
MY BORROWER HAS A WEB SITE — WHAT DO I DO NOW?

by Gerald L. Jenkins and Karen Ruth Bieber

The World Wide Web has become one of the most talked about means of communication since the advent of television. Anyone armed with a computer, a connection to the Internet, the right software and plenty of free time can look for “sites” on the Web. A site is a collection of interlinked electronic pages which can be downloaded one at a time and viewed on the user’s own computer using software called a “browser.” After finding an address for a site, the user can download it and read text, watch animated graphics, listen to CD-quality sound, watch video clips, play interactive games or buy products.

Businesses the world-round have decided that a Web site is important, if not critical, to their continued survival and profitability. As soon as fears of privacy and security are eliminated, consumers and purchasing agents alike will flock to the Web to select products, learn more about vendors, negotiate and buy. For these reasons, a company’s Web site is becoming an increasingly important part of its asset base.



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In order for a Web site to be valuable to its owner, two things are needed: a well-known and easily found address, and interesting, informative or entertaining content. The address will enable potential customers and users to find the site. Good content will attract new customers and keep the old ones coming back. The address of a Web site is based on the site owner’s domain name and can become a valuable asset in its own right.* However, without the proper content, even the best Internet address is of limited value.

* See the May/June issue of *THE SECURED LENDER* for an article on this topic.

Types of content on Web sites today

Attracting eyeballs. The most common model to make money on the Web is a site which offers a free useful service. A good example is a Web search engine (*e.g.*, lycos.com, yahoo.com, altavista.digital.com). Any user who visits one of these sites can type in a word or a series of words, and the search engine will attempt to find the Web sites (called “hits”) which are most interesting to the user.

Why would any businessperson offer this free service? The answer: advertising revenues. The owner (or “host”) of the search engine site charges advertisers to place “banners”



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on each Web page. A banner is a graphic image placed at a strategic location on the user’s computer screen. More users means higher advertising rates.

Increasing product awareness. This is especially common among computer hardware manufacturers and computer software producers. For example, a software producer may allow people visiting its Web site to download a beta version of its software at no charge. A beta version is a preproduction version of software which customers are encouraged to use and test in order to work out the final bugs.

Providing customer support. A Web site is available seven days a week, 24 hours a day. Through the use of lists of frequently asked questions (FAQs), product descriptions, downloadable software patches (small, self-installing programs which allow a user to fix software bugs on his or her own computer) and drivers (small programs which allow a particular type of hardware to work in a particular software environment), installation instructions, spare parts lists and lists of product options, a well-designed Web site can field a significant percentage of customer service calls.

Orders and sales. A few companies allow online orders (where the actual sale takes place via a subsequent telephone call) or online sales (where the sale itself takes place over the Internet). Consumers and vendors remain concerned that the Internet is an open and public network. People are, therefore, reluctant to provide credit card information over the Internet. As new encryption technologies are implemented and standardized however, the Internet will become safer, and the fear of the Internet as a vehicle to transact purchases and sales will diminish.

The necessary pieces

Although a full listing of the components of a successful Web site depends on the type of site, certain basic items are needed for all sites.

A continuous connection to the Internet backbone. All computers on the Internet must be connected to the Internet backbone, which carries the high-volume, high-speed traffic between the busiest computers on the Internet. A Web site's connection must be continuous so that someone can find the site regardless of the time or day. The connection must also be of sufficient bandwidth (the rate at which information can be transmitted over a connection) to give users adequate response times.

Computer hardware requirements. It is necessary to have sufficient computer hardware to operate a Web server (the computer which receives requests for information and sends it out to the users). The hardware needs to be reliable and fast, and it must have sufficient bandwidth to respond to requests from multiple users in a timely fashion.

Computer software requirements. A Web server needs two basic items: an operating system and server software. The operating system performs the same function that DOS or Windows performs on a desktop computer. Web server software keeps track of user requests, finds the information requested and sends it out to the user making the request.

Content creation. A Web page is a computer file containing text, graphics, audio clips, video clips, some instructions to the user's computer and typically "links" (mechanisms which allow a user to go directly to another page). Web pages can take two different forms: static and dynamic.

Static pages are prepared in advance, stored on the Web server, and sent out when requested by a user. Dynamic pages are created only after a request is made. For example, if a user visits a weather forecast site, the Web server does not necessarily have a series of up-to-the-minute weather pages. Instead, the Web server contains or has access to a database with the necessary weather information. Whenever the Web server receives an inquiry from a user, a small program is invoked by the server (often called a "server side applet" or "script"). The applet or script creates a customized weather page which is immediately sent to the user making the request.

Links. Almost all Web pages contain references or "links" to other Web pages. A link is an address of another

Web page embedded in the page containing the link, along with a mechanism that allows a user to click to the other page. By following links from one page to another, one can "surf" the Web. At a complicated Web site, links might run into hundreds or even thousands. The Web host must keep track of the links to make sure that they remain live (*i.e.*, the pages to which the links point still exist). Keeping track can be complicated and often requires a talented manager (often called a "webmaster").

Payment systems. If the Web host wants to sell goods or services over the Internet, its Web server must be able to conduct credit card, debit card or electronic cash transactions for consumers, and EDI (electronic data interchange) transactions for many business-to-business transactions. EDI is a highly structured system which is used to send private information from one business to another over secure networks called VANs (value added networks). Because EDI and VANs can be quite expensive, a number of attempts are underway to use Web sites to combine the reliability and safety of EDI and the cost effectiveness of the Internet.



How the pieces are put together

The various components of a successful Web site can be assembled in a number of ways depending on how active a site is. At the largest sites, the connection to the Internet backbone has a high bandwidth, the hardware is owned by the host, and most of the authors, graphic designers and programmers are employees of the host. Creation and maintenance costs of such a site can be millions of dollars.

As a site gets smaller and less active, bandwidth is lower, hardware is owned by the company which provides access to the Internet (called an Internet service provider, or ISP) and the authors, graphic artists and programmers tend to be outside contractors. Costs of the smaller sites vary widely and can be as low as a few thousand dollars. Most of the useful sites fall somewhere in the middle and tend to have some of the elements of big and small sites.

A Web site can be effective only if all of the pieces work effectively with each other. If one part breaks, the entire Web site is down. If it cannot be brought back up quickly, Web surfers go elsewhere and may never come back. The interrelationships of the various players who create the components and the agreements among them (often oral or on the back of an envelope) can be complex, confusing and almost impossible to follow. It is against this backdrop that a lender starts its due diligence process.

Due diligence: Fighting your way through the thicket

In order to analyze a Web site, a lender should first look for each required component and find out who owns it, who knows how it works and who maintains it. In the case of a Web site that is integral to the borrower's operations, the lender may want to retain the services of a Web expert to assist it in its due diligence efforts. The following steps should give any investigator a good start:

Visit the Web site.

Locate a computer with a browser and access to the Internet and visit the site. Keep a paper and pencil and maybe a color printer handy. Look at the home page (the page users are directed to at the beginning of their visit) and follow as many links as possible. Jot down response times. Critique quality of content and presentation. Print typical and interesting pages for others to see. Note links that don't work. Visit at various times of day (early evening Pacific time can be the worst time for many sites). Visit Web sites of direct competitors and compare them for content, presentation and response times. View sites known for their quality for benchmarking purposes. Finally, since most sites ask for user suggestions and criticisms, ask the borrower for a copy of its logs.

Check out the hardware. Ask the borrower who owns the server hardware and its location. Find out whether any backup systems or subsystems exist (backup servers ready to come on line at any time, duplicate disk drives, etc.). Read the leases for any hardware that is not owned. Review maintenance contracts for minimum response times and the scope of covered repairs. Check maintenance logs to ascertain reliability of the hardware.

List the software. Ask about the operating system (usually UNIX or NT) and the server software. Confirm through review of the license agreements that the borrower has licensed copies; if possible, get version numbers and

serial numbers. Find out if the license agreements are assignable. If the site uses server side applets or scripts, try to find out who wrote them, who maintains them, who has a copyright interest in them, who has the source code (the human readable form of a program before it is compiled into machine readable bits for execution) and what computer languages were used. If outside contractors are used, review copies of each contract. Since applets are a form of intellectual property, determine who owns the rights and whether the borrower has the power to assign its interest in them.

Find out who created the content. Find out who prepared the Web pages, wrote the text, designed the graphics and did the programming. Determine who owns the intellectual property rights associated with each item. If the Web site is tied to a database, ask who owns and who maintains it. Ask whether the content creators are employees or independent contractors. If independent contractors are involved, get copies of the relevant agreements and

review them. Investigate outside contractors and determine how proficient they are and whether they are financially viable.

Evaluate any payment systems. If the Web site allows payments to be made over the Internet, learn about the system. Find out the exact form of receivables in the system, who the account debtors are and how long it takes to transform receivables into cash.

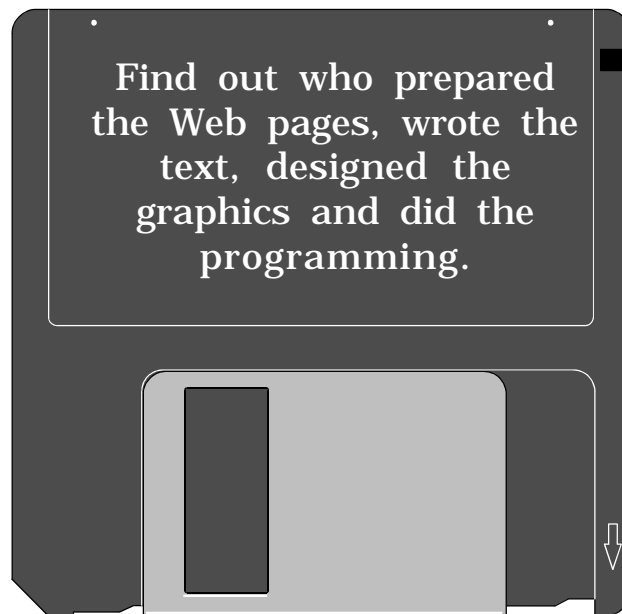
Check the connection to the Internet. Find out who provides the connection to the Internet. Evaluate the creditworthiness and the technological capabilities of the provider. Find out the bandwidth of the connection to the Internet backbone.

Analyze site maintenance. Determine who has overall authority for the Web site. Find out if responsibilities are assigned to only one person or whether there is redundant capacity. If outside contractors are involved, get copies of their agreements. Analyze security measures. Review maintenance logs.

UCC searches. Perform appropriate UCC searches and, if applicable, federal trademark, patent number and copyright registration searches to determine whether anyone else has obtained rights to the various elements of the Web site.

Protective steps

If its Web site is an important asset of the borrower, then before making a loan, the lender should insist on two things. First, the Web site should be durable and resilient



enough to keep operating under the normal ups and downs of business operations. Second, the lender should have sufficient rights to allow it to maintain and operate the Web site if necessary in the context of a workout and to transfer the Web site to a buyer in the context of a liquidation or sale of the business.

Durability and resilience depend on the quality of the equipment and software, the efficacy of maintenance procedures and the redundancy of critical components. Redundancy can mean backup tapes which can be reloaded in a few hours if time is not absolutely critical, or it can mean backup machines ready to take over at a moment's notice. Redundancy can also mean having more than one individual who knows how to maintain the Web site and well-documented software that can be easily maintained and upgraded.

Control of a Web site in a default scenario and ability to transfer it to a purchaser in liquidation depend on the lender having a fully prepared security interest in each component critical to the Web site. The security interest is created by a security agreement in favor of the lender covering equipment and general intangibles, as well as any other categories of goods (as defined in the UCC) that may be involved.

The hardware is equipment under the UCC. If it is owned by the borrower, the borrower can grant the security interest in the equipment itself. If it is leased, the borrower can grant a security interest in its rights under the lease. The lender's UCC searches should reveal the existence of any lessors of equipment, and their consent to assignment of the lease should be sought. The lender should also make an assessment of the likelihood that the hardware constitutes "fixtures" and, if so, should conduct the necessary additional UCC searches and obtain the necessary additional filings.

Each agreement (ISP agreements, equipment leases, license agreements, development agreements, maintenance agreements, etc.) between the site owner and the contractors building and maintaining the site should be assigned to the lender to the fullest extent possible. These agreements and the borrower's rights under them are general intangibles in which a security interest can be perfected by filing UCC financing statements in the appropriate jurisdictions. The lender should also obtain an acknowledgment and consent to the assignment from the other party to the contract whenever possible, as well as an agreement from that party to give the lender notice of any default by the borrower under the contract and to allow the lender a reasonable time period within which to cure the default. The lender should also try to obtain, if possible, the other party's consent to further assignment of the contract rights to a buyer from the lender in a liquidation. Finally, if the other party has any contractual or statutory liens, those should be waived or subordinated to the lender's liens.

During the course of its due diligence, the lender will have determined what intellectual property rights are involved in the Web site. These rights are also general

intangibles in which a security interest can be perfected by appropriate UCC filings. If any patents, trademarks or copyrights are registered with the United States federal patent, trademark or copyright offices, a separate mortgage document will need to be executed by the borrower and recorded in those offices. If any patents, trademarks or copyrights that are critical to the Web site are registered with any foreign government offices, it may be necessary to investigate the methods available for perfecting the lender's interest in those foreign registration rights.

Off-the-shelf computer software presents some unique challenges to the lender. It is not purchased, but is licensed to each user on a nonexclusive basis. The license printed on the box typically prevents an assignment and, as a practical matter, is not subject to negotiation. The lender should determine if the off-the-shelf software is readily available and how expensive it is. Should the need arise in pre-bankruptcy context, the lender can simply purchase its own licensed copy of that software. If the cost is high, the lender should consider a reserve against availability to cover it. While the same issue can arise with custom software, it is more likely that assignability, notice and the opportunity to cure can be negotiated with a developer.

The loan and security agreements between lender and borrower should contain covenants requiring the continuous operation of the Web site, ownership of, or valid licenses for, all existing and newly added intellectual property, and continuing compliance with the various agreements relating to the Web site. The lender should have rights to inspect and review all Web site components, both tangible and intangible. The lender's security interests should attach to after-acquired property of the borrower relating to its Web site, and the borrower should agree to take all steps requested by lender to perfect lender's liens in such property as it is acquired.

Ongoing protective measures

A careful lender should monitor a Web site at three levels. First, the lender should periodically check the Web site to insure that it is still there and operates properly.

Second, check to see if it is being maintained properly. For example, if a site includes product descriptions, make sure that new products are included. If product availability is posted on the site by tying the Web server to the borrower's inventory database, make sure that it is up-to-date and that the connection between the database and the Web server is intact. Check a number of links to see if they still point to live addresses. If a significant number of pages visited are "under construction," the lender should be concerned that the borrower may not be focusing enough attention on its Web site.

Third, the lender should periodically check whether the site is keeping up with technological developments. New

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Web browser upgrades, new methods of presenting information and new features created by software developers are announced weekly. A Web site that looked innovative and up-to-date six months ago can look tired and outmoded today. Although a law firm site may benefit from a traditional (six to twelve months old) look and feel, a site designed to attract generation X'ers must keep up with newest trends. Check sites of the borrower's competitors to determine how the borrower's site compares to the Web in general.

Bankruptcy issues

If the borrower files for bankruptcy or is the subject of an involuntary petition, it may be necessary for the lender to keep the borrower's Web site up and running. The lender may have to start meeting the borrower's obligations under the various contracts and agreements. If, as suggested above, the lender has negotiated for the right to assign the contracts and agreements, the right to receive notice of the borrower's default and the right to cure, it should be possible for the lender to keep the site running as long as it is willing to supply the necessary funds. Timing is absolutely critical. In fact, if the lender is taken by surprise and has not developed a game plan in advance, it is unlikely that the lender will be able to keep the site alive without a high level of cooperation from its borrower during the bankruptcy case. A better alternative: Before bankruptcy, detail a game plan. This should list the essential elements of the Web site, and a way to contact the key players and the relevant contractual provisions. The lender will thus have a head start if a bankruptcy case is commenced and may be able to maximize the value of its collateral by keeping the site running. However, stepping into the shoes of the borrower to keep the site running is at best a stop gap measure. It will not keep it fresh and up-to-date. Unless continuously under development by knowledgeable experts, over time the site will become less interesting and less attractive to its user base and, therefore, less valuable as collateral. Even if able to keep the site running, the lender should consider petitioning the bankruptcy court to allow an expedited sale of the Web site.

Conclusion

Web sites are becoming increasingly important to businesses all over the world. Novel and unusual two years ago, they may become essential to many businesses in the near future. Because sites are complicated and difficult to monitor, many lenders have either avoided lending to organizations for which a Web site is an essential or have ignored the particular issues the existence of the Web site raises. The wise lender will want to take a proactive approach to evaluating and protecting its interest in this valuable asset. ▲