

I N S I D E   T H E   M I N D S

# Telecommunications Client Strategies

*Leading Lawyers on Negotiating Agreements,  
Facilitating Transactions, and Resolving Disputes*



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Assisting Telecom Clients as  
Creditors in Bankruptcy  
Proceedings

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## **Bankruptcy Litigation Trends in the Telecom Realm**

Less than a decade ago, there was a high degree of resignation to the bankruptcy process by critical service suppliers, including telecom companies. Telecom service providers were forced into recognizing the importance of dealing with the bankruptcy filings of their commercial customers because of the magnitude of bankruptcy filings that occurred starting in 2000, when the telecom bubble burst, which affected the industry and crippled many telecom providers.

Not knowing how to react to these cases could have been a potential deathblow to even the most solvent and solid telecommunication companies. In the past, many telecom companies were resolved to accept the worst when a customer filed for bankruptcy protection. Typically, this included writing off past amounts owed by customers in bankruptcy, continuing to provide services without adequate assurance of payment, and to add insult to injury, paying money *to* the customer when faced with bankruptcy preference claims for having received payments from the customer within ninety days of the bankruptcy filing.

However, a much more informed and aggressive approach is now being taken with respect to bankruptcy cases—not only on the part of telecom clients, but also on the part of other suppliers of critical goods and services. Rather than accepting a customer’s bankruptcy filing with resignation and simply writing off the pre-petition amounts that are owed to them, telecom clients are discarding that thinking and taking a very proactive approach to bankruptcy cases. These days, it is advisable for counsel to jump in early in order to be seen and heard.

### **Pre-Petition Strategies – Obtaining Key Information**

Signs of trouble with a telecom customer are often apparent—bills are not paid or are paid out of time. It is important for a telecom company to recognize these signs and to deal with the customer promptly. Pre-bankruptcy planning includes identifying financially distressed customers; implementing pre-payment or cash on delivery (COD) terms; gathering information about the customer; meeting with the customer to obtain information about the customer’s financial condition; and, when

appropriate, entering forbearance agreements that address modification of payment terms and the release of claims against the telecom company.

### **Key Questions**

The following types of questions help determine the best pre- and post-bankruptcy filing strategy:

- a) What is the extent and magnitude of the relationship with the customer and do the parties want to continue the relationship?
- b) What was the payment history of the customer for the year before bankruptcy filing?
- c) Does the client want to continue the relationship with the customer (what is the balance of interests between the sales and credit collection departments)?
- d) Does the customer have intellectual property belonging to the telecom client?

These questions are designed to elicit information about the mindset of the telecom client and the financially distressed customer in terms of the continued business relationship; to assess the likelihood of a cooperative relationship with the customer during the bankruptcy case; and to assess potential pressure points (against both the customer and the telecom client).

For example, if there is a desire to continue the business relationship by both the telecom client and a customer in Chapter 11, a scaled-down litigation approach designed to get the attention of the debtor's counsel with respect to adequate assurance of payment for services provided during the bankruptcy case and the assumption of executory contracts may be effective. On the other hand, where the relationship between the telecom client and the customer deteriorated before the bankruptcy filing, and in instances where there is intellectual property at risk, a more aggressive litigation strategy is likely to be successful in terms of protecting the telecom client's interest. In these instances, a persistent presence in the case and the filing of appropriate motions and adversary proceedings is essential to

protect the telecom client's interests, contract rights and intellectual property.

### **Challenges of Working with Telecom Clients**

Perhaps the most challenging aspect of representing a telecom company as a creditor and service provider to a customer in Chapter 11 is the identification of all services and applicable business units of the telecom company that are involved in the relationship. Because there are often multiple layers of contractual relationships between a telecom company and its business customers, it is important for counsel to obtain a full understanding of all aspects of the relationship including all services that are provided; all business units that are involved; and the business objective of each unit in terms of collection and ongoing relationships.

An elevated level of due diligence is often required when representing a telecom client in a bankruptcy case, as opposed to a sole source provider of equipment or goods. The failure to understand all aspects of the business relationship can result in missed opportunities, or worse, disastrous results such as the unsuspecting waiver or release of rights of the telecom client.

### **Key Players in the Client Organization**

Typically, there are two levels of critical client contacts—in-house attorneys and business contacts. Although communications are usually through the client's in-house attorneys, whenever possible, it is important to have direct access to business clients who are responsible for the collection aspect of the bankruptcy process (i.e., monitoring accounts receivable and filing the appropriate claims), the account team/sales group (responsible for the ongoing relationship with the customer), and the credit department (responsible for determining what deposits or security is needed to provide services).

### **Determining Strategy**

It is important to assess the client's expectations in terms of severing or continuing the relationship with a customer in bankruptcy. While the initial approach may be the same in terms of seeking the court's assistance to

protect the telecom client's interests, a valued customer relationship may be saved and the telecom client's interests protected through the negotiation process. Such negotiations are often multifaceted and can be used to reach a "global resolution" of such issues as payment terms; the assumption of executory contracts pursuant to Section 365 of the Bankruptcy Code; and the negotiation or elimination of liability for potential preference claims.

If a customer of a telecom client files a bankruptcy case, it is important to recognize that a bankruptcy filing is the commencement of a case and to treat the bankruptcy with the same attention and diligence as a litigation case. Although the bankruptcy process requires artful negotiations, the willingness to litigate over issues often postures the case for a more favorable outcome for the client. Certainly, there are times when a client's financial status impacts strategy because of budgetary constraints. In such cases, counsel can temper the litigation approach and seek early avenues for negotiation and alternative dispute resolution when appropriate. Additionally, the magnitude of exposure in a bankruptcy case can heighten the need for an aggressive strategy where the client's financial status is threatened.

The bottom line is that information and preparedness is a telecom client's most important weapon. Counsel is well advised to take a "first strike" approach in terms of participating in the "first day" hearings in a bankruptcy case where such critical issues as deposits and adequate assurance of payment for future services and goods are typically dealt with. There is truth to the adage that the squeaky wheel gets the most oil in a bankruptcy case.

### **Managing Client Expectations**

When a telecom company is faced with a customer's bankruptcy filing, expectations are nearly always set at the worst possible outcome—especially in situations where the chances of recovering amounts owed before the bankruptcy are slim, and/or where the landscape is uncertain as to what the contractual relationship will be like following the bankruptcy proceedings. The good news is that taking the right approach to a bankruptcy case often results in an outcome that exceeds the client's expectations in terms of

recovering monies that are owed to the client, protecting contract rights, and limiting liability for potential bankruptcy preference claims.

### **Balancing the Client's Interests**

Balancing the need to take a more aggressive approach to bankruptcy litigation while leaving the door open to continue the business relationship with the customer sometimes requires using a “fist in a velvet glove” strategy. In the initial days after the commencement of a bankruptcy case, counsel frequently needs to educate adverse bankruptcy counsel as to the issues impacting the telecom client. This may be accomplished by filing motions to force the customer to assume or reject an executory contract and/or motions to compel the turnover of intellectual property. Such attention-getting steps are often necessary in the early stages of a bankruptcy proceeding, and are often the steps that lead by natural progression to negotiations. Counsel should be mindful of the fact that these steps are not necessarily mutually exclusive.

Of course, there are also situations where the telecom company and its customer are in communication, and are working together before and during the bankruptcy case. In those instances, all parties have their eyes open, and counsel can take a more tempered approach to litigation.

### **Negotiation Strategies**

Whether counsel takes a cooperative or aggressive approach to negotiations depends on various factors—i.e., the client's overall desired approach; the dynamics with adverse counsel; the relationship between client and debtor; and the types of issues involved. The general philosophy overriding almost all bankruptcy cases is that better resolutions are the result of negotiation rather than litigation. Bankruptcy counsel tend to look at a bankruptcy case as an opportunity to negotiate resolutions that are favorable to both sides. The goal when negotiating on behalf of a telecom client is to obtain favorable treatment of claims; reduce potential preference claim exposure; protect rights that are subject to executory contracts; and protect intellectual property.

In a bankruptcy liquidation where the debtor is closing its doors, counsel must be particularly vigilant in filing timely motions to make sure that any services provided post-bankruptcy will be paid, and intellectual property returned.

### **Protecting the Telecom Client's Contractual Rights**

An important role in representing telecom clients in bankruptcy proceedings is protecting their contractual rights after a debtor has filed for bankruptcy. For example, there are instances when telecom clients are considered "utilities" pursuant to Section 366 of Bankruptcy Code. In these instances, telecom clients are required to continue to provide services to the debtor after the bankruptcy filing under the current terms of their contract so long as the debtor provides some form of "adequate assurance" of payment to the telecom client. The type and amount of adequate assurance is negotiated between the debtor and the utility provider. Adequate assurance can include security deposits, prepayments, and letters of credits. Under the amendments to the Bankruptcy Code, which took effect in 2005, prepetition payment history, or the fact that a utility provider held a prepetition security deposit, are not factors in determining the form or extent of adequate assurance provided to utility providers by debtors.

In addition, it is important to know the debtor's intentions relative to the contractual relationship with the telecom client after the bankruptcy filing. Pursuant to Section 365 of the Bankruptcy Code, debtors have the ability to assume or reject executory contracts with non-debtors after the filing of their bankruptcy case. If a debtor assumes its agreement with the telecom client, it intends to continue the contractual relationship through the end of the agreement term. If this occurs, the debtor must "cure" all prepetition and post-petition monetary and non-monetary defaults under the contract. As such, all prepetition claims must be paid in full. In addition, an assumption will typically serve to insulate the non-debtor parties to contracts from any preference exposure pursuant to Section 547 of the Bankruptcy Code. Negotiations play a very important role in the assumption of the agreements between the debtor and the client as well as the payment of cure amounts associated with the assumption.

Conversely, if a debtor rejects its agreement with the telecom client, it terminates the contractual relationship. There are claims that arise from such a rejection and it is important to calculate the claims and meet all deadlines relative to filing such claims in a timely manner.

## **Protecting the Telecom Client’s Intellectual Property**

Customarily, telecom companies that supply telecommunications equipment enter into agreements with their customers that include licenses of software and firmware (the “licensed materials”) which are required for the operation of the equipment. Pursuant to such agreements, the telecom company normally retains title to the licensed materials and the licenses are “perpetual, non-exclusive, and non-transferable.” The customer only has the right to use the licensed materials pursuant to the license agreements. However, the customer in Chapter 11 may seek to sell its assets, including the telecommunications equipment in which the licensed materials are imbedded. Likewise, the Chapter 11 customer may also seek to assign executory contracts -- often supply or service agreements -- that contain the license agreement to third parties. In either situation, it is incumbent upon the telecom company to be vigilant as to its rights in protecting its intellectual property in the context of a bankruptcy proceeding. The failure to object may result in the transfer of intellectual property despite the restrictions on transferability in the license agreement.

Licensed materials that are “personal, non-transferable or non-exclusive licenses” of intellectual property cannot be assumed, or assumed and assigned, without the express consent of the telecom client pursuant to Section 365(c)(1) of the Bankruptcy Code. That section provides that a debtor “may not assume or assign any executory contract or unexpired lease of the debtor” if applicable non-bankruptcy law precludes assignment. It is well established that the “applicable law” referred to in Section 365(c)(1) includes patent and copyright law. Non-exclusive licenses of patents and copyrights are not generally assumable or assignable without the licensor’s consent as a matter of law. However, in a Chapter 11 proceeding, counsel for customers in Chapter 11 often file voluminous pleadings in a bankruptcy case (in a motion to assume contracts or in a plan of reorganization) in which contracts that the customer seeks to assume and assign are identified in a lengthy schedule. The failure of a creditor,

including a telecom company, to object to a motion to assume or assign a contract will typically be construed as “consent” by the bankruptcy court. Further, despite the fact that Section 365(b)(1)(A) of the Bankruptcy Code requires that all prepetition amounts owed be “cured” (i.e., paid in full) in connection with the assumption and/or assumption and assignment of an executory contract, oftentimes the Chapter 11 customer will identify the cure amount as “zero,” thus, placing the telecom client at risk should they fail to object to the assumption or cure amount. Again, the failure to do so can result in the forfeiture of any rights to object to the assumption and assignment and to the establishment of the cure amount as zero.

Because of the many potential land mines associated with protecting intellectual property rights, counsel should consider an aggressive approach to representing clients’ interests in this regard. Despite the fact that the bankruptcy code entitles the customer in Chapter 11 to reserve decision on which contracts should be assumed and/or assumed and assigned until its plan of reorganization, the filing of a motion early in the case to compel assumption or rejection of the license agreement is often advisable. The argument in favor of such relief is that the customer in bankruptcy needs, and is using, the telecom communications equipment, but is not entitled to a free ride on the licensed materials without assuming its obligations under the license agreement and paying all amounts owed. Although bankruptcy courts typically allow a debtor time to decide whether to assume or reject a license agreement, once the issue is raised, it must be dealt with by the customer in Chapter 11.

## **Conclusion**

Protecting the interests of telecom companies that are in contractual relationships with financially distressed customers presents various challenges. Pre-bankruptcy planning with the telecom company provides a distinct advantage in terms of identifying customers in financial difficulty; implementing favorable payment terms for services and for amounts owed and appropriately documenting same; and gathering information about the customer, its financial problems, and the extent and nature of the relationship with the telecom client. Further, upon the filing for bankruptcy protection by a customer of a telecom client, counsel is well advised to actively and aggressively engage in the bankruptcy at the commencement of

the case and to proactively take steps to secure adequate assurance of performance for future services provided by the telecom client; protect the telecom client's contractual rights; reduce potential liability for exposure to bankruptcy avoidance actions, including preference claims; and protect intellectual property. Extreme diligence is required by counsel to ensure that opportunities are not missed to protect the telecom client's rights in connection with critical filings in the bankruptcy case, especially with respect to the first day utility motions dealing with adequate assurance issues; assumption or rejection of contracts; the establishment of cure amounts for assumed contracts; proof of claim bar dates; and plans of reorganization. A well-organized approach to the representation of the telecom client can maximize the financial return to the client and minimize potential risk and liability.

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