

INITIAL PUBLIC OFFERINGS

What A Turbulent, Often Unpredictable IPO Can Teach

ABSTRACTED FROM: *Google's CEO On The Enduring Lessons Of A Quirky IPO*

BY: Eric Schmidt, Google, Mountain View CA

Harvard Business Review, Vol. 88, No. 5, Pgs. 108-112

Google wanted employee stock participation. Eric Schmidt, the CEO of Google, understands how going public can change a company, and not always for the good. He tells the story of Google's IPO, which did not turn out quite as expected. Founded in 1998, Google had grown dramatically by the time it decided on an IPO in 2004. It started out simply wanting to give its employees some equity. When the number of stockholders exceeded 500, US securities laws gave it three choices: report its financials as if it were public; become a public entity; or reduce the number of stockholders. Eliminating employee/shareholders was contrary to the ethos of the company and therefore unacceptable, yet the other options were not ideal either. Many in the company feared that going public would destroy the quirky culture that fostered Google creativity. In the end, the company decided on an IPO, but not done in the usual way. Reluctant to leave huge amounts of money on the table when the stock popped right after the IPO (the usual scenario for high-tech companies), the dealmakers decided on a Dutch auction. They thought this method would be more likely to set a fair post-IPO market value and would level the playing field for the usually overshadowed retail investors. They were wrong.

Not a rosy reception. The media and analyst attention generated by the Dutch auction process turned decidedly hostile. From the company's point of view, the critics had failed to understand Google's potential and accomplishments. The pundits were derisive, and the analysts gloomy (some warned

IN THIS ISSUE

Editor's Note: Because of the vacation publishing schedule, the July and August issues of the *Bowne Review* are shortened. The full-length newsletter will return in September 2010.

INITIAL PUBLIC OFFERINGS	1
• What A Turbulent, Often Unpredictable IPO Can Teach	
BANKRUPTCY & INSOLVENCY	2
• How To Buy Assets From A Bankrupt Debtor	
SECURITIES & DEBT OFFERINGS	3
• Corporate And Government Refinancings Will Trigger A New Credit Crunch	
GLOBAL MARKETS	4
• Get A Global Reach By Cross-Listing On Euronext	
MERGERS & ACQUISITIONS	5
• Practical Techniques For Finding Intellectual Property Pitfalls	

investors to stay away from this “wildly speculative” issue). To make matters worse, Google’s founders, Larry Page and Sergey Brin, gave an interview that appeared in *Playboy* during the quiet period. The company was now faced with taking a lower bid, reducing the number of shares offered, or delaying the IPO. The author and his colleagues decided to march ahead. They wanted to complete the IPO, even at the cost of a lower share price, to be finished with it so they could get back to business. IPOs distract management, the author warns. The process consumes an enormous amount of time and resources, shifting the focus off the daily business of running a company. During the hoopla, many issuers also begin to move away from the values that made them successful enough to go public.

The process remains a mystery. Google executives wanted to get back to work and to preserve the company’s unique identity, goals that were generally achieved. The auction price was lower than hoped, but the stock had a big first-day bounce. Google had expected the Dutch auction to produce an initial price between \$106 and \$135, but bad publicity just before the IPO sank the price to \$85. Nevertheless, the stock began trading at \$100 and, within a few days, had risen to \$110. Although the company chose an auction to reduce the money left on the table, the process actually yielded a low issuance price and an immediate pop, just what the author had hoped to avoid. Unfortunately, even with the benefit of hindsight, much of the IPO process and pricing dynamics remain a mystery.

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BANKRUPTCY & INSOLVENCY

How To Buy Assets From A Bankrupt Debtor

ABSTRACTED FROM: *Distressed Acquisitions: How You Can Create Value During Difficult Times*

BY: Robert Loewer, Stephen Sayre, and Richard Bendix

National Railway Equipment Company, Mt. Vernon IL (RL); Dykema Gossett, Chicago IL (SS and RB)
ACC Docket, Vol. 28, No. 3, Pgs. 47-54

FAQs on distressed acquisitions. Although buying a failing company’s assets can be tricky, attorneys Robert Loewer, Stephen Sayre, and Richard Bendix suggest some routes are better for success. Foreclosure under UCC Article 9 lets a secured lender sell collateral by a commercially reasonable public or private method following the debtor’s default. The sale transfers all the debtor’s rights to the buyer and discharges any junior security interests. This process is relatively inexpensive and, if the debtor cooperates, extremely rapid; unfortunately, if the debtor does not, it can take months. One drawback is that the Uniform Commercial Code covers only personalty. Another is that the sale usually takes place outside of court, so the buyer cannot rely on judicial findings concerning the discharge of senior liens (such as tax liens), the sufficiency of the purchase price, or the buyer’s liabilities as the debtor’s successor. Instead, a cautious buyer should conduct due diligence.

IOU holders have some say. An assignment for the benefit of creditors is a second method for obtaining assets, the authors explain. The debtor signs a trust agreement transferring all assets to an independent third party, which then liquidates the debtor. This transfer has to be approved in the manner dictated by the debtor’s charter and by the statutes or common law of the debtor’s state of incorporation. The debtor can make the assignment without the creditors’ consent, but the assignee needs the consent of the secured creditors in order to wipe out their liens in the liquidation sales. Because the assignee

conducts an auction that sets the assets' market value, the winning bidders face little risk that a court will subsequently find that the sales to them were fraudulent conveyances.

KO liens by way of bankruptcy. The third method noted by the authors is an asset sale by the debtor or a trustee under Chapter 11 of the Bankruptcy Code. Confirmation of a Chapter 11 reorganization plan is much slower than a Section 363 sale outside a plan. The Section 363 sale that is not in the ordinary course of business must be approved by a bankruptcy court's order; then the debtor may sell assets free and clear of all liens and interests, assuming the presence of any of five specified but vague conditions (which courts usually interpret broadly). The court order should have thorough factual findings and legal conclusions on the fairness of the price paid and the selling process. This not only shields the buyer from other creditors' claims but also removes the risk that sales will be subsequently challenged as fraudulent conveyances. The order frequently protects against successor liability, but exceptions include all environmental-remediation and some collective-bargaining obligations. Another advantage to this method is that the buyer can cherry-pick the debtor's unexecuted agreements and unexpired leases, since the Bankruptcy Code allows the debtor to cancel or assume and assign them. There are, however, drawbacks: the Section 363 process is ordinarily slower and more costly than an Article 9 foreclosure sale or an assignment for the benefit of creditors, and it could drive up the purchase price.

SOP under Section 363. An asset-purchase agreement is much less complicated for a Section 363 sale than for a nonbankruptcy sale, the authors point out, since the debtor is selling assets "as is." It therefore does not make most of the representations and warranties that, as a seller, it otherwise would. The buyer cannot expect to recover damages from a bankrupt debtor and must therefore perform painstaking due diligence to evaluate the deal's risks. The purchase price can then be adjusted to reflect those risks. A stalking-horse bidder customarily makes the first offer and signs an agreement, after which a public auction occurs. Rival bidders usually have to show that they can close and that they consent to the terms of the stalking horse's agreement. They must also put down a considerable deposit. The stalking horse often gets special protections, such as a breakup fee if a third party outbids it.

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SECURITIES & DEBT OFFERINGS

Corporate And Government Refinancings Will Trigger A New Credit Crunch

ABSTRACTED FROM: *Hitting The Wall*

BY: Jonathan Gregson

Global Finance, May 2010, Pgs. 22-25

Record government debt will need refinancing. Governments in both the United States and Europe have been borrowing at record levels. To make up for deficit spending, they are issuing government bonds with various maturity dates. In 2012 alone, \$860 billion in US treasury bonds will mature, Jonathan Gregson reports, and \$1.4 trillion will be added to the national debt each year through 2014. Since the European and American administrations will be operating at a deficit for years to come, the existing debt must be rolled over at maturity and added to new debt, thus putting additional pressure on

the debt markets. Include corporate debt in the equation, and the total snowballs even more over the next five years or so.

Companies face tighter credit and cannot retire debt. Companies that loaded up on debt during the easy-credit frenzy assumed they would be able to refinance loans and reissue bonds at maturity. The recession has cut corporate incomes, the author indicates, and credit is becoming harder to find and more expensive to obtain for those with any but the strongest balance sheets. Around \$34 billion in US corporations' high-yield bonds will mature in 2010, a figure that escalates to \$120 billion in 2015. According to analysis by Credit Suisse, the combination of maturing corporate bonds and loans that come due in the next five years will add \$560 billion of abnormal demand to the debt markets. Anticipating this credit squeeze, some companies are trying to restructure debt before it comes due by, for example, issuing bonds to pay loans. Since less high-quality corporate debt is available currently than the demand for it, the best companies can get good terms. Unfortunately, that may exacerbate the mounting problem during the next few years, because the worse-performing companies will be waiting until maturity to roll their debt over.

Convertible and variable bonds have new allure. Given the recovery of many stock prices, it may be a good time to consider convertible bonds, the author suggests. The cost of convertibles is lower, although they do dilute the issuer's stock at maturity. To reassure investors and get lower current rates, some companies are agreeing to pay higher interest if ratings decrease or payments are not made on time. Sound companies can enjoy particularly good rates at the moment because nervous investors have withheld money from the markets. As much as \$400 billion may be sitting on the sidelines waiting to snap up safer bond offerings. Companies that can act to restructure their balance sheets before the coming credit crunch will find favorable conditions. Those that wait, and especially those with junk ratings, may find that credit cannot be had at any price. Then rates will certainly rise as the tsunami of debt restructuring overwhelms the debt markets.

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GLOBAL MARKETS

Get A Global Reach By Cross-Listing On Euronext

ABSTRACTED FROM: *Foreign Exchange: US-Listed Public Companies*

May Benefit From Cross-Listing In The Eurozone

BY: Julius Melnitzer

Inside Counsel, May 2010, Pgs. 42-44

Cross-listing for visibility and profit. Not satisfied with your current exposure in the capital markets? Feeling that the bigger, wider world should (but does not) know about your company and its products? Perhaps the answer for a Fortune 500 company or an opportunistic American corporation hoping to raise its profile is cross-listing overseas. Thus far, Julius Melnitzer reports, about 50 US companies seeking a diversified shareholder base and a European trading presence are cross-listed on the EU's largest regulated equities market, the NYSE Euronext in Paris. Familiar names include Anheuser-Busch and Philip Morris; a not-so-familiar face is Cliffs Natural Resources, a US mining company and North America's largest supplier of iron ore. With customers in South America and the

Asia/Pacific Region, Cliffs felt compelled to join the fraternity of globally recognized mining and metals companies. Within a year after listing on Euronext, Cliffs found that its institutional shareholder base in Europe and the United Kingdom had quadrupled. Similarly, a Brazilian mining company diversified its shareholder base with a Euronext listing and increased its European shareholder base by over 66 million shares within nine months of cross-listing.

Benefits and caveats. Cross-listing has other benefits, the author notes, including the ability to trade the company's stock in euros and dollars, lower the cost of capital through increased liquidity premiums, achieve lower bid/ask spreads for the stock, and garner more analyst coverage. The cross-listing process was enhanced when Euronext introduced Fast Path in January 2008. Fast Path streamlines many of the regulatory hurdles by allowing US-listed companies to rely on their existing SEC filings, thus avoiding the need to file a separate prospectus with each regulator in Europe. A current prospectus, wrapped in a summary for any additional EU or local requirements, is sufficient. Cliffs chose to fast-track onto Euronext rather than undertake the more involved, costlier process of listing on the London Stock Exchange. Experts warn, however, of drawbacks, such as the potential for diluting the cross-lister's market and adversely impacting its liquidity in the United States. Another concern is the problem of conflicting disclosure requirements in the European Union and the United States.

Making it work. The prime candidate for cross-listing, observes the author, is an American corporation that already has a substantial presence in the European market. Aggressive but relatively unknown companies will find that Euronext's subsidiary, Alternext, is suitable for small and mid-cap companies. To start the process of cross-listing, form a team from staff in the legal and investor relations departments. Set up a schedule with outside counsel that incorporates the availability of the chief executive and financial officers. Notify the company's financial reporting group and the auditors of the plan. Although Fast Path does not require an accountant's consent, good corporate governance suggests that having the auditors review documents before listing is in order. Investor relations, financial reporting, and legal counsel will need to understand the process and the reporting issues.

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MERGERS & ACQUISITIONS

Practical Techniques For Finding Intellectual Property Pitfalls

ABSTRACTED FROM: *IP Issue Spotting For M&A Deals*

BY: B. Delano Jordan and Andrea Hence Evans

Jordan Law, Chevy Chase MD (BDJ); Law Firm of Andrea Hence Evans, Washington DC (AHE)

Practical Lawyer, Vol. 56, No. 2, Pgs. 56-60

Brooklyn Bridge for sale. In acquiring a business with significant intellectual property, the first task of the acquiror's counsel, according to IP specialists B. Delano Jordan and Andrea Hence Evans, is to make sure the target really owns the necessary rights to operate its business. The IP—whether patents, trademarks, copyrights, or trade secrets—could be owned either outright or by licensing. *National Licensing Association v. Inland Joseph Fruit Company*, a 2004 Eastern District of Washington decision, holds that the grant of a right to enforce patents and trademarks, without an express transfer of any property rights in them, does not invest the grantee with standing to sue for infringement. Be aware:

Ascertaining that the target actually owns its IP does not assure that the acquiror can prevent others from using or easily circumventing it. In the case of trade secrets, for example, the strength of protection depends heavily on the owner's efforts to secure its secrecy. For a patent, its potency derives from its relationship to prior patents, how broadly its claims reach, and how well the patent attorney drafted them. The authors cite occasions when poorly drafted claims have rendered the patent—and, as described in a 2007 federal circuit case, *Immunocept v. Fulbright*, the entire acquisition—worthless.

Do not misplace the license. With respect to copyrights, the authors raise several concerns for dealmakers to watch. Typical problems with software licenses, for example, include whether the target purchased as many license copies as it was using; whether its use was within the scope of the license granted (e.g., production rather than evaluation or development licenses); and whether the manner of acquisition by the acquiror, or by the target if it succeeded to a prior licensee, requires permission from the licensor, even if the license transfers by operation of law. The best answers to these concerns come from reviewing written license agreements, which the target should scrupulously maintain and the acquiror should carefully review as part of its due diligence. (In *Netbula v. BindView Development* (2007), the California district court could not resolve certain issues because the target had lost all written copies of the license.)

Liability traps. Liability for infringement of a third party's intellectual property is not always readily apparent. The authors caution that operation or integration of the target after the acquisition can trigger issues which might not have existed beforehand. The 1971 Seventh Circuit decision of *Forest Labs v. Pillsbury Company* illustrates the problem. Acquiror Pillsbury's ability to use a trade secret licensed to the target hinged on whether the purchase-and-sale agreement—in that case, an asset purchase—allocated any consideration in the merger specifically to the trade secrets. Knowledgeable review of the target's intellectual property by IP specialists, the authors suggest, might have identified this and other hidden constraints that affected the transaction's structure and could have minimized the acquiror's exposure.

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