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Tech (and IP-Driven) Company Restarts

Wind-downs, Last-Money-in-Refinancings, Relaunches, and Distressed Sale Techniques in Difficult Times

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Agenda

- Special Challenges for Technology and IP-Driven Companies in a Tight Credit Economy
- Wind-Down Techniques: Lengthening the Runway
- Last Money-In Financing Techniques
- Restarts, Reboots, Reanimations and Relaunches
- Purchase, Sale, or Merger of Distressed Technology and IP-Driven Companies
- Pitfalls to Avoid, Including Director and Officer Liability

Characteristics of IP and Tech

- Because these Companies Scale, there Is Often a Huge Upside
- The Skills and Know-How of Individual Employees Is Often a Critical Assets, but an Asset Free to Leave
- Often Financed/Owned Through the VC- and Angel- Model of Preferred Stock for Outside Investors, Common Stock for Founders/Principals, and Options for Key Employees and Directors

IP and Tech Companies Do Poorly on the Downside

- With No Upside, the Talented and Mobile Work Force Leaves
- Little or No Liquidation Value to Hard Assets
- Technology and IP-Driven Companies Need Positive Momentum and Growth to Continue to Be Cutting Edge and to Capture Market Share
- Different Liquidation Priorities Mean Mis-Aligned Incentives in Downside Salvage Plays
- Continuing Research and Development Requires Continued Funding

Lengthening the Runway

- Conserving Cash: Deferred Compensation Agreements for Exempt Employees
- Cash Flow Projections in Advance: Why Layoffs Cost Money
- Going Virtual: Suspended Animation/Spore State for Companies, and Common Pitfalls
- Cost-Cutting: A Nose for Realism Versus the Smell of Impending Doom

Deferred Comp and Stay-Pay

- Deferred Compensation: Draw (Reduced Salary) and Bonus Upon Funding/Sale/Product Launch
- Problem Areas: Cash Flow Needs, Exempt Employees, Tax Issues
- Stay Pay Agreements: Managing Toward a Salvage Sale
- Hurdles, Issues, Timing, and Aligning Incentives

Cash Flow Management

- In Crisis, Real Cash-Flow Projections Are Critical
- It Costs Money to Save Money: Layoffs Accelerate Payment of Liabilities
- Don’t Borrow From Uncle Sam (Payroll and Withholding Tax Obligations)
- If You Can’t Pay for It or Finance It Until It Generates Revenue, It’s Not a Business.
- Explore and Implement Plan B and C While There Is Time to Execute Them.

Going Virtual or Dormant

- Coordinated Leaves/Vacations as an Alternative to Layoffs
- The Spore Model of Company Contraction/Expansion
- Why Dormancy/Shrinking to a Virtual Company Often Fails: Credibility, Overhead, Capital Structure and Debts, Critical Mass, and Rapid Depreciation
- Shrinking to Fit an Existing Sub-Business
- IP Alternative: The Troll-Like Zombie Company

Cost-Cutting: Realism/Perception

- Most Companies in Crisis Delay Cost-Cutting Measures for Too Long
- That Is Especially True for IP-Driven and Technology Companies, for Fear Key Employees Will Bolt (Example: Computer Game Developers)
- For Most Companies, Though, Honesty and Early Action Is a Better Choice (Possible Exception: Computer Game Developers)
- Share a Strategy and Manage Toward an End Game: The Worst Sin in Business Is Not Making Payroll

Last Money In Financing

- General Rule: Last Money in Is First Money Out
- The Pay to Play: Squeeze Down Down Round
- The Loan to Own Secured by All Assets: When the Bridge Loan Becomes a Pier Loan for a Bottom Fisher.
- The Bridge Loan from an Acquirer
- The Troll-Like Zombie Company Financing from a Patent Fund
- The Earmarked Loan to Pay Guarantied Debts

Wind-Up and Restart Problems

- The Only Practical Informed Buyers Are Often Existing Employees, Management, Founders, Board Members or Investors
- How Do You Avoid Conflict of Interest, Misappropriation of Corporate Opportunity, Breach of Fiduciary Duty, or Fraudulent Transfer Liability in a Deal Among Insiders?
- But Without Some Relaunch/Transfer Free of the Old Debt or Old Capital Structure, No One Will Put Up New Funds.

Fraudulent Transfer Issues

- Defined: Transfer With the Intent to Hinder, Delay or Defraud Creditors.
- Constructive Fraudulent Transfer: One for Less than Reasonably Equivalent Value, While the Transferor Is Insolvent, Inadequately Capitalized, or Has Reason to Know It Is Unable to Pay Debts When Due.
- Long Statute of Limitations, Any Creditor Can Sue
- But Who Would Fund a New Venture to Pay Old Liabilities?

Other Legal Problems

- Management Cannot Misappropriate a Corporate Opportunity
- New Ideas May Belong to the Current Employer by Assignment of Inventions Agreement
- The Board Has a Fiduciary Duty to Shareholders (and Perhaps to Creditors, in the Zone of Insolvency)
- Secured Creditors May Have a Perfected Priority Claim to Some or All IP Assets
- Speed vs. Certainty and Managing Toward a Successful Second Exit Strategy

Windup-Relaunch Deal Structures

- Asset Sale
- Merger
- Technology/IP Licensing Agreement
- Assignment for Benefit of Creditors Sale
- Secured Debt Foreclosure
- Bankruptcy Sale
- Bankruptcy Reorganization

Asset Sale

- Sale of Substantially All the Assets Must Be Approved by Shareholders
- Consideration Paid Goes to Secured Creditors, Unsecured Creditors, Preferred Shareholders, then Common Shareholders. Why Should Common Agree?
- Under Amendments XIII and XV to the U.S. Constitution, People Cannot Be Sold, Just Given Incentives

Merger and “Cut Out” Merger

- Merger with a Better-Capitalized Partner
- “Cut Out” Merger Typically Wipes Out Common and Junior Preferred (Key Employees Receive Options in NewCo)
- Corralling the Votes: Delaware (Majority of All Shares) v. California (Majority of Each Class)
- The Quasi-California Corporation
- Don’t Forget Contract Rights
- Dissenters’ Rights
  - What is “fair value?
  - Appraisal as exclusive remedy?
- Work-Arounds and Solutions
  - Best with dominant preferred investor
  - Drag along rights
  - Sweeteners to discourage dissent
  - Fairness hearing

Technology Licensing Agreement

- The Barnyard Rule: Little Pigs Get Fed, Large Hogs Get Slaughtered.
- The Same Fraudulent Transfer and Fiduciary Duty etc. Principles Apply to a Licensing Transaction
- Licensing Is Almost Endlessly Flexible in Dividing IP Rights and Economics
- May Not Require Shareholder Approval

Assignment for Benefit of Creditors Sale

- 99% of Silicon Valley Collapsed Dot.coms Were Liquidated Through ABCs, Not Bankruptcies (DoJ)
- Fast, Practical, and a True Arms' Length Fiduciary
- Speed Is Critical if There Is Anything to Salvage
- Preempts Creditor Attempts to Attach Assets
- Still Need Shareholder Approval
- Secured Creditor, Tax, and Some Employee Wage Claim Priorities

Secured Loan Foreclosure

- Do You Have a Perfected Security Interest in Everything You Need?
- Can You Buy a Secured Loan and Foreclose?
- Friendly vs. Unfriendly vs. Winston Churchill Foreclosure
- Timing: Ten Day Personal Property Timeline
- Bankruptcy as an Intervening Event
- Common Structure: Foreclosure Sale Plus Quitclaim Deed Plus Further Assurances

Bankruptcy Sale

- Maximum Certainty of Title: Good Faith Purchaser Owns Assets Free and Clear
- Maximum Impracticality: Bankruptcy is Slow, Expensive, Uncertain, and Purchases Are Subject to Overbid
- Some Wrinkles: Landlord Damage Claims Are Capped; Some Non-Assignable Agreements May Be Assigned in Bankruptcy; Creditor Attachments in the 90 Days Before Bankruptcy Are Annulled; the Automatic Stay Prevents Foreclosure; Unperfected Security Interests Don't Count

Avoiding Liability

- Pay Withholding and Trust Fund Taxes. Seriously.
- Don't Have Employees Come to Work if There Are No Funds to Pay Them.
- Don't Engage in a Fraudulent Transfer
- Consider Leaving D&O Insurance in Place or Filing Bankruptcy Before It Lapses—Or Not
- Understand WARN Act Obligations
- Document Decisions by the Board, and Entertain All Offers: The Business Judgment Rule
- Behave as a Fiduciary to the Stakeholders

Prior Webinars

- **Buying Hotels (and Other Commercial Real Estate) Out of Bankruptcy** (03.17.10)
- **Guaranties of Debt in Default: What to Do Now (for Guarantors and Their Creditors) (**03.31.10)
- **Working Out Problem Hotel Loans (**04.14.10)
- **Tax Aspects of Debt Restructuring and Foreclosure: Using Tax Savings and Motivations to Make Better Deals**

  (05.19.10)

Prior Webinars (Cont.)

- **Insurance in Bankruptcy: Preserving and Maximizing Insurance Assets of a Bankrupt Entity (**06.02.10)
- **Recapitalizing, Repositioning, Restructuring or Reorganizing Opportunities in the Wine Industry** (09.15.10)
- **Employment Issues for Troubled Companies and Companies in Transition** (10.21.10)

To listen to those webinars, please go to www.fbm.com, click on Media, click on Speaking Engagements and search by the webinar date.

Speakers

- Dean Gloster is a partner and head of the insolvency, reorganization, and creditors rights practice group at Farella, Braun + Martel in San Francisco He also has extensive experience with start up, technology and emerging growth companies, particularly those built around intellectual property assets.
- Matt Lewis is a partner and head of the corporate and business transactions practice group at Farella Braun + Martel in San Francisco.