

Professional Perspective

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# Acquisition Tools for Purchasing IP During the Pandemic

**Editor's Note:** The opinions expressed are those of the authors and do not necessarily reflect the views of the firm or its clients.

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The Covid-19 pandemic has caused financial hardship for companies in many sectors of the economy, particularly in energy, retail, entertainment, and travel. These distressed companies often have valuable intellectual property (IP) that they are interested in selling to avoid bankruptcy or must sell as part of a bankruptcy proceeding or an alternative form of workout or liquidation. Now is an opportune time for savvy players to grow their business by acquiring those IP assets from distressed companies, especially from a competitor or supplier, or even just warehousing valuable brands until better times.

Take brand accumulator Retail Ecommerce Ventures (REV), for instance. REV focuses on paying discount prices for the IP of high-volume businesses with strong brands, and it has purchased some brands that suffered in the economic downturn. Specifically, REV bought the IP of Pier 1 Imports for \$31 million in July and the IP of Modell's Sporting Goods for \$3.64 million in August. These two sales involved patents, trademarks, copyrights, internet domain names, customer data, and rights under related license agreements. See *In re Pier 1 Imps., Inc.*, Case No. 20-30805 (KRH), U.S. Bankruptcy Court for the Eastern District of Virginia and *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VFP), U.S. Bankruptcy Court for the District of New Jersey.

There are a variety of tools for acquiring IP in such situations. Popular tools include Section 363 sales and Chapter 11 plans that dispose of assets, as well as assignments for the benefit of creditors, consensual and nonconsensual foreclosures, and receiverships outside of bankruptcy. All can be effective in the proper circumstance, and often the acquiror is able to prescribe the form of transaction. This article addresses the tools that are available and considerations for buyers.

## **Section 363 Sales**

A sale under Section 363 of the U.S. Bankruptcy Code (Section 363 sale) provides a buyer with the opportunity to purchase a distressed company's IP assets through a public auction under the supervision of a bankruptcy court. Typical timing for a Section 363 sale is about two months but often may be faster, depending on pre-case commencement activity and the ability of the debtor to maintain the asset during Chapter 11.

While there is tremendous flexibility in Chapter 11, there are "typical" fact patterns. First, prospective buyers submit bids and draft asset purchase agreements in a private forum, and the debtor selects the buyer with the best offer to be the "stalking horse bidder." This bidder guarantees a base price for a subsequent auction. The debtor and the stalking horse will negotiate bidding procedures for the auction, which include protection for the stalking horse, such as a break-up fee, expense reimbursement, minimum overbid, subsequent bid increments, specified deposits, bid qualification rules, and the timing for submission of bids.

If a qualifying bid is submitted, the auction is then held to select the "highest and best bid," and the bankruptcy court enters an order authorizing the sale. The court's approval is required at several points throughout this Section 363 sale process, including approval of the auction procedures and the final sale terms. The sale order affords far more protection for a buyer than anything that can be obtained outside the court process.

When and how to get involved in a Section 363 sale are important considerations for a potential buyer. The timing of a bid should be strategically planned and take into account the benefits and downsides of being selected as the stalking horse. The structure of a bid must be carefully considered as well, as the highest bid may not be selected if a competing bid better addresses the debtor's or other case constituents' specific needs. Due diligence for Section 363 sales also involves unique issues specific to the bankruptcy context, and this is particularly true for sales of IP, for which the interpretation of bankruptcy provisions can vary dramatically across federal court circuits.

As an example of a Section 363 sale of IP, pharmaceutical company Otsuka acquired IP related to smart-pill technology from Proteus in August 2020 through a Section 363 sale after a successful stalking horse bid. Otsuka had been the primary licensee of a significant portion of Proteus's IP. The bankruptcy court approved the sale despite a group of Proteus's equity holders arguing that the \$15 million price was a "giveaway" and "incredibly low." See *In re Proteus Dig. Health, Inc.*, Case No. 20-11580 (BLS), U.S. Bankruptcy Court for the District of Delaware.

Section 363 sales present buyers with several advantages over sales outside of bankruptcy. For example, Section 363(f) provides that IP assets may be sold "free and clear" of any interest held by another party if certain requirements are met, which can lessen the burden of performing due diligence regarding liabilities attached to the IP assets. For example, under a well-crafted sale order, a buyer can avoid liability for future claims of fraudulent transfer or successor liability, and the finality of the sale may be protected by the court's designation of the buyer as a good faith purchaser.

The uniqueness of the bankruptcy sale process also often depresses prices. Additionally, favorable IP licenses tied to the IP assets may be transferred to the buyer under Section 365 of the Bankruptcy Code despite anti-assignment clauses, subject to other requirements that must be considered. (See discussion of IP licenses, *infra*.)

While Section 363 sales may provide buyers with more certainty and protections compared to non-bankruptcy sales, there are potential drawbacks. Buyers will be subject to the court's timing and approval at several stages of the Section 363 sale process, and the time period for due diligence may be limited. Moreover, the transparent nature of the largely public sale process can lead to confidentiality issues and even stigmatizing effects associated with bankruptcies. Moreover, the process is, by its nature, public, so overbid risks may be substantial.

## Chapter 11 Plan Sales

An interested buyer also may purchase the IP assets of a distressed company through its Chapter 11 bankruptcy plan. A Chapter 11 plan sale is allowed by the Bankruptcy Code to provide proceeds for holders of claims or interests under Section 1123(b)(4) and/or to fund the implementation of the plan under Section 1123(a)(5)(D).

For a plan sale, a buyer can work privately with a debtor and/or other plan sponsors to effect an IP asset acquisition to be implemented by way of the Chapter 11 plan. While these negotiations may be private, the Chapter 11 plan must still be publicly confirmed by the bankruptcy court, which will be subject to creditor objection. Another less-common option is for the plan sale to involve a public auction similar to the process described above for Section 363 sales. Whether privately negotiated or publicly auctioned, adequate information regarding the plan sale must accompany the Chapter 11 plan in a document called a disclosure statement, which is similar to a prospectus.

A plan may only be confirmed if at least one "impaired" class of creditors votes in favor of the plan and if the court approves the plan and disclosure statement. Plan sales differ from Section 363 sales because plan sales are subject to affirmative creditor approval, as opposed to objection, and are evaluated by the court within the context of the complex plan confirmation process. Also, other interested parties may, in certain circumstances, file competing plans that put forth alternative sales terms or processes.

Plan sales offer certain potential advantages over Section 363 sales. While Section 363 sales usually entail a public auction, plan sales can be structured with limited competition and thus possibly lower prices. Plan sales can also provide more flexibility for how the sale is structured. For example, plan sales allow for mergers, securities offerings, and non-cash payment, whereas Section 363 sales are often cash transactions. Additionally, plan sales are exempt from transfer taxes, and, depending on the underlying facts and venue of the bankruptcy case, the buyer may be protected by third-party release provisions included in the Chapter 11 plan that may not be available with Section 363 sales.

On the other hand, plan sales are slower and costlier than Section 363 sales. Moreover, plan sales require confirmation of the plan as a whole, which implicates tangential factors outside of the sale—e.g., allocation of proceeds to creditors—and is dependent in part upon creditor voting.

## IP Licenses in Bankruptcy

The Section 363 sales and Chapter 11 plan sales discussed above both regularly involve the transfer of IP licensing rights. Section 365 of the Bankruptcy Code authorizes a debtor to take certain actions regarding its “executory contracts,” which generally covers IP licenses. Specifically, Section 365 allows for the license to be rejected, assumed, or assumed and assigned by the debtor, and Section 365 also provides protections for non-debtor parties to such licenses. Parties should be aware though that bankruptcy courts’ interpretation of the provisions in Section 365 is heavily jurisdiction dependent.

Section 365 provides for the acquisition of a distressed company’s IP licensing rights whether as a licensee or as an IP owner and licensor. A debtor-licensee may, for example, assume and assign its rights under an IP license to a third party that desires those rights. Also, the buyer of a debtor-licensor’s IP assets may selectively direct the debtor-licensor to reject or to assume and assign licenses tied to the purchased IP assets. As an example, the Section 363 sale of Proteus’s IP to Otsuka, referenced above, involved the assumption and assignment of licenses under Section 365. Assumption and assignment of an IP license by the debtor requires that the debtor cure any defaults, or provide adequate assurance that the defaults will be promptly cured, and that the assignee give adequate assurance of future performance.

Notably, Section 365(f) authorizes a debtor to assign an IP license despite the license containing provisions that would otherwise prohibit assignment outside of the bankruptcy context. Section 365(c), however, imposes restrictions on the types of IP licenses that may be assumed and assigned if another party to the license does not consent. Whether assumption and assignment of an IP license is permitted is a complex issue and depends on several factors, such as the court in which the bankruptcy case is filed, the type of IP involved, and the specifics of the license. For example, a debtor-licensee generally cannot assign a non-exclusive IP license without the licensor’s consent, and the licensor may not consent to the assignment if the assignee poses a competitive risk.

Additionally, Section 365(n) provides that even if a debtor-licensor rejects an IP license—i.e., essentially breaches the license—the licensee may nonetheless elect to retain its rights under the license. Should a licensee elect to retain its license rights to the IP, the licensee must then continue to make royalty payments, but those payments might go to the debtor rather than a buyer who purchases the underlying IP asset through a Section 363 sale. See, e.g., *In re CellNet Data Sys., Inc.*, 327 F.3d 242, 244 (3d Cir. 2003).

## Assignments for Benefit of Creditors

Acquisition of a distressed company’s IP outside of the bankruptcy context can be achieved in a number of ways, one of which is an assignment for the benefit of creditors. An ABC is a state law procedure for liquidating an insolvent business and an alternative to formal bankruptcy proceedings. ABCs are not approved vehicles in all states but are frequently used, for example, in California and Delaware.

For an ABC, a distressed company assigns its assets in trust to an independent third-party assignee—e.g., a professional liquidator—who then sells the assets and distributes the proceeds to the distressed company’s creditors. The distressed company is responsible for hiring the assignee and would likely select a sophisticated assignee with experience marketing and monetizing IP assets. The assignee has discretion as to how the company’s assets should be liquidated.

States have varying laws regarding the regulation and extent of court supervision for ABCs, but generally speaking, an ABC is a faster, less costly, less stigmatized, and more private process than bankruptcy. And because an ABC is usually less structured and formal than bankruptcy, it allows for more flexibility in how the sale is conducted. A potential buyer could purchase a distressed company or its IP assets, for example, through a sale that is negotiated before the ABC is commenced and is then executed concurrently with the triggering assignment.

A buyer purchasing IP assets through an ABC, however, does not receive many of the protections afforded to buyers in bankruptcy sales. For example, an ABC sale may be subject to fraudulent transfer claims, particularly if the purchase price is low. In addition, the ABC process lacks bankruptcy protection against bringing or continuing actions against the assets or debtor, does not provide for assignment of contracts that prohibit assignments by their terms, and does not have the broad protections of a bankruptcy sale or plan confirmation order. Still, an ABC sale can provide lower risk and a competitive advantage compared to purchasing IP assets outside of an insolvency proceeding, especially when the debtor owns the relevant IP.

## What You Should Do Now

While the Covid-19 pandemic imposes difficult times on many companies, it simultaneously creates opportunities for others to grow and prosper with the acquisition of IP assets and associated business lines at reduced prices through bankruptcy proceedings or out-of-court alternatives.

As preliminary measures, a potential buyer should perform a self-assessment of their own business and IP needs, identify and evaluate target sellers and/or IP assets, and develop a purchase strategy. A buyer can negotiate a transaction with a distressed seller before or during bankruptcy or an alternative proceeding, including negotiating whether the best method for the sale might be a Section 363 sale, Chapter 11 plan sale, ABC sale, or other process.

Potential buyers can engage counsel experienced in the intersection of IP and bankruptcy law to navigate the processes described above. A comprehensive plan will identify risks through tailored due diligence, secure favorable purchase protections, maximize cost savings, analyze complex licensing and assignment issues, and structure a winning auction bid, plan sale, or other transaction.