

**BANKRUPTCY AND SECURED LENDING
IN CYBERSPACE**

By Warren E. Agin

New York: Bowne & Co., Inc., 2000

Pp. 572. \$225.00 (loose-leaf). ISBN 1-886100-16-0

*David E. Barrett**

I. INTRODUCTION

The technological innovation known as the Internet is just beginning to make its mark in the business world. As use of the Internet continues to grow exponentially, the values of the parts that make it work — the “cyberassets” — naturally increase as well. Therefore, the importance of these assets to businesses continues to escalate, and the use of cyberassets as collateral in financing arrangements is becoming increasingly common. Warren E. Agin has recognized these trends and has written an excellent guidebook for bankruptcy and secured lending attorneys who encounter cyberassets in *Bankruptcy and Secured Lending in Cyberspace*.

Agin organizes the book into essentially three sections: “the Internet’s effect on the practice of bankruptcy law; the ways substantive bankruptcy law handles the impact of cyberspace on basic concepts and procedures; and issues related to cyberassets as secured lending collateral” (p. 2-1).¹ Agin then concludes the book with coverage of the ongoing modifications to the Uniform Commercial Code (“UCC”)² and proposals for related laws that would pertain specifically to software licenses. He further provides an extensive list of web resources and a vast appendix with relevant forms, rules, laws, and regulations.

Agin’s book is written for the Internet “newbie” as well as the expert, and he wisely includes a basic introduction to the Internet in Chapter 1 and describes key technology concepts in simple terms throughout the book. The coverage of bankruptcy and secured lending

* J.D. 2001 (expected), Harvard Law School.

1. Each chapter of *Bankruptcy and Secured Lending in Cyberspace* is separately paginated. Page numbers in this book note refer to chapter, then page number. For example, Chapter 2, page 1 is cited as (p. 2-1).

2. Article 9 of the UCC governs secured transactions.

in the context of cyberspace is in-depth and thorough, and Agin organizes the book so that it can be easily utilized as a desk reference.

Beyond the practical material covered in *Bankruptcy and Secured Lending in Cyberspace*, Agin includes brief discussions on cutting-edge and developing theories at the intersection of cyberspace and traditional business methods. Awareness of cyberassets is so new that their place in the business concept of assets is not yet established. As Agin explains, “[T]he exact nature of these assets — whether they are tangible or intangible assets, whether they have value, how rights in them are obtained and transferred — is poorly understood” (p. 3-1). While Agin does not have all the answers to these difficult questions, he provides an able discussion of the current points of view.

II. CYBERASSETS

The heart of *Bankruptcy and Secured Lending in Cyberspace* begins in Chapter 3, where Agin discusses the cyberassets with which bankruptcy and commercial law deal. Websites and domain names are the most common examples of cyberassets, and Agin describes their technical nature, including the hardware components of websites, in some detail. He further explains the domain name registration and transfer process and the requirements that must be met to register a particular domain name. A brief description of the Internet Corporation for Assigned Names and Numbers (“ICANN”) follows.³

Owners of a domain name can certainly acquire trademark rights in a particular name, but beyond intellectual property rights, the property rights of domain names have not been fully explored. Agin discusses analogous legal doctrines, such as postal addresses, which would not yield any independent property right in a domain name, and contract rights, which arise from the domain name registrar’s service agreement (pp. 3-4 to 3-12). Although Agin deals with the issue of whether domain names can constitute assets, recent court decisions issued after the book went to press are obviously omitted.⁴

Agin discusses the methods used to value both websites and domain names. Various accounting techniques may be employed to value cyberassets, although for Agin it is “extremely difficult and, in most

3. ICANN is “the non-profit corporation that was formed to assume responsibility for the IP address space allocation, protocol parameter assignment, domain name system management, and root server system management functions previously performed under U.S. Government contract by IANA and other entities.” *About ICANN*, at <http://www.icann.org/general/abouticann.htm> (last modified Nov. 26, 2000).

4. *See, e.g.*, *Network Solutions, Inc. v. Umbro Int’l, Inc.*, 529 S.E.2d 80 (Va. 2000).

cases, impossible," to do so (p. 3-16). For example, the market value of a website may be established if the site is sold in an arm's-length transaction, or an income approach may be utilized by computing a multiple of the revenue generated by a particular site (p. 3-17). Agin argues that since the current marketplace for websites is "too limited," the income approach is most useful (p. 3-17).

Agin concludes the chapter by discussing the appropriate bankruptcy law procedures relevant to identifying, scheduling, and exempting cyberassets and computers in a bankruptcy case. He provides an interesting analysis regarding whether computers are luxury goods for the purpose of discharge in a Chapter 7 case.⁵ Agin concludes that such a determination would depend on the timing of the purchase⁶ and a court determination of the computer's necessity to the debtor (p. 3-22). A final discussion revolves around online charges in a Chapter 13 filing. Depending on the particular case, charges for online services may be considered necessary expenses, and thus a court may allow a debtor to include payments for online services in his or her bankruptcy plan (p. 3-23).

Chapter 4 discusses the effect cyberassets have on venue and jurisdiction in bankruptcy cases. While the legal doctrine pertaining to this area does not differ greatly between cyber- and non-cyberassets, cyberspace itself creates some interesting jurisdictional quandaries. As Agin points out: "Over the Internet, an individual can have the same impact on entities in other states and countries as a multinational corporation can" (p. 4-1). Therefore, the question arises whether a small business with a website can be sued anywhere, like a multinational business can be sued anywhere it has a place of business. Recent court cases indicate that Internet businesses will not be subject to such personal jurisdiction based on the mere presence of passive advertising.⁷

III. THE INTERNET'S EFFECT ON THE JUDICIAL SYSTEM

Chapter 5 discusses some of the recent advances in electronic filing and access to records as courts and agencies begin to allow retrieval of such data via the Internet. In Chapter 6, Agin points out the efficiency

5. If characterized as a luxury good, debt obtained to purchase a computer would be nondischargeable, and therefore, a debtor would have to pay off any such debt. See 11 U.S.C. § 523(a)(2)(C) (1994).

6. If the computer is purchased on credit for personal use on or within 60 days prior to the filing, such credit may be non-dischargeable. See *id.*

7. See, e.g., *IDS Life Ins. Co. v. SunAmerica, Inc.*, 958 F. Supp. 1258 (N.D. Ill. 1997); *SF Hotel Co., L.P. v. Energy Inv., Inc.*, 985 F. Supp. 1032 (D. Kan. 1997). But see *Inset Systems, Inc. v. Instruction Set, Inc.*, 937 F. Supp. 161 (D. Conn. 1996).

and speed with which the Internet can deliver important information to parties concerned with a bankruptcy matter. While the bankruptcy rules do not provide the elaborate guidelines for electronic filings that the SEC allows (p. 6-1), current rules explicitly provide for electronic dissemination of notices to parties that request so in writing⁸ (p. 6-3), and other rules are flexible enough to allow e-mail communication or web publication in many instances (pp. 6-5 to 6-6). Furthermore, Agin notes that governing bodies are beginning to examine more closely the advantages electronic communications can provide in bankruptcy cases (p. 6-5).

IV. ADMINISTRATION OF BANKRUPTCY ESTATES WITH CYBERASSETS

Chapter 7 begins the discussion of administration of bankruptcy estates with cyberassets. Agin provides “clues” that help identify cyberassets that are not itemized on bankruptcy schedules⁹ (pp. 7-2 to 7-3), and lists a number of questions that should be asked of the debtor’s principals to determine the role cyberassets play in the debtor company (pp. 7-4 to 7-6). Moreover, Agin discusses ways to preserve the cyberassets in bankruptcy cases since the rights in such assets “can be easily lost” (p. 7-10). Preserving cyberassets — such as sustaining the operation of a website — can be crucial since online businesses count on their stability to maintain their customer base. Just like retail stores, “[o]nce [the business] closes its doors, some consumers will not return when the doors reopen” (p. 7-21).

Chapter 8 provides information on the ways the Internet can maximize returns on the sale of estate assets. Besides cyberassets, this information applies to the sale of any goods. Agin suggests a number of methods of selling assets on the Internet, such as soliciting offers on newsgroups (pp. 8-1 to 8-2), finding buyers using listservs (p. 8-3), posting sale information on websites (pp. 8-3 to 8-7), and selling assets through Internet auctions (pp. 8-8 to 8-14). Agin continues this discussion in Chapter 9 with information on trading bankruptcy claims over the Internet. Agin warns of the problems with such trading,

8. See FED. R. BANKR. P. 9036. Agin contends that Rule 9036 provides a “more convenient and less costly” method for entities, such as banks, credit card companies, and taxing authorities, “that ordinarily receive notices in a large volume of bankruptcy cases” (p. 6-3).

9. Examples include computer equipment and other hardware “associated with operating a website,” “software or intellectual property licenses that are executory in nature, equipment leases of Internet-related computers, website hosting agreements, website maintenance and development contracts, and connectivity agreements” (p. 7-3).

however, such as limitations provided by the securities laws. The Internet's "use [in this context] may, as a practical matter, be limited to matching buyers and sellers for single claim transactions and providing a forum for an insider or speculator to solicit offers to sell individual claims" (p. 9-11).

Licenses, ranging from web hosting agreements to technology contracts, are a critical component of any business with cyberassets. These licenses may be assumed or rejected by a debtor in bankruptcy.¹⁰ Agin begins Chapter 10's discussion of these contracts with a basic introduction to the treatment of executory contracts under the Bankruptcy Code. Agin also provides suggestions for the drafting of license agreements in order to avoid many of the problems, such as assignment or permitted non-performance, that may arise when a party files for bankruptcy relief (pp. 10-13 to 10-16).

V. SECURED LENDING WITH CYBERASSETS

Chapter 11 of *Bankruptcy and Secured Lending in Cyberspace* begins Agin's coverage of secured lending with cyberassets. One critical feature of secured lending with cyberassets is the technology escrow agreement.¹¹ While these agreements are most common in the licensing field, especially with software licensing, they can also be utilized with secured finance. Agin provides two reasons why lenders should consider technology escrow agreements: (1) the borrower may use material from third parties, and the lender would then want to make certain it has access to that material at any time it desires; and (2) the lender would want to make sure it can repossess the proprietary collateral—data if the borrower defaults (p. 11-3). The escrow agreement provides a means for the lender to obtain access to the critical collateral—the website's code. Finally, although Agin states that these escrow agreements are "fairly standardized" (p. 11-3), he advises drafting such agreements from scratch, and points out specific terms that should be included in any such agreement (pp. 11-4 to 11-8).

Obtaining, perfecting, and enforcing security interests in cyberassets raise unique issues for the secured lender, and Agin discusses these concerns thoroughly. The "ephemeral nature" of cyberassets requires

10. See 11 U.S.C. § 365(a) (1994).

11. "A technology escrow agreement allows a borrower or licensor to deposit data and other proprietary information, such as website content, with a trusted third party. The data and information are then available to a third party, a licensee or a lender, in the event the licensor or borrower becomes unable to perform under the underlying agreement" (p. 11-1).

special care to “ensure that, in cases of default, the assets are recoverable and usable” (p. 12-2). Besides domain names and websites, Agin discusses security interests in computer hardware and general intangibles, such as computer programs, trademarks, and goodwill (pp. 12-3 to 12-8). Since many intangibles — in particular, copyrights, trademarks, and patents — are affected by federal statutes, such federal laws will preempt states laws on secured lending. Agin provides in-depth discussions on the particularities of copyrights (pp. 12-8 to 12-11), trademarks (pp. 12-11 to 12-14), and patents (pp. 12-14 to 12-15), as they pertain to federal preemption and necessary lending procedures.

Since websites and domain names are the principal cyberassets considered in the book, Agin provides a series of chapters devoted to obtaining, perfecting, and enforcing security interests in these particular assets, as well as pertinent bankruptcy concerns. Websites are discussed in Chapters 13 through 15, and domain names are covered in Chapters 16 through 18.

A. Websites

As Agin warns, because websites are a “collection of assets” governed by both state and federal laws, “simply obtaining a security interest in ‘all assets including general intangibles’ and recording a UCC-1 Financing Statement are not enough” (p. 13-1). Agin suggests breaking down websites into components in order to assess the security interest’s power over each piece of the asset (p. 13-2). Due diligence is required to ensure the components are properly perfected as well as to “assess the strengths and weaknesses of the website as part of the lending decision” (13-2). Agin provides particular due diligence concerns for hardware, Internet connections, website hosting services, website content, and Year 2000 (“Y2K”) concerns (pp. 13-2 to 13-6). Moreover, he extensively covers due diligence matters pertaining to copyrights, trademarks, and patents (pp. 13-6 to 13-9).

Agin provides specific provisions that should be included in any security agreement for websites and computer hardware, and he warns that a lender must continue to monitor the website and police the related collateral after the loan is closed due to the rapid changes typical in web content. For instance, the lender should: (1) make certain that copyrights in new material are registered; (2) review licenses for any new software used; (3) make sure escrowed materials remain current; (4) audit hardware for movements to new locations and added equipment; and (5) maintain payments to web hosting services or Internet service providers (“ISPs”) (pp. 13-15 to 13-16). He also suggests monitoring a

web business' revenue, as any decline in income may result in a decline in the value of the website itself (p. 13-16).

If the lender takes special care in the development of the loan documents, it should be able to "take control of the website without significant loss of value" in the case of borrower default (p. 14-1). Still, according to Agin, the process will not be a straightforward one because of the individualized nature of websites. In Chapter 14, Agin discusses ways to preserve and transfer website collateral in such a situation. Many websites depend on continuous service, and Agin points out the need to transfer control of such sites with as little interruption as possible (p. 14-2). One key ingredient for a smooth transfer is the site operator's assistance. Since many borrowers will not be willing, or able, to assist in a transfer of a website, Agin suggests placing a provision in the security agreement to require the debtor to "assemble the collateral and make it available at a place . . . reasonably convenient to both parties" (p. 14-3). Then, the lender can leave the assets for sale at the borrower's place of business. The key here is minimizing the loss of value to the site by continuing the operation of the site throughout the transfer process.

B. Domain Names

Domain names represent general intangibles, a catch-all category under the UCC that, according to Agin, includes many types of contracts analogous to the domain name service contract.¹² While Agin claims these examples demonstrate that a domain name owner can grant a valid security interest in his or her right to use the name, he raises the concern that the government may have the power to restrict such encumbrances, as the Federal Communications Commission does with broadcasting licenses (pp. 16-2 to 16-3). Nevertheless, transfers of interests in domain names are not currently restricted (p. 16-3).

Secured lenders should engage in the same due diligence for domain name collateral as for websites, including making sure they identify the parties with control over the domain name's operation (pp. 16-3 to 16-5). Furthermore, because of the close ties between domain names and trademarks, a lender should inspect the borrower's trademark rights in the domain name (pp. 16-4 to 16-8). As he does with website collateral, Agin also provides assistance for the preparation of security agreements and UCC-1 financing statements for domain names. Establishing rights against the root domain name administrator and website hosting services

12. Examples include liquor licenses, telephone numbers, and franchise agreements (p. 16-1).

are essential, as well as continued monitoring of the collateral (pp. 16-11 to 16-13).

In Chapter 17, Agin discusses the unique problems associated with selling domain names and transferring ownership of them. Since this area of law is so new, practices have not yet been established for liquidating domain names (p. 17-1), and forcing the domain name registrar to transfer ownership without the current owner's consent is still quite difficult (pp. 17-2 to 17-4). Associated trademarks and goodwill must also be considered when selling domain names (pp. 17-4 to 17-5).

VI. CONCLUDING CHAPTERS

In the final chapters, Agin discusses proposed revisions to the UCC and the need for such changes in light of cyberspace's poor fit with traditional paper contracts and handwritten signatures of old. The recent revisions to the UCC's Article 9 recognize electronic assets and records, security interests in intangible chattel paper, security interests in licenses, and limitations on federal preemption of Article 9 (pp. 19-2 to 19-9). Agin also discusses the new Uniform Computer Information Transactions Act ("UCITA"), which covers computer information licenses, such as software licenses (pp. 19-9 to 19-15).¹³

Chapter 20 provides a somewhat out-of-date description of the Y2K problem. Agin seems to have written this chapter pre-2000, as he speaks about Y2K as occurring in the future and cites sources predicting "significant failures" due to Y2K errors (p. 20-4). Nevertheless, Agin's discussion of the bankruptcy concerns that arise due to the Y2K problem may be useful for the few businesses that experienced significant Y2K failures.

Agin concludes the book with a chapter on Internet resources for bankruptcy and secured lending, including newgroups, listservers, and websites (pp. 21-1 to 21-38). He gives a brief description of each website and even provides visuals. The lengthy Appendix contains sample bankruptcy and lending transaction forms, court orders for electronic filing projects, and domain name registration forms. Agin also includes relevant sections of the Bankruptcy Code, Article 9 of the UCC, the Copyright Act, and the Lanham Act.

In conclusion, *Bankruptcy and Secured Lending in Cyberspace* provides an exceptionally comprehensive and detailed resource for the increasingly important role cyberassets play in today's business world.

13. Agin characterizes the prospects for the UCITA's adoption as "questionable" (p. 19-11).

The book is ideal for those of all levels of Internet expertise and provides insights into many of the unresolved issues in the field today. Any bankruptcy or finance attorney dealing with websites or domain names as assets will certainly find Agin's book to be an invaluable resource.