

SMARTER PERSPECTIVE: INTELLECTUAL PROPERTY

# Shift Technologies, Inc.: Salvaging Technology & Digital Assets in Chapter 11

A Case Study by Hilco Streambank<sup>1</sup>

By David Peress and Jordon Parker

## INTRODUCTION

Launched in 2014, Shift Technologies was a consumer-centric, omnichannel retailer for buying and selling used cars with the goal of improving the customer car-buying experience. The company went public in 2020 via a de-SPAC merger, and thereafter effectuated a number of strategic acquisitions, including the acquisition of complementary online vehicle selling technology platform, Fair Dealer Services, LLC and CarLotz, Inc., a consignment-to-retail used vehicles marketplace that operated a tech-enabled buying, sourcing, and selling model online and at physical dealer locations.

Shift generated more than \$670 million in revenue in FY22 by prioritizing growth over profitability. Shift deployed hundreds of millions of dollars to develop its technology solutions and to effectuate its various M&A activity, all with the expectation that its access to the capital markets would continue to support its growth strategies. The capital markets, however, began to tighten in early 2023, precipitated by the failure of Silicon Valley Bank, and, coming off the heels of a costly restructuring plan and facing industry-wide headwinds, Shift needed

to avail itself of Chapter 11 by October 2023.

Hilco Streambank was engaged as the company's intellectual property advisor with a mandate to manage a marketing and sale campaign for Shift's intangible assets, including its proprietary software technology. Unfortunately, after its swift rise and fall, Shift did not have the capacity or resources to preserve its technology in an active, usable, and demonstrable development environment. In spite of that, the sale of Shift's IP generated more than \$2.4 million in value. The primary drivers of value were the company's domain names.

This article will serve as a brief case study and practical guide for bankruptcy attorneys and professionals, operators, and secured lenders to consider when faced with scenarios necessitating rapid preservation and monetization strategies in the technology sector.

## Shift Technologies' Innovative Technology Solutions

Shift developed its own unique,

proprietary technology utilizing machine learning-driven pricing models to acquire and price used cars based on aggregated real-time market data, predicted sale prices, reconditioning requirements, and internal margin targets. Shift's solutions relied upon a legacy monolithic system architecture, which supported four primary application modules: its (i) pricing engine; (ii) direct-to-consumer e-commerce dealership platform; (iii) third-party marketplace; and (iv) dealership pricing engine as a service.

The pricing and acquisition engine predicted the price Shift would pay for a seller's vehicle, the price at which the vehicle could be resold, the approximate level of reconditioning required (and therefore impact on margin and operations), and the likelihood that consumers would purchase ancillary products in connection with the sale of the vehicle.

The direct-to-consumer e-commerce platform provided a user-friendly, end-to-end buying and selling experience for individual consumers. Shift sourced its inventory directly

from consumer-sellers and third-party consumer-facing partners. Its differentiated, algorithmic platform solutions exploited real-time, market-based demand metrics to establish both a profitable market clearing price for vehicles as well as a competitive selling price for consumers.

The third-party marketplace provided a third-party seller experience designed to align with a dealer's workflow, offering them the option to utilize the Shift Dealer Portal or their own technology via integration with the Shift marketplace.

Finally, the dealership pricing engine was a SaaS solution for individual dealers and dealer networks providing several efficiencies, including customer management, order management and fulfillment, payment processing, and customer appointment management. Shift deployed its SaaS solutions in the form of customizable dealership portal systems meeting specific customer needs.

Separate from Shift's own in-production tech stack, it also maintained the legacy codebase supporting the marketplace platform operated by Fair Technologies, which it acquired in May of 2022. After a brief period of operating that platform, the company made the decision to shutter the operation. It took the learnings from operating that marketplace and applied them to its own solutions.

### **Considerations for the Preservation & Monetization of Software-Related Assets**

Shift Technologies operated for a time under the perhaps not unfounded expectation that capital markets would remain available to support its growth strategies, despite being unprofitable. When this expectation proved to be false, coupled with industrywide headwinds, the company needed to quickly avail itself of bankruptcy

protection. This need for speed forestalled consideration of a plan designed to preserve and maintain the value of its technology platform.

When dealing with software-related and high-technology assets that rely upon cloud storage solutions and third-party integrations, there are a number of important factors to consider in order to preserve value. The minutiae can become overwhelming, but broad issues to keep in mind include:

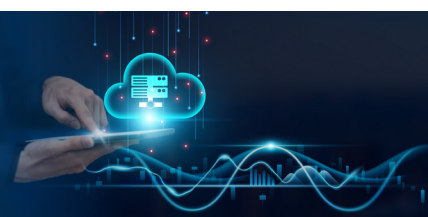
- Hosting environment and associated costs
- Required third-party integrations to maintain operability
- Data repositories and inputs; whether the data is owned or licensed
- Code repositories, including size, location, and coding languages
- Understanding the software development lifecycle (SDLC):
  - Development practices
  - Partial development testing and push to production protocols
  - Security and penetration testing, protocols, and analyses
  - Availability of technical and architectural documentation and diagrams
  - Technical debt
- Key people with systems knowledge
- Repository and data access for purposes of deliverability

In the case of Shift, the debtors had the advantage of retaining the company's lead engineer, who had both technical and historical knowledge of, among other things, coding practices, system architectures, and existing and in-development systems capabilities. While this resource was highly valuable throughout the sale process, particularly for providing highly detailed technical background to potential buyers and for assisting in the ultimate delivery of the codebases to a buyer, Shift did not, however,

benefit from having an in-production, demonstrable platform, which buyers could easily view in order to determine operability, functionality, and ultimately applicability for future strategic uses. The debtors' inability to provide interactive and video demonstrations of the functionality and utility of its software platform ultimately had an impact on some buyers' ability to overcome their own diligence requirements or to create a valuation case.

It is not always an easy decision for a company to decide whether to maintain its systems in a live production environment. An easily identifiable threshold issue is cost. While a simple architecture hosted in a cloud-based environment such as AWS or Azure may be relatively inexpensive, companies with large code repositories that rely on massive datasets for their inputs and outputs can see hosting costs quickly scale in an exponential manner. Further, it may be the case that a fully operable platform, while generally proprietary in nature, likely will require third-party integrations to actually function in any demonstrable format, namely enterprise resource planning (ERP) software such as NetSuite or Oracle, customer relationship management (CRM) software such as Salesforce or HubSpot, and other business intelligence (BI) and customer analytical tools such as Snowflake, Looker, Tableau, Zoho, and so on. Each of these has associated costs. It may very well be that a debtor-in-possession, financial advisor, or trustee concludes that these ongoing costs required to maintain an in-production platform may simply outweigh any potential recovery.

In difficult scenarios such as Shift's, the decision-making process for preservation and monetization of software assets becomes one of cost-benefit triage. Is it worth it to pay the substantial AWS bill



in order to keep the lights on for another month? Are there enough documented descriptive materials, recorded demonstrations, board presentations, and platform output reports to sufficiently describe the software to potential buyers? Much of this calculus comes down to available time and associated costs. While in many sale contexts, speed and value maximization are inapposite to each other, in cases with a heavy software component, speed and value maximization go hand in hand. The application programming interfaces (APIs) between the company's platform and required third-party applications require frequent updating—as do the core systems themselves—simply to remain functional. This ongoing development and maintenance is often costly, both in terms of capital, developer resources, and project management bandwidth.

### **Domain Names, Often Overlooked Value-Driving Digital Assets**

Oftentimes, a company's digital assets, such as domain names, can be overlooked value-drivers. Domain names are technically owned by registries (e.g., VeriSign, Inc. owns all .coms and Public Interest Registry owns all .orgs), and end users reserve the exclusive right to use a domain name by paying the periodic fee set by the registrars (e.g., GoDaddy or Network Solutions) administering the domain names. We generally think of domain buyers in two broad categories: strategic end users, and domain investors. When it comes to value, the former is nearly always willing to pay more than the latter.

The value and use cases for domain names are unique to each domain name and each user at a particular point in time. In general, single-word or short, categorical names can potentially carry significant value, but that value depends on the ultimate end user's needs and financial wherewithal at a point in time. DSW, a shoe retailer, uses shoes.com, for example, which is a single-

word categorical name that makes obvious sense given DSW's business, and it drives significant web traffic. A strategic end user, particularly one that is early stage and has benefitted from a capital raise and needs to show investors commensurate growth, may determine that a significant investment in a categorical domain name that will drive significant web traffic makes economical and business sense. Ultimately, the end user has both the balance sheet and the business need to have a particular domain name.

Conversely, a domain name investor typically has less but more patient financial wherewithal. The carrying costs for .com domain names, for instance, are de minimis, generally under \$20 per year. Where a strategic end user may be willing to pay six, seven, even eight figures with the purpose of use, an investor may only pay four, five, or maybe six figures with the purpose of return. Given the combination of relatively low acquisition cost coupled with low carrying costs, the domain investor's time horizons can be quite long. Their expectations revolve around return on investment, which can often exceed ten turns on the initial investment.

In addition to its proprietary software platform, Shift held its eponymous domain name shift.com, as well as fair.com and carlotz.com, each stemming from prior acquisitions, as well as variations on the foregoing. "Shift" and "fair" in particular could have numerous applications, and an end user would likely ascribe high value due to a number of factors, including the brevity and memorability of the names.

### **THE SHIFT BIDDING PROCESS & AUCTION RESULTS**

In the Shift Technologies case, it was apparent from the onset that a potentially likely outcome, one which would hopefully increase value for the debtors' estates, would be a series of transactions. Broadly speaking, the categories of assets included the debtors' (i) technology platform and

related U.S. patent; and its domain names and brand assets related to (ii) shift.com; (iii) fair.com; and (iv) carlotz.com.

Given these initial assumptions, the debtors included important flexibility into their bidding procedures from the onset, including requested relief to designate a stalking horse bidder or bidders and award customary stalking horse protections, and to set and adjust the format of an auction based on the debtors' judgment to maximize value.

Indeed, throughout the marketing and sale process, Hilco Streambank identified numerous interested parties, many of which expressed significant interest in unique subsets of the debtors' assets. Largely, parties expressed interest in either the software or the domain names, but generally not both. The debtors' designation of a stalking horse bidder for \$1 million for the domain name assets provided the debtors with a valuable strategic position, which served both to appropriately orient other bidders' value expectations for the domain names, and to enable the debtors to separately focus on a different subset of buyers of the software platform.

Ultimately, Shift determined to bifurcate the auction process, with the first portion pertaining to the domain name and branded assets subject to the stalking horse bid, and the second portion pertaining to the software-related assets. Regarding the domain name assets, the debtors managed multiple rounds of open cry bidding—both in combination and for individual domain names—and a final round of sealed bids. Shift designated a single qualified bidder for the software assets, obviating the need for a live auction. The process culminated in four separate transactions to three unique bidders for each of the categories of assets described above, for aggregate consideration of \$2,420,000, more than two times the starting stalking horse offer.



## CONCLUSION

In today's technological age, increasingly more of a company's valuable assets are intangible in nature. These can often include digital assets such as domain names. Increasingly, more of a company's potential going concern value is rooted in its technological solutions. When approaching an inflection point such as the need for bankruptcy protection, stakeholders and professionals involved with tech companies should prepare as early as possible the groundwork for preserving and maintaining the various components that enable the company's technology. Through cost-benefit analysis, the logical conclusion may very well be in certain cases that preserving live, in-production technology may not produce a net benefit to an estate; however, preparing the groundwork to do so early on will provide optionality and the potential for greater recoveries. Practitioners should always keep in mind; it is far easier to flip the switch off than it is to flip it back on.

## ABOUT HILCO STREAMBANK

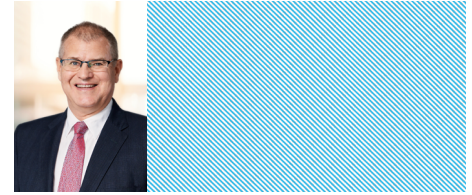
Hilco Streambank is a market-leading advisory firm specializing

in intellectual property valuation, advisory, and monetization. Having completed numerous transactions, including sales in publicly reported transactions, private transactions, and online sales through IPv4. Global, Hilco Streambank has established itself as the premier intermediary in the consumer brand, internet, technology, and telecom communities.

Hilco Streambank is part of Northbrook, Illinois-based Hilco Global, the world's leading authority on maximizing the value of business assets by delivering valuation, monetization, and advisory solutions to an international marketplace.

Hilco Global operates more than twenty specialized business units offering services that include asset valuation and appraisal, retail and industrial inventory acquisition and disposition, real estate, and strategic capital equity investments.

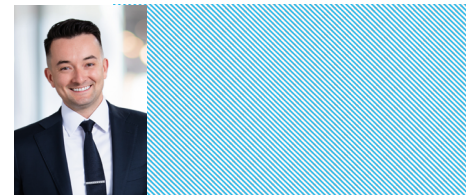
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**DAVID PERESS IS EXECUTIVE VICE PRESIDENT OF HILCO RETAIL SERVICES AND A PRINCIPAL OF HILCO STREAMBANK**

Prior, to his roles at Hilco, Mr. Peress held positions as bankruptcy law partner at Young Conaway Stargatt & Taylor LLP, managing director and general counsel of The Ozer Group, and a principal of private investment fund Crystal Capital. Mr. Peress earned his J.D. from the University of Pittsburgh School of Law and his B.A. from the University of Michigan.

David can be reached directly at [dperess@hilcoglobal.com](mailto:dperess@hilcoglobal.com).



**JORDON PARKER IS VICE PRESIDENT OF HILCO STREAMBANK**

Prior to joining Hilco Streambank, Mr. Parker served as corporate counsel to a leading NYC-based FinTech company. He earned his J.D. from the Benjamin N. Cardozo School of Law and his B.A. from the University of Denver.

Jordan can be reached directly at [jparker@hilcoglobal.com](mailto:jparker@hilcoglobal.com).

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