UNC SCHOOL OF LAW

NORTH CAROLINA JOURNAL OF LAW & TECHNOLOGY

Volume 4
Issue 1 *Fall 2002*

Article 9

10-1-2002

Liquidating a Technology Company in Bankruptcy

Katherine J. Clayton

Comment: Liquidating a Technology Company in Bankruptcy

Katherine J. Clayton[1]

I. Introduction

Since the peak of the NASDAQ in March of 2000, many technology companies have found either that they cannot raise enough capital to implement their business plans or that they have an untenable business plan. Some have simply shut their doors and gone out of business, while others have filed for bankruptcy. Either way, these companies have left many unsatisfied creditors. For example, Webvan.com was a start-up company in the late 1990's that raised over $1.2 billion in equity, $375 million of which came from an IPO in November 1999.[2] It had very ambitious business plans to build a series of warehouses and deliver groceries to fulfill customer orders placed over the Internet.[3] Webvan.com, however, faced a number of challenges, including a downturn in the economy, and quickly ran through its capital.[4] Webvan.com filed for Chapter 11 bankruptcy protection in July 1999 and reported that it owed $106 million to creditors.[5] By January 2002, it reported that the value of its liquidated assets totaled only $25 million, leaving its creditors to receive pennies on the dollar and its investors to receive little or nothing for their $1.2 billion investment in the company.[6]

While most companies today utilize technology in their businesses, a technology company as discussed in this paper is one whose business centers on technology, particularly information technology. A technology company as discussed herein

---

[1] J.D. Candidate, University of North Carolina School of Law, 2004.
[2] Jerry T. Meyers, *Where Have All the Assets Gone? Finding the Intangible Value of the Bankrupt E-Commerce Company* 697 PLI/PAT 41, 43 (2002) [hereinafter Meyers, *Where Have All the Assets Gone*].
[3] *Id.* at 44.
[4] *Id.*
[5] *Id.* at 45.
[6] *Id.*

encompasses a software company as well as an e-commerce company—the typical dot-com company. A technology company may also be a service business, such as a consulting company, or a virtual company comprising groups of individuals or teams linked together through agreements to develop or market a service or product.

Like Webvan.com, the majority of technology companies have few tangible assets of the type that the Federal Bankruptcy Code ("Code")[7] was originally designed to handle, as technology companies often have little equipment, inventory, or real property.[8] Many technology companies pride themselves on being virtual companies, not tied down with the brick-and-mortar assets of traditional companies.[9] They do have assets, however. Their assets are predominantly intellectual property and other general intangible assets, including human capital. A technology company's balance sheet does not show many of these assets, and special care must be taken not only to identify all the assets of a technology company but also to preserve their value in bankruptcy.[10] As one author put it, "The challenge lies not in the quantity of the assets but rather in the difficulty one faces in liquidating these non-traditional assets."[11] Some of this property is deemed property of the bankruptcy estate as defined by the Code, while some is not.[12] Using fire-sale or straight liquidation procedures under the direction of a bankruptcy trustee, the bankrupt technology company's assets and their associated value rapidly disappear because their worth is very much dependent on

---

[7] Bankruptcy Code, 11 U.S.C. §§ 101-1330 (2002).

[8] Andrew M. Kaufman, *Counseling the Financially Distressed Technology Company: Finding and Preserving Value in E-Commerce Assets*, 697 PLI/Pat 69 (Practising Law Institute, 2002) [hereinafter Kaufman, *Preserving Assets*].

[9] Marjorie Chertok & Warren E. Agin, *Restart.Com: Identifying, Securing and Maximizing the Liquidation Value of Cyber-Assets in Bankruptcy Proceedings*, 8 AM. BANKR. INST. L. REV. 255, 261–62 (2000) [hereinafter Chertok, *Restart.com*].

[10] General intangibles include contract rights such as registration agreements for domain names, licenses to or for intellectual property, royalty agreements, distribution agreements, marketing agreements, leases, and strategic alliances. Chertok, *Restart.Com*, *supra* note 9, at 262.

[11] Meyers, *Where Have All the Assets Gone*, *supra* note 2, at 45–46.

[12] 11 U.S.C. § 541 (2002).

the people within the business and the continued operation of the bankrupt business. Value to creditors can be maximized, however, to the extent that a business can be held together and then sold in discrete units or segments, while also retaining the support and loyalty of the people associated with each unit.

Therefore, because of the nature of a technology company's assets, to maximize the value to creditors, a technology company should be liquidated under Chapter 11 with the debtor in possession of the business rather than under the direction of a trustee pursuant to Chapter 7 of the Code.[13] The debtor in possession of the business is most likely to know the business' diverse assets, as well as their value in the market place. Therefore, the debtor in possession, working in conjunction with the secured creditors and the unsecured creditor's committee, is the one most likely to be able to preserve the value of the assets until they can be sold. Furthermore, the debtor in possession is also more likely to obtain fair value for those assets upon their sale.[14]

II. Overview of the Federal Bankruptcy Code

A company faced with insolvency and an inability to pay its bills has several options. Generally, the best option for a company in trouble is to avoid bankruptcy and sell its business intact as a going concern to either a competitor or another company that sees a strategic fit between its own business and the failing business.[15] Absent an ability to sell its business outside of bankruptcy, many companies seek protection under the Code[16]

---

[13] Chapter 11 of the Code also has a provision for the appointment of a trustee. A trustee, however, in Chapter 11 would be little more effective than a trustee under Chapter 7. *See* 11 U.S.C. § 1104(a).

[14] In addition, the marketplace seems to attach less stigma to a Chapter 11 filing than to a Chapter 7 filing, and thus, assets liquidated under Chapter 11 as opposed to Chapter 7 will be perceived by buyers to have more value. Telephone interview with George Oliver, attorney at Stubbs & Perdue, PLLC (Oct. 22, 2002).

[15] Kaufman, *Preserving Assets*, *supra* note 8, at 81.

[16] Most states also have state bankruptcy codes or receivership statutes. Generally a debtor has the option of filing under the state or the federal statute.

from creditors by filing a petition with a Federal Bankruptcy Court for relief from their debts.[17] Under the protection of the Code, a debtor will either seek to reorganize its business to emerge from bankruptcy as a going concern or seek to sell or liquidate its business.

A. Filing for Bankruptcy

When filing a bankruptcy petition, a debtor files under a particular Chapter of the Code. Businesses file under either Chapter 7[18] or Chapter 11[19] of the Code. Chapter 7 is the general chapter for liquidation of a business' assets.[20] Upon filing of the bankruptcy petition, the Chapter 7 rules provide for automatic displacement of the board of directors and the appointment or election of a trustee to liquidate the business' assets for the benefit of the creditors of the debtor.[21] Chapter 11 is called the Reorganization Chapter and is designed to allow a debtor to reorganize its business and pay its creditors over time.[22] Under Chapter 11, unless a trustee is appointed (which is the exception), a debtor's officers and board of directors are authorized to continue to operate their business as a "debtor in possession."[23] A debtor in possession can continue to operate the business in the ordinary course but has certain additional duties while in bankruptcy. The debtor in possession has the duty to maximize the value of the estate, to "refrain from self-dealing, to avoid conflicts of interest and the appearance of impropriety, to treat all parties to the case

---

This paper deals exclusively with the Federal Bankruptcy Code, Title 11 of the United States Code.

[17] 11 U.S.C. § 301. The U.S. Constitution, in Article I Section 8 Clause 4, gives Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." Congress gave the Federal District Courts jurisdiction over Title 11 matters in 28 U.S.C. § 1334 (2002).

[18] *See* 11 U.S.C. §§ 701-765.

[19] *See* 11 U.S.C. §§ 1101-1174.

[20] 11 U.S.C. § 726.

[21] 11 U.S.C. §§ 701-703.

[22] 11 U.S.C. § 1101.

[23] 11 U.S.C. §§ 1101(1), 1107, and 1108.

fairly, and to maximize the value of the estate."[24] To emerge from bankruptcy as a reorganized business, the debtor must devise a "plan" of reorganization, which first must be approved by its creditors and then confirmed by the bankruptcy court.[25] Upon confirmation of the plan, the debtor must execute the plan according to its terms.[26]

B. Automatic Stay

Immediately upon the filing of a petition under either Chapter 7 or Chapter 11, an automatic stay goes into effect.[27] The automatic stay is extremely powerful and prevents any of the debtor's creditors or other parties, including governmental agencies, from: (1) commencing any actions against the debtor; (2) enforcing any judgments against the debtor; (3) attempting to take or exercise any control over the property of the debtor; (4) creating or perfecting any lien against any property of the debtor; (5) attempting to collect any claim or setoff any debt that arose prior to the filing of the petition; or (6) commencing or continuing any proceeding before the United States Tax Courts.[28] A party may apply to the court for relief from the automatic stay[29] for "cause, including the lack of adequate protection of an interest in property" of the party requesting relief.[30]

---

[24] 7 COLLIER ON BANKRUPTCY ¶ 1108.09 (Lawrence P. King ed., 15th ed. 2002).
[25] 11 U.S.C. §§ 1121-1129 (2002).
[26] 11 U.S.C. § 1142.
[27] 11 U.S.C. § 362.
[28] *Id.* § 362(a).
[29] *Id.* § 362(d)(1).
[30] 11 U.S.C. § 361. Adequate protection is a concept designed "to preserve the recoverable value a secured creditor enjoys in the subject property." 3 CHAPTER 11 THEORY AND PRACTICE § 16.01, at 16:3 (James F. Queenan, Jr. et al. eds., 1994). In bankruptcy, a secured creditor's right to its collateral is changed into a "right to eventually receive the *value* of the collateral" allowing the debtor to "utilize property to benefit the estate." 3 *id.* § 16.03, at 16:5. For the debtor in possession to orderly liquidate the estate, the cash collateral of secured lenders will most likely be required to stay in operation and pay post-petition bills. If a secured creditor requests relief from the automatic stay because the value of his collateral is being diminished, it is up to the trustee or debtor in possession to show the court that the creditor's interest in his property is being adequately

C. The Bankruptcy Estate

The filing of a bankruptcy petition also creates an estate—the bankruptcy estate.[31] Generally, the bankruptcy estate comprises all the debtor's property and includes "all legal or equitable interest of the debtor in property as of the commencement of the case;"[32] as well as any property acquired by the debtor after the filing of the petition.[33] The Supreme Court has interpreted this language very broadly based on the legislative history of the Code. It has held that the bankruptcy estate must include all tangible and intangible property of the debtor, as well as other forms of property including interests in contracts and leases.[34] Although filing under the Code is a federal cause of action, state law generally defines property interests unless a federal interest requires otherwise, such as for patents and copyrights.[35]

The bankruptcy estate is considered a new legal entity and the debtor's property passes to the estate on the filing of the petition.[36] The trustee, or the debtor in possession, has the duty to maximize the property of the estate for the benefit of creditors[37]

protected. This is just what this article is designed to show, because the only other alternative for the secured creditor is to take over the property itself or to have a trustee appointed to liquidate its collateral along with the rest of the estate.

[31] *See* 11 U.S.C. § 541.

[32] *Id.* § 541(a)(1).

[33] *See id.* § 541(a)(7).

[34] United States v. Whiting Pools, 462 U.S. 198, 204–05 (1983) (holding that Congress intended a broad range of property to be included in the estate, including property in which a creditor has a secured interest as well as unsold property seized by the IRS to satisfy a tax obligation of the debtor).

[35] La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 252 (5th Cir. 1988) (citing Butner v. United States, 440 U.S. 48, 55 (1979)) (holding that property rights in the assets of a bankrupt estate are controlled by state law).

[36] Tina L. Brozman & Scott K. Seamon, *Bankruptcy and Intellectual Property*, *in* INTELLECTUAL PROPERTY ISSUES IN STRUCTURING DEALS 7 DRAFTING AGREEMENTS 2002: A SATELITE PROGRAM (Practising Law Institute, 2002) [hereinafter Brozman, *Intellectual Property*].

[37] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352 (1985).

and has wide management authority to do so.[38] In bankruptcy, the debtor in possession, like a trustee, bears a fiduciary duty to both shareholders and creditors of the debtor with the interests of shareholders subordinate to those of creditors.[39] Until a corporation can be reorganized or liquidated, a trustee, or the debtor in possession, is authorized to manage the property of the estate.[40] In Chapter 11, both the trustee and the debtor in possession can operate the business in the ordinary course without the permission of the court.[41] Each, however, must receive the court's permission to dispose of assets of the debtor outside of the ordinary course of business[42] unless such disposal is part of a confirmed plan of reorganization.[43]

III. Comparison of Chapter 7 and Chapter 11 Liquidation

Under the Code, those debtor companies that believe some relief from existing creditors or burdensome contracts would enable them to successfully reorganize their business file under Chapter 11 Reorganization of the Code.[44] Many companies attempt reorganization under Chapter 11 but find that they are not viable as an independent enterprise, their plan of reorganization is not confirmed, or they cannot obtain the needed financing to continue operations. Thus, many companies are not able to reorganize and emerge from bankruptcy under Chapter 11.[45] In

[38] *See id.*
[39] *See id.* at 355.
[40] *La. World Exposition*, 858 F.2d at 245 (holding that the trustee or debtor in possession is obligated to pursue a cause of action against a third party if pursuing such action would maximize the value of the estate).
[41] Bankruptcy Code, 11 U.S.C. § 1108 (2002). A trustee in Chapter 7, however, must receive the permission of the court to operate the business and then that operation is restricted. 11 U.S.C. § 721.
[42] 11 U.S.C. § 363(b)-(c).
[43] 11 U.S.C. § 1142.
[44] 11 U.S.C. §§ 1101-1174.
[45] A study conducted by the Administrative Office of the United States Courts in 1989, estimated only 17% of debtors are actually able to have a plan confirmed. Therefore, most businesses that enter Chapter 11 to reorganize either are liquidated under Chapter 7 or Chapter 11 or have their cases dismissed. 7 COLLIER ON BANKRUPTCY, *supra* note 24, ¶ 1112.04[4][b], n.22.

such a case, a company can then convert its case from one under Chapter 11 to one under Chapter 7, at which point the court appoints a trustee to liquidate the company.[46] However, a business does not have to liquidate under Chapter 7; it may also liquidate under Chapter 11 with the debtor in possession.[47]

A. Liquidation Under Chapter 7

A trustee is responsible for liquidation under Chapter 7.[48] The mandate of a trustee is to "collect and reduce to money the property of the estate . . . and close such estate as *expeditiously* as is compatible with the best interests of the parties in interest."[49] A trustee may, with the consent of the court, "operate the business of the debtor for a *limited* period, if such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate."[50] Thus, the trustee is operating under statutorily imposed time constraints. Potential buyers are aware of these constraints and, hoping for a bargain, may wait for a fire-sale.[51]

When a trustee is appointed to liquidate a business, the trustee is likely someone who has no previous experience with the debtor or experience in the debtor's market. In the Eastern District of North Carolina, for example, the court almost always appoints an attorney as trustee based on the attorney's familiarity with the bankruptcy process rather than knowledge of the area of business of the debtor.[52]

The appointment of a trustee is a shock to the business and its employees. Employees concerned about the fate of the business before the appointment become even more concerned when a trustee comes in, immediately ousts the existing board of directors,

---

[46] *See* 11 U.S.C. §§ 701-702.
[47] 7 COLLIER ON BANKRUPTCY, *supra* note 24, ¶ 1108.12.
[48] *See* 11 U.S.C. § 704.
[49] *Id.* § 704(1) (emphasis added).
[50] 11 U.S.C. § 721 (emphasis added).
[51] *See* 6 CHAPTER 11 THEORY AND PRACTICE, *supra* note 30, § 30.02, at 30:6.
[52] Telephone interview with Marjorie Lynch, Bankruptcy Administrator for the Eastern District of North Carolina (Sept. 5, 2002). An attorney familiar with liquidating an estate under the Code is thought to be able to liquidate the estate of the debtor as expeditiously as possible with minimum expense.

and takes control of the company away from the existing management.[53] With management, to whom the employees are loyal, no longer in control of the company,[54] the employees that had been trickling away now often depart in droves, leaving the trustee with few or no people familiar with the business and its intangible assets. The key to maximizing the value of intangible assets is to retain the people who understand those assets and who may have relationships with outsiders who might be interested in purchasing the assets of the company at a private sale. If the trustee does not operate or cannot operate the business without the key employees, the trustee will have to shut down the business and begin the auction process.[55] Once the trustee terminates business operations, the going concern value[56] of the business or its segments dissipate and assets that might have had value may have little or no value left–if the trustee is even able to identify what those assets were.[57]

Once a trustee is appointed, secured lenders become more aggressive in opposing the use of their cash collateral. Since the company is on the road to "expeditious" liquidation,[58] the bankruptcy court is likely to grant a secured creditor's request for relief from stay.[59] If the court grants relief from the automatic stay, the secured lenders, who typically have a blanket lien on all the property of the debtor, quickly seize and sell the debtor's property themselves. Like the trustee, the secured creditors usually have no expertise in the debtor's business and therefore face the same hurdles that the Chapter 7 trustee faces. These hurdles

---

[53] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352–53 (1985) (stating that when a trustee is appointed the existing board of directors is ousted and the trustee is in charge of the company).
[54] *See* 6 CHAPTER 11 THEORY AND PRACTICE, *supra* note 30, § 30.02, at 30:8.
[55] *See* 6 *id.* at 30:9.
[56] The going concern value of a business is its value to its owner as an operating business and is heavily dependent on the ability of the business to earn a profit for its owners. *See* 6 *id.* § 30.03, at 30:12. *See generally* 6 *id.* at 30:12-30:19 (giving a more complete discussion of the going concern value of a business and some methods for determining such value).
[57] 6 *id.* § 30.02, at 30:9.
[58] *See* Bankruptcy Code, 11 U.S.C. § 704 (2002).
[59] *See* 6 CHAPTER 11 THEORY AND PRACTICE, *supra* note 30, § 30.02, at 30:7.

include not only retaining key employees to operate the business but also identifying the business' intangible assets to sell them for the greatest value.

B. Liquidation Under Chapter 11

In Chapter 11, with the debtor in possession, the liquidation process is quite different. Employees, while rightly concerned about the fate of their employer, will see fewer differences in the day-to-day operation of the business than they would under a trustee. Existing officers and directors can assure employees that, while the employees may not be able to work for the debtor long-term, they are important to the various segments of the business. The officers and directors can assure the employees that every effort will be made to convey their worth to future purchasers of the business segments. These are not hollow pledges on the part of management. The ability of management to retain key employees who choose to work with the purchaser of a business segment should allow the debtor to obtain more value for that segment, thereby assisting management, as debtor in possession, to fulfill its statutory duty to maximize the value of the estate.[60]

IV. Assets of a Technology Company

The assets of a technology company are predominantly intangible assets and can be divided into several main types. They are: (1) the debtor's employees and the teams of those employees created to develop, implement, and run not only the base business of the debtor but also individual programs and projects;[61] (2) intellectual property, including patents, copyrights, trademarks, licenses, and domain names;[62] (3) executory contracts, including strategic alliance agreements, joint venture agreements, joint development contracts, and many licenses for intellectual

[60] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352 (1985).
[61] Meyers, *Where Have All the Assets Gone*, *supra* note 2, at 51.
[62] 11 U.S.C. § 101(35A) (2002).

property;[63] (4) customer lists and information;[64] (5) data developed or secured by the corporation, including trade secrets;[65] and (6) work in process or under development by the debtor. A debtor in possession will bring more value to the bankruptcy estate when liquidating these types of assets, than will a trustee.

A. Human Capital

> A large and growing share of the wealth that is created by corporations comes from things like intellectual capital, idea capital, organizational capital and all kinds of intangible assets. We do not really understand very well what these assets are, but we have good reasons to believe that they consist of things that are embodied in the employees, their knowledge, their skills, and their relationships to each other. We can be pretty sure that this stuff gets on the elevator at night and goes down and walks out the door and gets in the car and goes home and it is not really appropriate to talk about shareholders owning these assets.[66]

The most valuable assets of a technology company are its employees.[67] Employees understand the technology and how to make it work. They "can transfer to another company when the ship begins to founder."[68] The intellectual property or intangible

[63] Kenneth N. Klee et al. *The Effect of Bankruptcy on Intellectual Property Rights*, SG001 ALI-ABA 407, 436 (2001) [hereinafter Klee, *IP Rights*].
[64] Chertok, *Restart.Com, supra* note 9, at 262.
[65] Jonathan C. Lipson, *Financing Information Technologies: Fairness and Function*, 2001 WIS. L. REV. 1067, 1073 (2001) [hereinafter Lipson, *Fairness and Function*].
[66] Margaret Blair, *Speech: Corporate Disclosure*, 48 CATH. U. L. REV. 7, 8 (1998).
[67] *Id.*
[68] William P. Weintraub, *Reorganizing High-Tech Businesses: "Find Me Some Lawyers Who Wear Suits," Part II*, 19 NO. 7 COMPUTER & INTERNET LAW. 23, 23 (2002) [hereinafter Weintraub, *Part II*].

assets may have little value in the absence of these critical individuals.[69]

These employees often receive retention bonuses as an incentive to stay during the liquidation process, a strategy available to both a trustee and a debtor in possession.[70] Money alone, however, may not be adequate to retain employees. The employees of technology companies are often young and well-educated and create a unique culture within their organizations.[71] Typically, the leaders of these businesses are also the founders and are integral to maintaining the culture and teamwork of the organization. Their continued presence and control of the business during the liquidation phase is critical to preserving these invaluable teams of employees. In each of the asset types that a technology company may possess, it is the employees that are critical to preserving the value of intangible property of the estate.

B. Intellectual Property

The most readily definable property a technology company may have is its intellectual property. Intellectual property is property of the estate.[72] The Code definition of intellectual property includes trade secrets, patents, patent applications, and copyrights.[73] While this definition does not include trademarks, courts have included trademarks within the definition of intellectual property.[74] Patents, patent applications, and copyrights

---

[69] Lois R Lupica, *The Technology-Rich "Dot-Com" in Bankruptcy: The Debtor as Owner of Intellectual Property*, 53 ME. L. REV. 361, 381 (2001) [hereinafter Lupica, *Technology-Rich Dot-Com*].
[70] Weintraub, *Part II*, *supra* note 68, at 26.
[71] William P. Weintraub, *Reorganizing High-Tech Businesses: "Find Me Some Lawyers Who Wear Suits,"* 19 NO. 6 COMPUTER & INTERNET LAWYER 7, 7 (2002) [hereinafter Weintraub, *Part I*].
[72] Bankruptcy Code, 11 U.S.C. § 541 (2002).
[73] 11 U.S.C. § 101(35A).
[74] United States v. Inslaw, Inc., 932 F.2d 1467, 1471 (D.C. Cir. 1991) (holding that it is "undisputed that [property of the estate] encompasses . . . the debtor's intellectual property, such as interests in patents, trademarks and copyrights."). Although the courts have considered trademarks intellectual property for purposes of the Code, federal trademark protection is based on the Commerce

that the debtor owns and does not license to others are rather straightforward to assign for consideration, subject to the federal laws governing patents[75] and copyrights.[76] Licenses for patents and copyrights are generally considered executory contracts under the Code and their assignment is subject to additional rules.[77] Whether a debtor can assign these licenses depends upon whether the licenses are exclusive or non-exclusive and whether the debtor is the licensor or licensee.[78] The ability to assign these licenses is governed not only by the section of the Code covering the assignment of executory contracts[79] as discussed later herein, but also by federal patent and copyright law.[80] Trademarks represent the reputation and goodwill of a business. Under the Lanham Trademark Act, trademarks must be transferred with the goodwill of the business.[81] Bankruptcy courts have been lenient in interpreting the amount of goodwill[82] that must be transferred with a trademark and have allowed trademarks to be sold with only segments or portions of the business with which the trademark is aligned, rather than requiring a sale of the entire business to transfer a trademark for value.[83]

Clause (U.S. Const. art. I, § 8, cl. 3) rather than the Intellectual Property Clause (U.S. Const. art. I, § 8, cl. 8).

[75] Klee, *IP Rights*, *supra* note 63, at 418–19.

[76] *Id.* at 415–16.

[77] *Id.* at 410.

[78] A complete discussion of intellectual property rights is beyond the scope of this paper. There are several recent discussions of intellectual property rights in the context of bankruptcy that give a complete discussion of the topic. *See* Klee, *IP Rights*, *supra* note 63. *See also* Lupica, *Technology-Rich Dot-Com*, *supra* note 69.

[79] Bankruptcy Code, 11 U.S.C. § 365 (2002).

[80] Laws governing patents are covered by the Patent Act, Title 35 of the United States Code, and laws governing copyrights are covered by the Copyright Act, Title 17 of the United States Code.

[81] 15 U.S.C. § 1060 (2002). "A registered mark or a mark for which an application to register has been filed shall be assignable with the goodwill of the business in which the mark is used, or with that part of the goodwill of the business connected with the use of and symbolized by the mark." *Id.*

[82] Goodwill is defined as "[A] business's reputation, patronage and other intangible assets that are considered when appraising a business . . . ." BLACK'S LAW DICTIONARY 703 (7th ed. 1999).

[83] Weintraub, *Part I*, *supra* note 71, at 9.

Although the rules dealing with intellectual property are no different under Chapter 11 than under Chapter 7, the value to be realized for these assets can be maximized under the control of the debtor as opposed to that of a trustee. For example, the debtor in possession will know more than is shown and described on the face of a patent itself. The debtor in possession will be more apt to understand the strategic importance and strength of a patent and be in a better position to identify a buyer with an interest in acquiring the rights to the patent, than will a trustee.

Domain names for the Internet also are considered intellectual property. The Patent and Trademark Office considers a domain name a trademark when it serves as a "'source identifier' for services that are being offered on the Internet."[84] Like a trademark, a domain name must be sold with some of the goodwill of the company with which it is associated.[85] Therefore, if there is no goodwill of the business to be sold, there may be no ability to sell the domain name.[86] Again, the value of a domain name to the estate is measured by the willingness of someone to pay a price for it. The debtor in possession likely is better able to locate a buyer and to identify the goodwill related to the domain name. Thus, the debtor in possession is more likely to obtain value for the name.

C. Executory Contracts

Under the Code, both a debtor in possession and a trustee have the option, with the court's permission, to assume, assign, or reject "executory contracts."[87] This allows the debtor in possession or trustee to maximize the value of the estate through the rejection of "burdensome contracts" and the assumption of "beneficial ones."[88] An executory contract is a contract "on which

[84] Lupica, *Technology-Rich Dot-Com*, *supra* note 69, at 379 (referring to Patent and Trademark Office, Examination Guide No. 2-99 (Sept. 29, 1999)).
[85] 15 U.S.C. § 1060 (2002).
[86] There are contrary authorities that hold that a domain name is like a telephone number and is considered a personal service contract with the entity that assigns the names and therefore, is not assignable to a third party. Chertok, *Restart.Com*, *supra* note 9, at 274.
[87] Bankruptcy Code, 11 U.S.C. § 365 (2002).
[88] Brozman, *Intellectual Property*, *supra* note 36, at 347.

performance remains due to some extent on both sides."[89] To assign an executory contract to a third party, the debtor must first assume the contract.[90] A contract can be assumed and assigned over the objection of the other parties in interest, notwithstanding an "ipso facto" clause prohibiting its assignment.[91] In addition, to assume or assign an executory contract or unexpired lease, the debtor must show that she made the decision with sound business judgment.[92] The Code prohibits the assignment of not only contracts deemed to be personal service contracts, such as employment contracts, without the consent of the other party, but also any other contract where other applicable law excuses a party other than the debtor from "accepting . . . or rendering performance."[93]

Executory contracts in which a technology company is a party will often include licenses for intellectual property, strategic alliances, joint venture agreements, design and technology development agreements (including website and software development agreements), Web page linking agreements, and marketing agreements.[94] Many of these contracts are active contracts with requisite deadlines to avoid default and require ongoing input from each party. While the Code allows executory contracts to be assumed and assigned, it requires before assignment either that the debtor cure any defaults under the contracts or that the debtor provide adequate assurance that the defaults will be

[89] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 523 (1984). Many courts also use a definition for executory contracts developed by Vern Countryman and called the Countryman definition. He defined an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the Contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy, Part I*, 57 Minn. L. Rev. 439, 460 (1973).
[90] 11 U.S.C. § 365(f)(2).
[91] 11 U.S.C. § 365(f)(1).
[92] *In re* ANC Rental Corp., 278 B.R. 714, 723 (Bankr. D. Del. 2002) (holding that an executory contract was properly assigned as the party objecting to the assignment had no standing to object and that the debtors had sound business reason for assuming and assigning the contract).
[93] 11 U.S.C. § 365(c)(1).
[94] Klee, *IP Rights*, *supra* note 74, at 436.

promptly cured.[95] Thus, it is generally very difficult for a debtor, under the control of a trustee, to retain the necessary resources and people needed to cure any defaults in executory contracts as required for their assignment for value to a third party. If the debtor cannot pass along to a purchaser any value from an executory contract, the debtor essentially abandons the contract. Abandonment allows the other party to the contract to keep all the value created by the contract.

Many of these executory contracts define either a strategic alliance or a joint venture. Technology companies have made greater use of strategic alliances and joint ventures than other businesses, routinely entering into these relationships.[96] Companies enter into strategic alliances or joint ventures to achieve strategic synergies, to gain entry into new markets, to gain skills, technology or products, and to share fixed costs.[97] A strategic alliance or joint venture is a "business venture that involves two or more entities working together to achieve mutually agreed on business objectives."[98] The difference between a strategic alliance and a joint venture is that a strategic alliance is strictly a contractual relationship between two distinct parties, whereas a joint venture creates a separate legal entity, usually a partnership or limited liability company.[99] Both a partnership agreement and a limited liability company operating agreement, however, are considered executory contracts under the Code. A debtor in possession will, therefore, have the same benefits in getting more value than a trustee from these types of executory contracts as the debtor in possession would for any executory contract.[100] Moreover, many technology companies use alliances

---

[95] 11 U.S.C. § 365(b)(1).

[96] Robert M. Fogler & E. Lee Reichert, *Establishing Strategic Alliances and Joint Ventures*, 31 COLO. LAW. 65, 65 (May 2002) [hereinafter Fogler, *Alliances and Ventures*].

[97] David E. Brown, Jr., et al., *Strategic Alliances: Why, How, and What to Watch For*, 3 N.C. BANKING INST. 57, 60 (1999) [hereinafter Brown, *Strategic Alliances*].

[98] Fogler, *Alliances and Ventures*, *supra* note 96, at 65.

[99] *Id.*

[100] *See* Woskob v. Woskob (*In re* Woskob), 305 F.3d 177, 184–88 (3d Cir. 2002). *See also* Stumpf v. McGee (*In re* O'Connor), 258 F.3d 392, 400 (5th Cir.

and joint ventures as a means of infusing additional capital into their businesses. Technology companies often structure their alliance or venture agreements so that the other party contributes capital or tangible assets while the technology company contributes intangible, not easily valued assets, such as intellectual property and human capital.[101] Often these alliance or venture agreements contain "non-solicitation provision[s] restricting each party's ability to recruit the other's employees."[102] As a result, the debtor benefits by having the ability to assume such contracts in order to prevent the other party to the agreement from recruiting employees that the debtor seeks to retain. The debtor needs these employees to continue to operate and to prevent default of, or to cure defaults in, those very same agreements so that the debtor can assign the contracts for value. This provides another reason why the debtor in possession is likely to realize more value than a trustee from venture and alliance agreements.

D. Customer Lists and Customer Information

Customer lists with individual information about the debtor's customers are property of the estate and may be one of its most valuable and saleable assets.[103] Technology companies collect customer information when customers voluntarily provide information to the company and through information obtained from "cookies" when customers visit a website.[104] The information voluntarily submitted by customers in accordance with a privacy policy of the company may not be able to be sold without

---

2001). *But see* Catron v. Breeden (*In re* Catron), No. 93-2227, 1994 U.S. App. LEXIS 14585 (4th Cir. June 14, 1994) (per curium) (unpublished table decision) (holding that a partnership agreement was a personal service executory contract coming under 11 U.S.C. § 365(c)(1)(A) and as such could not be assigned without the consent of the other partners).

101 Fogler, *Alliances and Ventures*, *supra* note 96, at 66.

102 *Id.* at 68.

103 Klee, *IP Rights*, *supra* note 63, at 438.

104 Meyers, *Where Have All the Assets Gone*, *supra* note 2, at 52 (explaining that a cookie is a small piece of data delivered to a computer browser when the browser connects with a website).

the customers' permission.[105] The privacy policy may be determined to be an enforceable contract with the customer, and if the policy stipulates that the customer information provided will not be shared, then the company may not be able to sell that information.[106] The law currently is not settled in this area.[107] But since customer lists are hard data and readily identifiable as such, either a trustee or a debtor in possession should be able to realize essentially the same value for the information. This would hold true, provided the trustee is able, as is the debtor in possession, to identify likely purchasers. Therefore, customer lists may be one asset for which the debtor in possession may have no advantage over the trustee in obtaining value.

E. Data

Data is information that does not qualify under the law as intellectual property.[108] It includes the raw facts that constitute customer lists, competitive intelligence, research, business methods or plans, and information that might constitute a trade secret.[109] "A trade secret is any formula, pattern, device or compilation with commercial value that is used in a business, is kept secret by the business, and provides the business with a competitive advantage over others who do not know or use the information."[110] Software the debtor may choose not to copyright also is considered a trade secret.[111] By its very definition, sale of data rising to the level of a trade secret depends on the key

---

[105] Lupica, *Technology Rich Dot-Com*, *supra* note 69, at 377.
[106] In the bankruptcy of Toysmart.com, the e-tailer attempted to sell its customer information provided to the company under a privacy agreement that said such information would never be shared. The FTC intervened on behalf of the customers' privacy rights. The issue became moot when the purchaser of the list destroyed it. Meyers, *Where Have All the Assets Gone*, *supra* note 2, at 52–53.
[107] *Id.* Because a final decision was not reached on the merits of the Toysmart.com case, the law currently is not settled in this area.
[108] Lipson, *Fairness and Function*, *supra* note 65, at 1073.
[109] *Id.* Data that meets the requirements to be determined a trade secret is classified as intellectual property under the Code. Bankruptcy Code, 11 U.S.C. § 101(35A) (2002).
[110] Lipson, *Fairness and Function*, *supra* note 65, at 1080.
[111] Chertok, *Restart.Com*, *supra* note 9, at 273.

employees in the company to identify a debtor's trade secrets and to package and market them to third parties that would benefit most from their use. A trustee working without the key employees will not be able to identify, effectively market, and sell the trade secrets. Hence, the trustee will not realize as much value from their sale as would a debtor in possession.

The company also may have data that does not rise to the level of a trade secret that would be even more difficult for an outsider to identify, thus, depriving the estate of further value. Moreover, a company may have thousands of records and computerized data files. Any given data file standing alone may not have value to a third party, but it may be key to the understanding or the functioning of a segment of a business. Perhaps the data is the work product of a joint venture or strategic alliance. Therefore, proper identification of the relevant data and its alignment with the appropriate asset may increase the value that that asset will bring when sold. The debtor in possession is in a much better position than a trustee to identify the data and match it with appropriate assets. Hence, a debtor in possession would again contribute more to the estate.

F. Work in Process

Technology companies also have developments in process and not yet complete that may have value to a potential purchaser. These may include websites, software, processes and procedures, and other research and development projects.[112] These developments can be sold in their finished or unfinished state. Either way, the developments are critically dependent upon the debtor's key employees who are working on the projects. Most likely, the maximum value will be obtained for completed projects, as opposed to those partially finished, and key employees will need to continue their development until completion. Unlike unfinished widgets in a manufacturing plant, the unfinished portion of the typical projects in a technology company rests in the minds of those developing them. Thus, not just anyone can step in and

---

[112] Nick Tabakoff, *Dot-com Disaster Area*, BUSINESS REVIEW WEEKLY, June 30, 2000, 2000 WL 9739003 at *4 (2000).

complete the projects, regardless of their qualifications. As stated earlier, the debtor in possession is more likely than a trustee to retain the key employees necessary to complete the projects. Alternatively, if the debtor is not able to complete the projects prior to their sale, they may need to be sold only partially completed. If a trustee has been appointed, however, and key employees have dispersed and are unavailable for hire by the purchaser, then abandoned, partially completed projects may have little or no market value.

V. Maximizing Value Under Chapter 11

There are two basic ways to maximize the value to the estate—reduce expenses or increase the sale price of the assets. Often, when weighing whether to liquidate in Chapter 7 or Chapter 11, the expense side of the equation receives the most attention.[113] Costs of liquidation can be greater in a Chapter 11 liquidation; however, the nature of the assets in a technology company are such that the amount to be realized on the sale of those assets with a debtor in possession under Chapter 11 liquidation should greatly exceed such additional costs.[114]

To maximize value in Chapter 11, the creditors, both secured and unsecured, and debtor should work together. While secured creditors may be concerned about adequate protection because it is often their collateral that is used to fund the operations of the business, secured creditors should consider the additional

[113] *See In re* Wright Air Lines, Inc., 51 B.R. 96, 100 (Bankr. N.D. Ohio 1985) (holding that a trustee should be appointed to liquidate the business unless the debtor in possession could do so more expeditiously and less expensively).

[114] The additional costs of a Chapter 11 liquidation are the "cash burn" of the business during the liquidation process and the administrative expenses which include those of the debtor's and creditor's committee counsel. These costs are offset by the cost of the Chapter 7 trustee and any consultants, attorneys or experts that the trustee may require to aid in the liquidation of the business. John C Anderson & Peter G. Wright, *Liquidating Plans of Reorganization*, 56 AM. BANKR. L.J. 29, 47 (1982) [hereinafter Anderson, *Liquidating Plans*]. However, a debtor in possession should always estimate these costs as well as the estimated increase in sales price of the assets that a Chapter 11 liquidation will bring before determining that liquidation in Chapter 11 is preferable over liquidation in Chapter 7.

value that the debtor in possession is creating that would otherwise be lost under a trustee appointment. The fact that the debtor, with whom the secured creditor is accustomed to dealing, is still in charge of the business can be considered part of the creditor's adequate protection.[115] In one liquidating Chapter 11 case, the court acknowledged the preference of the creditor bank for the current management to continue serving as debtor in possession, rather than a trustee, where the bank claimed that the stability of the management was part of its adequate protection.[116]

Not every liquidation, though, is a case where the debtor should be in possession. The anomaly of Chapter 11 is that it requires cash to remain in Chapter 11, whether the business is reorganized or liquidated. Therefore, the debtor must have access to adequate working capital to complete the liquidation process. Second, if the directors and officers were involved in any fraudulent activity prior to the filing of the petition, then the debtor's creditors and the court would not want them in charge of the liquidation. Some may question the motivation of pre-bankruptcy officers and directors, arguing that the self-serving motivation of these officers and directors may conflict with the interests of the other parties. "However this same motivation may cause a debtor to render the most able service in . . . liquidating his estate."[117] To protect the other parties in interest, the creditor's committee can monitor the debtor.[118] Although a trustee may be thought to be impartial, "experience has proven that this impartiality does not necessarily provide this court-appointed fiduciary with greater motivation than the debtor and his creditor to promptly and efficiently liquidate a debtor's estate."[119] In summary, "'bringing in new parties and attorneys in the middle or at the end of the reorganization process to begin a liquidation in a

---

[115] Unsecured Creditors' Comm. V. Jones Truck Lines, Inc. (*In re* Jones Truck Lines, Inc.), 156 B.R. 608, 614 (W.D. Ark. 1992) (holding that the right to call a loan in the event of new management applied even in a liquidating Chapter 11 where the post-petition financing agreement terminated the debtor's right to use cash collateral on the appointment of a trustee).

[116] *Id.*

[117] Anderson, *Liquidating Plans*, *supra* note 114, at 46.

[118] *Id.*

[119] *Id.* at 46–47.

Chapter 7 proceeding is generally not the most practical, efficient, expeditious or most effective manner of liquidating estates.'"[120]

Finally, by working to liquidate their company as efficiently as possible, the managers, officers, and directors may be able to turn what they have viewed as the failure of their company into a successful liquidation. They will know that they did everything in their power, given the circumstances in which they find themselves, to wind down their business honorably and for the maximum benefit of their creditors.

VII. Conclusion

Many technology companies are finding that they cannot survive as independent companies and may not be able to reorganize even under the auspices of the Bankruptcy Code and so must liquidate their assets. If they must liquidate, then liquidation under Chapter 11 with the debtor in possession is preferable over either Chapter 11 or Chapter 7 under the direction of a trustee. The debtor in possession is in a better position than a trustee, who will probably not completely understand the debtor's business, to marshal the unique intangible assets of the bankrupt technology company, retain the key employees, and sell the assets to strategic purchasers. A debtor in possession is best able to maximize the value of the estate so that the debtor may pay out the most to all those to whom it is indebted.

[120] *In re* Jartran, Inc. 886 F.2d 859, 868 (7th Cir. 1989) (quoting Anderson, *Liquidating Plans, supra* note 114, at 47).