



A123 Bankruptcy

1-2-3 Levels of Loss for Citizens and Taxpayers

October 26, 2012

SPECIAL BULLETIN

On Tuesday, October 16, 2012, A123 Systems, Inc. filed for bankruptcy protection and announced plans to sell its automotive battery business to Johnson Controls, Inc. for \$125 million. The bankruptcy filing has brought serious public policy and financial issues to the forefront. M·CAM is providing information and analysis on those matters.

National Security Issues

National security concerns on the uncontrolled transfer of military technology are front and center in this case. A123 technologies have been adapted for US military purposes. Once that occurs, the Federal government can exercise controls over any proposed transfer of the technology itself. At least three of A123's manufacturing facilities are outside the United States, including plants in China and South Korea. Although it is possible that the technologies have already been comprised, the Federal military and intelligence establishment still retains broad discretion to control the legal use of the technology outside the United States.

Development of the A123 battery technology was primarily funded by US Department of Energy research grants and contracts, initially provided to the Massachusetts Institute of Technology (MIT). MIT in turn "spun out" a company that became A123 Systems, Inc., while retaining a research linkage for future technology development to flow from the university to the company. And remember, that was research funded by US taxpayers. When the US government funds research, it creates rights for the government to access and control the resulting technology.

And now for another complication: A123's patent portfolio has been signed over and title is now recorded for Wanxiang America Corporation, a subsidiary of China's largest auto parts firm, Wanxiang Group. The Federal government can intervene and prevent Wanxiang America or its parent from exercising any rights with respect to the patent portfolio on national security grounds. Until it does so, the title to the patent estate is encumbered by the financial security agreement that gives control to Wanxiang.

So there are multiple levels of Federal control at work already in any proposed transaction involving the A123 battery technology – national security export controls and federal control of the title to the intellectual property estate.

Taxpayer and Financial Issues

So what does Johnson Controls, a competitor of A123, do in its reported \$125 million transaction to take control of the automotive battery portion of A123's business? Title to the patent estate is already encumbered by Wanxiang America Corporation, with the prospect of the US government stepping in to take control of the relevant intellectual property assets. Johnson Controls will have to get into a lengthening queue with Chinese business and US government interests if it wants to get clear title to the assets. Worse, as Johnson Controls has indicated that it could structure a \$72.5 million debtor-in-possession (DIP) credit facility for A123's assets, any lien Johnson Controls seeks on those assets to serve as collateral is now standing behind at least Wanxiang and the US government.¹

¹ <http://www.a123systems.com/db09dea4-181a-43d4-9974-cc67d51bc3bc/media-room-2012-press-releases-detail.htm>

But wait, there's more. According to its SEC filings, A123 may have allocated at least \$1.8 million in federal research and experimentation tax credits, to be used to reduce tax liabilities in future years. As A123 was annually producing massive losses, it remains to be seen if the company's estate in bankruptcy is able to retain those tax credits.

Mind you, that amount is on top of the \$249.1 million US Department of Energy grant provided in 2009 to A123 to support manufacturing operations. The manufacturing grant was preceded by a minimum of tens of millions of dollars in previous US Energy Department research grants and contracts. All of this represents a massive failure of the federal research & development diligence process that has again wasted taxpayer money.

At the state level, Michigan is the biggest loser, with \$100 million in tax credits and millions more in grants extended to A123. Massachusetts also provided substantial incentives to the company.²

Information now coming to light indicates that A123 executives have asked the bankruptcy court for \$4.2 million in executive and retention bonuses.³

Senator Charles Grassley, the ranking member of the US Senate Judiciary Committee and the primary author of the Federal whistleblower laws designed to root out illegal and wasteful spending, said "the bankruptcy raises the prospect that the taxpayers will get little or no return on their investment in A123 and will lose millions of dollars."

M-CAM will continue its long history of assisting law enforcement and clean government initiatives by providing deeper information and analysis to the Senate and House Judiciary Committees, the Justice Department, and other authorities on this matter.

For more detailed information regarding A123 Systems, please contact us at patentlyobvious@m-cam.com.

² <http://www.a123systems.com/2aa42516-62ce-45e9-b553-1f11ad69ade5/media-room-2009-press-releases-detail.htm>

³ <http://nlpc.org/stories/2012/10/25/executive-premeditators-bankrupt-a123-want-their-bonuses-now>

A Brief Primer on the Patent System

In recent years, the importance of patents and intellectual property rights as an important variable in the marketplace has come to the forefront of the public consciousness as world leaders declare their country's lead in the innovation race. Damaging intellectual property litigation is becoming increasingly common across all industries. This is exacerbated when patent rights are granted for non-novel ideas. A vast amount of precedent innovation is unconsidered by patent-granting authorities in the creation of new IP rights. Patent granting authorities including the United States Patent and Trademark Office (USPTO), European Patent Office (EPO), Japanese Patent Office (JPO), Chinese State Intellectual Property Office (SIPO), Korean Intellectual Property Office (KIPO) and many others are constrained by the use of patent classification systems which are routinely circumvented by patent applicants.

There is a two-way social contract underlying the patent system. In the United States, patent terms are generally limited to 20 years from the date of application. By statutory intention, once a patent has expired, the patent holder loses the right to exclude others from fully utilizing any innovation described in the patent. A large number of patents enter the public domain when they are "abandoned" – when owners discontinue paying patent maintenance fees. Patents also only provide an exclusionary right in the country for which the patent is filed. As demonstrated by the Global Innovation Commons⁴ (G.I.C.), using intellectual property available in the public domain eliminates the need to pay licensing fees on those innovations in countries where the patent was never registered, or worldwide, if abandoned.

Patently Obvious® is a weekly report focusing on select groups of patents in order to increase transparency in markets, addressing information asymmetries, and providing a more level playing field for all parties.

The information in this report was prepared by M-CAM, Inc. ("M-CAM"). M-CAM has used reasonable efforts in collecting, preparing and providing quality information and material, but does not warrant or guarantee the accuracy, completeness, adequacy or currency of the information contained in this report. Users of the information do so at their own risk and should independently corroborate said information prior to any use of it. M-CAM is not responsible for the results of any defects that may be found to exist in this material, or any lost profits or other consequential damages that may result from such defects. The information contained in this report is *not* to be construed as advice and should not be confused as any sort of advice. M-CAM does not undertake to advise the recipient or any other reader of this report of changes in its opinions or information. This information is provided "as is." M-CAM or its employees have or may have a long or short position or holding in the securities, options on securities, or other related investments of companies mentioned herein. This report is based on information available to the public.

⁴ <http://www.globalinnovationcommons.org/>