case, hhgregg rejected its prepetition contingency fee contract with the entity that filed claims in the class-action cases on the debtor's behalf, paving the way for the purchaser to achieve a full recovery of the class-action settlement proceeds. It also increased the likelihood that the estate will receive an additional share of the proceeds based on its agreement with the purchaser of the class-action claims.

Similarly, the stakeholders in Tweeter, CompUSA, and Circuit City saw significant recoveries from litigation against flat-panel display manufacturers several years after the retailers' inventory liquidations.

Digital Assets

As the world becomes more reliant on technology, companies have acquired various forms of digital assets which help them connect with their clients

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and customers. Two types of such assets can often be easily separated from, and marketed differently than, a debtor's other intellectual property.

Domain Names. Domain names include both top-level domain names (*e.g.,* com, org, gov, etc.) and second-level domain names (*i.e., l*etters before .com, .org, .gov, etc.). Most bankruptcy sales of domain names have involved second-level domain names. Yet, as more top-level domains are released for sale,[2] it appears likely that some of them will be traded in a distressed context, including in bankruptcy. Many firms that grew through mergers and acquisitions have accumulated a significant portfolio of valuable second-level domain names that lay dormant.

In a recent sale arising out of the bankruptcy of Vanity Shops, a women's apparel and accessories retailer, the company worked with its advisors to separate the valuable vanity.com domain name from the company's trademarks and other intellectual property. The domain name was marketed to potential buyers in the domain community, as well as to those in the vanity phone number space. The company marketed its trademarks, customer data, and other domain names to parties in the apparel and accessories space and to investors in such brands.

The two groups of assets were sold separately, with a company that sells vanity phone numbers purchasing the vanity.com domain name and an apparel investor purchasing the remaining assets. Similarly, Circuit City, the electronics and appliance retailer, marketed and sold the 800.com domain name separate and apart from the Circuit City brand assets and customer data.

IPv4 Addresses. Other digital assets that can be separated relatively easily from a debtor's remaining assets and monetized are internet protocol (IP) addresses. Akin to a postal address, an IP address is a unique numerical string that identifies each computer and other internet-enabled device on a network. IP addresses were originally provided to companies for free but are now only transferrable based on "need" to those who can demonstrate planned utilization.[3]

A new protocol of IP addresses, version 6 (IPv6), was introduced in 2011 to replace version 4 (IPv4), because all of the earlier version's roughly 4.29 billion available addresses had been assigned. However, the newer addresses, which contain much longer numerical strings than IPv4 addresses, are not universally recognized by some older software and routing equipment. As a result, demand for IPv4 addresses remains greater than supply, and a market exists to sell addresses assigned to companies but never utilized.

IP addresses rarely show up on balance sheets, so many debtors only become aware of those assets when they begin liquidating.

The first recorded stand-alone sale of IP addresses in bankruptcy was Nortel's sale of IP addresses to Microsoft in 2011 for $7.5 million.[4] Since then, there have been a handful of sales of IP addresses (including outright sales or sales of designation rights), including in the Borders, Mervyn's, Dowling College, and Maxus Energy cases. While each of these cases involved liquidating debtors, given that the vast majority of IP addresses are sold by healthy companies, debtors and case constituents in going concern sales and reorganizations should be aware of these assets and the opportunity to monetize unused addresses separate and apart from an ongoing business.

Customer Data

As companies develop greater e-commerce capabilities, including more effective customer relationship management tools, the value of the accumulated data to third parties increases. In certain cases, the principal value of a debtor's intellectual property lies in its customer data.[5] The brands and trademarks follow the customer data in such cases, as opposed to the other way around, although the value of the customer data stems from the brand's relationship with its customers.

Competitors may look to acquire a debtor's customer data to convert those customers into their own. The trade names do not serve as the primary source of value, but rather as entry points to migrate customers to the buyer's own brand, combined with the burial, over time, of the debtor's brand. The bankruptcy process presents unique opportunities when it comes to the sale of customer data, particularly when a debtor's privacy policy appears to prohibit or restrict the sale of such data.

The Bankruptcy Code explicitly contemplates the sale of customer data where a privacy policy appears to prohibit such a sale.[6] Exemplar cases, starting with Toysmart and continuing with RadioShack, have established standards under which customer data may be transferred, notwithstanding a restrictive privacy policy.[7] In such cases, a consumer privacy ombudsman (CPO) is appointed, and he or she makes recommendations to the court with respect to the proposed sale or lease of personally identifiable information (PII).[8]

One such sale involved the intellectual property of Borders, where the company sold certain assets, including the Borders and Waldenbooks names and customer data, to Barnes & Noble. Visitors to borders.com and waldenbooks.com are now redirected to the Barnes & Noble website, where they are greeted with a welcome note inviting them to discover Barnes & Noble.

Similarly, Systemax (the owner of the CompUSA intellectual property) purchased the intellectual property of Circuit City. While Systemax initially engaged the customers through the Circuit City brand, it eventually migrated them to its TigerDirect.com platform. In 2015, Systemax sold the Circuit City trademarks and domain name (but not the customer data) to a third party.

Sellers are best served by embracing the appointment of a CPO and working with that individual throughout the sale process to ensure a full flow of information. That way, the CPO's recommendations can be tailored to the outcome of the sale, and the sale is not delayed while an ombudsman gets up to speed. Working closely with the ombudsman also allows sellers to collaborate with potential buyers in developing terms of a sale that are more likely to be consistent with the CPO's recommendations and approved by the court.

The CPO's recommendations, backed by a court order, allow:

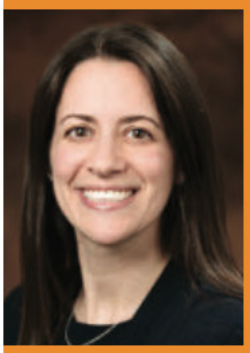
- Buyers to use customer data in a way that might be more difficult to do outside of bankruptcy
- Sellers to maximize the value of data they have cultivated in an increasingly digital environment

- Customers to transact with a brand they have come to know and trust

In business-to-business cases, there is no statutory requirement to appoint a CPO because the customer data typically does not fall within the definition of PII under the Bankruptcy Code. In those cases, customer lists can be extremely valuable, though often quite perishable. In the case of maintenance, repair, and operations businesses and fuel distribution businesses, for example, competitors in the market may be willing to spend heavily for exclusive access to a marketing list, but are often uninterested in the debtor's trademarks. For new entrants to a market without an established brand, however, the trademarks may offer value.

Evaluating All Options

The value of intangible assets, if they appear on a balance sheet at all, often is not accurately reflected. Restructuring professionals should question their clients to ensure that every possible asset class is evaluated and, if appropriate, monetized. Certain intangible assets are often not core to a debtor's business, even in a restructuring or a going concern sale, leaving companies with an opportunity to sell those assets free and clear of liens and claims in a Section 363 sale.



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[1] Claims held by debtors against third parties in which the debtors are members of the class.

[2] See newgtlds.icann.org/en/program-status/delegated-strings

[3] Address transfer rules vary by region, and not all addresses are equally transferrable. Within the United States and Canada, as of 2018, addresses can be transferred to both the European and Asia-Pacific regions, as well as within the North American region.

[4] Microsoft paid $11.25 per address. The market for each address now ranges from $16 to more than $20 per address.

[5] Customer data in the majority of retail cases includes personally identifiable information (PII). As defined in Section 101(41A) of the Bankruptcy Code, PII broadly includes such items as names, physical mailing addresses, email addresses, and phone numbers, if provided by an individual to the debtor in connection with obtaining a product or a service primarily for personal, family, or household purposes.

[6] Section 363(b)(1)(B) of the Bankruptcy Code provides, in relevant part, that the trustee "may not sell or lease personally identifiable information to any person unless (A) such sale or such lease is consistent with [the privacy] policy; or (B) after appointment of a consumer privacy ombudsman [...] the court approves such sale or lease [....]".

[7] These standards may include selling the PII to a "qualified buyer" that (i) concentrates in the same business and market as the debtor, (ii) agrees to be responsible for any violation of the privacy policy following the sale, (iii) agrees to be bound by and meet the standards established by the debtor's privacy policy, and (iv) provides notice to customers whose PII is being sold and an opportunity to opt-out as part of the notification process, to the extent required by law. If the PII is sold to an entity that is not a "qualified buyer," that buyer would typically (i) agree to abide by or meet the standards of the debtor's existing privacy policy, (ii) provide notice to customers, and (iii) as part of the notice, provide an opportunity to opt-in to the transfer, absent which data pertaining to that customer would not be utilized.

[8] The CPO makes recommendations to the court with respect to the sale of PII, including providing information regarding potential losses or gains of privacy to consumers, potential costs or benefits to consumers, and potential alternatives that would mitigate potential privacy losses or potential costs to consumers. The court will give "due consideration to the facts, circumstances, and conditions of such sale or lease" under Section 363(b)(1)(B)(i) of the Bankruptcy Code.