

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:

NOVAN, INC., *et al.*,¹

Debtors.

Chapter 11

Case No. 23-10937 (LSS)

(Jointly Administered)

Obj. Deadline: August 28, 2023 at 4 p.m. ET
Re: D.I. 16 & 59

**LIMITED OBJECTION AND RESERVATION OF RIGHTS OF DR. REDDY'S
LABORATORIES LTD. AND CERTAIN AFFILIATES TO THE DEBTORS' SALE**

Dr. Reddy's Laboratories Ltd. ("Dr. Reddy's Ltd."), Promius Pharma, LLC ("Promius"), and Dr. Reddy's Laboratories, Inc. ("Dr. Reddy's Inc." and collectively, "Dr. Reddy's"), submit this limited objection and reservation of rights to the motion (the "Sale Motion") [D.I. 16] filed by Novan, Inc., and its debtor affiliate (together, the "Debtors") for approval of the sale substantially all the Debtors' assets, and the Debtors' proposed Private Sale Order (as defined below) [D.I. 59], and respectfully states as follows:

BACKGROUND

1. Prior to the Petition Date, Debtor EPI Health, LLC ("EPI") and Dr. Reddy's Ltd. entered into to the *Asset Purchase and License Agreement*, dated August 20, 2018 (the "MinoLira APA"), pursuant to which Dr. Reddy's Ltd. transferred certain rights related to the sale of the pharmaceutical product MinoLira to EPI subject to certain "Milestone Payments" (as defined in the MinoLira APA) based on EPI's future sales of MinoLira. *See* MinoLira APA § 3.01.

¹ The Debtors in these chapter 11 cases, along with the last four digits of the Debtors federal tax identification number (if applicable), are: Novan, Inc. (7682) and EPI Health, LLC (9118). The corporate headquarters and the mailing address for the Debtors is 4020 Stirrup Creek Drive, Suite 110, Durham, NC 27703.



2. Under the MinoLira APA, Dr. Reddy's Ltd. also granted EPI a non-transferable license to certain related intellectual property, referred to as the "License Grant." *Id.* § 9.01. The License Grant is limited by various rights retained by Dr. Reddy's Ltd. Among other things, under section 9.01(a), the "License Grant does not include a license to Intellectual Property Rights that extend beyond the Product and/or Future Product in the Territory." The scope of the License Grant is further curtailed by section 9.01(b), which limits rights related to sublicenses and manufacturing:

Purchaser may grant sublicenses under the Seller Intellectual Property Rights, subject to Seller's consent, which will not be unreasonably withheld or unduly delayed, to develop, manufacture, have manufactured, market, offer to sell, sell, use, import, export, distribute or otherwise commercialize the Product and/or Future Product in the Territory. Seller hereby grants a non-exclusive license under the Know-How and patent rights owned by or licensed to Seller to manufacture the Product and/or Future Product outside the Territory solely for importation, offer for sale, sale, and use in the Territory.

3. As part of entering into the MinoLira APA, the parties executed a series of related agreements, which are identified on the Cure Notice (defined below) as ID # 266 to 271 (collectively with the MinoLira APA, the "MinoLira Transaction Documents"). As discussed in the Limited Cure Objection, the MinoLira Transaction Documents constitute an integrated agreement.

4. Also prior to the Petition Date, Promius and Dr. Reddy's Inc., on the one hand, and EPI, on the other, entered into the *Asset Purchase Agreement*, dated September 28, 2018 (the "Cloderm APA"), pursuant to which Promius and Dr. Reddy's Inc. transferred certain rights and intellectual property related to the sale of pharmaceutical product Cloderm. Like with MinoLira, Promius and Dr. Reddy's Inc. retained certain rights in the Cloderm-related intellectual property by limiting the grant to a defined geographic territory and use. *See* Cloderm APA § 3.01.

5. On or about July 17, 2023, the Debtors filed the Sale Motion (the "Sale Motion") seeking entry of (a) an order (the "Bidding Procedures Order"): (i) approving bidding procedures

to be used in connection with one or more sales (each, a “Sale”) of the Debtors’ development and commercialization rights to their research and development portfolio (the “R&D Assets”) and to the rights to commercialize the Debtors’ commercial portfolio (the “Commercial Assets” and together with the R&D Assets, the “Assets,” as more fully defined in the Bidding Procedures) free and clear of all liens, claims, interests, and encumbrances; (ii) authorizing the Debtors to designate one or more affiliates of Ligand Pharmaceuticals, Incorporated or its designee (“Ligand”) as the Stalking Horse Bidder² for all of the Assets in connection with considering the entry of the Bidding Procedures Order; (iii) scheduling one or more auctions (each, an “Auction”), if necessary, and schedule one or more hearings to approve a sale of the Debtors’ Assets (a “Sale Hearing”); (iv) approving the form and manner of notice of the proposed Bidding Procedures, the Auction, and the Sale Hearing, substantially in the form attached to the Bidding Procedures Order as Exhibit 2 (the “Auction Notice”); (v) authorizing procedures governing the assumption and assignment of certain executory contracts and unexpired leases (the “Assumed Contracts”) in connection with any Sale (the “Assumption and Assignment Procedures”); (vi) approving the form and manner of notice to each relevant non-debtor counterparty to an Assumed Contract (each a “Counterparty”), of (A) the Debtors’ calculation of the amount necessary to cure any default under the applicable Assumed Contract (the “Cure Amounts”); and (B) certain other information regarding the potential assumption and assignment of Assumed Contracts in connection with a Sale, substantially in the form attached to the Bidding Procedures Order as Exhibit 3 (the “Assumption and Assignment Notice”); and (vii) granting related relief; and (b) one or more orders of the Court (collectively, the “Sale Orders”): (i) authorizing the sale of the Debtors’ Assets free and clear of all liens, claims, interests, and encumbrances, except as provide in the Sale Order; (ii) authorizing the assumption

² Capitalized terms used but not otherwise defined herein shall have the means ascribed to them in the Sale Motion.

and assignment of certain Assumed Contracts in connection with the Sale(s); and (iii) granting related relief; or (c) in the event the Bidding Procedures Order or the DIP Order are not entered by the Court on or before 35 days after the Petition Date, a Sale Order (the “Private Sale Order”) (i) authorizing the sale to Ligand of the Debtors’ Assets free and clear of all liens, claims, interests, and encumbrances in accordance with the Stalking Horse Agreement; (ii) authorizing the assumption and assignment of certain Assumed Contracts in connection with the Sale; and (iii) granting related relief.

6. The Debtors attached a copy of the Stalking Horse Agreement as an exhibit to the Sale Motion. The Stalking Horse Agreement does not identify which contracts will be Assumed Contracts or itemize the Assets that will be purchased.

7. On July 25, 2023, the Debtor filed the *Notice of Filing of Private Sale Order* [D.I. 59], which attached a revised proposed Private Sale Order.

8. Also on July 25, 2023, the Debtors’ filed the *Initial Notice of Possible Assumption and Assignment of Certain Executory Contracts and Unexpired Leases* [D.I. 60] (the “Cure Notice”), listing executory contracts and unexpired leases the Debtors may attempt to assume and assign as part of the Sale and the proposed cure payment for each. The Cure Notice lists several agreements with Dr. Reddy’s, including the MinoLira Transaction Documents and Cloderm APA.

9. On August 10, 2023, Dr. Reddy’s timely filed its *Limited Objection and Reservation of Rights of Dr. Reddy’s Laboratories Ltd. and Certain Affiliates to Initial Notice of Possible Assumption and Assignment of Certain Executory Contracts and Unexpired Lease* [D.I. 141] (the “Limited Cure Objection”).

OBJECTION

10. Dr. Reddy’s files this Limited Sale Objection out of an abundance of caution. In its Limited Cure Objection, Dr. Reddy’s objected to the assumption and assignment of Dr. Reddy’s

agreements to the extent it was not *cum onere* or failed to cure all pre and postpetition monetary defaults. Dr. Reddy's further objects to the Sale to the extent the Debtors attempt to sell their rights and licenses related to MinoLira and Cloderm that were obtained through the MinoLira Transaction Documents and Cloderm APA, respectfully, "free and clear" of Dr. Reddy's rights and related licenses under those agreements.

11. The proposed Private Sale Order includes provisions that arguably could be read to expand the Debtors' rights or violate the *cum onere* principle. For example, paragraph U. of the proposed Private Sale Order includes findings that the Debtors are the sole owners of the Purchased Assets (as defined in the Private Sale Order) and that the Sale will be free and clear of, among other things, all third parties' rights and license interests:

The Debtors are the sole and lawful owners of the Purchased Assets, and no other Person has any ownership right, title, or interests therein. The Purchased Assets constitute property of the Debtors' estates and good title thereto is vested in the Debtors' estates within the meaning of section 541(a) of the Bankruptcy Code. The Debtors have (except to the extent otherwise provided in the Purchase Agreement) all right, title, and interest in the Purchased Assets. The transfer of the Purchased Assets to the Buyer will be, as of the Closing, a legal, valid, and effective transfer of the Purchased Assets, **which transfer vests or will vest the Buyer with all right, title, and interest of the Debtors to the Purchased Assets free and clear of any and all** (i) liens (including any liens as that term is defined in section 101(37) of the Bankruptcy Code) and encumbrances relating to, accruing, or arising any time prior to the Closing (collectively, the "Liens"), and (ii) all debts (as that term is defined in section 101(12) of the Bankruptcy Code) arising under, relating to, or in connection with any act of the Debtors or claims (as that term is defined in section 101(5) of the Bankruptcy Code), **liabilities, obligations**, demands, guaranties, options in favor of third parties, rights, contractual commitments, restrictions, interests, mortgages, hypothecations, charges, indentures, loan agreements, instruments, collective bargaining agreements, leases, **licenses**, deeds of trust, security interests or similar interests, conditional sale or other title retention agreements and other similar impositions, imperfections or restrictions on transfer or use, pledges, judgments, claims for reimbursement, contribution, indemnity, exoneration, infringement, products liability, alter ego liability, suits, defenses, credits, allowances, options, limitations, action, causes of action, choses in action, rights of first refusal or first offer, rebate, chargeback, credit, or return, proxy, voting trust or agreement or transfer restriction under any shareholder or similar agreement or encumbrance, and matters of any kind and nature, whether arising

prior to or subsequent to the commencement of the Chapter 11 Cases, whether known or unknown, legal or equitable, matured or unmatured, contingent or noncontingent, liquidated or unliquidated, asserted or unasserted, and whether imposed by agreement, understanding, law, equity or otherwise (including, without limitation, rights with respect to Claims (as defined below) and Liens (x) that purport to give to any party a right or option to effect a setoff against, or a right or option to effect any forfeiture, modification, profit sharing interest, right of first refusal, purchase, or repurchase right or option, or termination of, any of the Debtors' or the Buyer's interests in the Purchased Assets, or any similar rights, if any, or (y) in respect of taxes, restrictions, rights of first refusal, charges or interests of any kind or nature, if any, including, without limitation, any restriction of use, voting, transfer, receipt of income, or other exercise of any attributes of ownership) (the items in this clause (ii), collectively, the "Claims", and together with the Liens and other interests of any kind or nature whatsoever, the "Claims and Interests"), relating to, accruing, or arising any time prior to entry of this Order), with the exception of any such Claims and Interests that are expressly assumed by the Buyer as Assumed Liabilities solely to the extent set forth in the Purchase Agreement, including, for the avoidance of any doubt, Cure Amounts or any other obligations arising under the Assumed Contracts solely to the extent set forth in the Purchase Agreement.

Emphasis added.

12. Neither the Private Sale Order nor the Stalking Horse Agreement specifies whether the Debtors proposes to assume and assign any agreements with Dr. Reddy's or the specific Assets the Debtors intend to sell. However, to the extent the Debtors ultimately attempt to assume agreements with Dr. Reddy's or sell assets and licenses obtained from Dr. Reddy's, they cannot do so in a manner that expands the Debtors' rights through the Sale. *See, e.g. Claybrook v. Consol. Foods, Inc. (In re Bake-Line Grp., LLC)*, 359 B.R. 566, 570 (Bankr. D. Del. 2007) ("A debtor may not increase its rights to property through the filing of a bankruptcy petition."). The Debtors may sell, pursuant to Code section 363, only those property rights it held as of the bankruptcy filing. *See, e.g., In re Whitehall Jewelers Holdings, Inc.*, No. 08-11261 (KG), 2008 WL 2951974, at *4 (Bankr. D. Del. July 28, 2008) (debtor could not sell inventory under section 363 prior to demonstrating that it was property of the estate).

13. When Dr. Reddy's transferred assets to EPI under the MinoLira Transaction Documents and Cloderm APA, Dr. Reddy's retained certain rights in and related to the transferred assets. For example, under section 3.01 of the MinoLira APA, Dr. Reddy's Ltd. transferred certain rights related to the sale of the pharmaceutical product MinoLira to EPI in exchange for, among other things, "Milestone Payments" based on EPI's future sales of MinoLira. *See* MinoLira APA § 3.01.

14. Further, Dr. Reddy's transfer of intellectual property to EPI under the MinoLira Transaction Documents and Cloderm APA was not absolute. Dr. Reddy's retained various rights to the intellectual property by limiting the use, geographic territory, or transfer or manufacturing rights granted to EPI. The rights not transferred to EPI were retained by Dr. Reddy's.

15. Any transfer of the Debtors' assets obtained through an agreement with Dr. Reddy's must be subject to the rights that Dr. Reddy's retained in those assets, including the rights to Milestone Payments and various license rights. Allowing the Debtors to do otherwise would impermissibly expand the Debtors' property rights by *de facto* selling Dr. Reddy's rights along with the assets.

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WHEREFORE, Dr. Reddy's objects to the Sale to the extent the Debtors attempt to assume and assign any assets, including licenses, obtained under agreements with Dr. Reddy's, including the MinoLira Transaction Documents and Cloderm APA, free and clear of Dr. Reddy's existing and ongoing rights related to such assets, and requests such other and further relief as the Court deems just and proper.³

Dated: August 28, 2023
Wilmington, Delaware

COLE SCHOTZ P.C.

/s/ Andrew J. Roth-Moore

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Counsel to Dr. Reddy's

³ Dr. Reddy's reserves the right to amend or supplement this Limited Sale Objection or the Limited Cure Objection, including to the extent the Debtors seek approval of any additional or amended Sale Orders.

CERTIFICATE OF SERVICE

I hereby certify that on August 28, 2023, a copy of this **Limited Objection and Reservation of Rights of Dr. Reddy's Laboratories Ltd. and Certain Affiliates to the Debtors' Sale** will be served on the following parties in the manner described below:

Via First Class Mail:

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Via Electronic Mail:

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