Best Practices for Corporate Venture Capital & Strategic Investment Programs

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Agenda

• Venture Capital and Corporate Venture Capital Overview
• CVC Governance and Structure
• Investment Terms
• Risk Mitigation
• Exit Planning
Venture Capital and Corporate Venture Capital
What is Venture Capital (VC)?

• Primary goal of financial VC investors is financial return
• Typical structure:
  – Preferred stock
  – Special stockholder rights
• Other structures:
  – Convertible debt
  – Other convertible securities (e.g., SAFEs, warrants)
What is Corporate Venture Capital (CVC)?

- Investment in startup companies by established companies
- Investments focus on both strategic/commercial and financial goals
- CVC goals for making investments
- Company goals for taking CVC
Key Differences with Financial VC

- Greater variety of positive outcomes
- Lower level of control sought
- Not subject to typical 10-year VC fund structure
- Relatively limited financial exposure
- Focus on side letter agreement
- Commercial agreements
CVC Trends: Investments

CVC investment accounted for approximately 25% of all VC investment in the first half of 2021.

Source: CB Insights, The 2021 Mid-Year Global CVC Report, July 2021
CVC Trends: Exits

Source: CB Insights, The 2021 Mid-Year Global CVC Report, July 2021
CVC Governance and Structure
CVC Program Organization

• CVC program structuring
  – Legal structure
  – Placement within organization

• Key features of a CVC program
  – Decision-making process and authority
  – Capital allocation
  – Balancing financial vs. commercial goals
  – Compensation arrangements

• How structure impacts investment process/company relationships
Investment Terms
Typical VC Financing Terms

• Economic
  – Dividends
  – Liquidation preference
  – Antidilution protection
  – Pro rata rights
  – Registration rights
  – Rights of first refusal on secondary transfers

• Information
  – Reporting
  – Inspection

• Governance
  – Board
  – Voting
Typical VC Financing Documents

- Stock Purchase Agreement
- Certificate of Incorporation
- Investors’ Rights Agreement
- Voting Agreement
- Right of First Refusal and Co-Sale Agreement
- Others:
  - Letter agreement
  - Director indemnification agreement

- Similar structure for CVC investments, with focus on specific provisions and on side letter
Key CVC Side Letter Terms

- Basic information rights
- “Major Investor” status
- Public announcements
- Not a “Competitor”
- Right to conduct activities
- Board observer
- M&A rights
- Rights with respect to competitor financings
- Rights with respect to competitor commercial transactions
- RFP rights
- Branding
- MFNs
- Compliance / regulatory covenants
- Put rights
- Drag-along carve-outs *(preferably needs to go in Voting Agreement)*
- Extended survival periods
- Residuals clause
IP Disclosure and Contamination

- CVCs and companies must address issues regarding the disclosure of technical IP and competitive and business information
  - Concern during due diligence and post-investment
  - CVCs need to preserve freedom
  - Companies need to protect confidential information/IP

- Key considerations:
  - “Competitors”
  - Clean teams
  - Redaction/withholding
  - Board observers vs. directors
  - Residuals clauses
Exclusivity and Notice Rights

• CVCs may want exclusivity or visibility with respect to strategic transactions
• Companies want to limit restrictive exclusivity, notice, and negotiation rights
• Key considerations:
  – Scope of exclusivity and notice rights
  – Veto rights over exits
  – Negotiating with multiple CVCs who want equivalent rights
Deal Timing

- CVC investment thesis may be tied to commercial relationship, but the timing of entering into commercial agreement may not align with the financial investment
- Timing considerations
- Allocating risk of failure to reach agreement
Risk Mitigation
Risk Mitigation Concerns

• Potential reputational damage to CVC investor
• Key compliance risk areas include:
  – Anti-bribery, anti-corruption and anti-money laundering
  – Data privacy and data security
  – Business dealings with sanctioned entities or countries
  – #metoo issues
  – Jurisdiction-specific issues (e.g., local workers’ rights laws)
  – Tech industry scrutiny
  – Thin line between founder puffery and fraud

• Highly regulated investors have additional concerns
Risk Mitigation Techniques

- Due diligence
- Investment documents
- Quick path to exit
- Stay informed
- D&O matters
- Regulatory provisions
Board Service

- Director obligations
  - Duty of loyalty
  - Duty of care

- Board observer
  - Contractual confidentiality obligations
  - De facto director doctrine

- Indemnification
  - Indemnification agreements
  - D&O coverage
Exit Planning
Thinking Ahead for Exit Transactions

- Planning for positive scenarios
- Planning for distressed scenarios
- Disclosure considerations for public company CVCs
- Special considerations for CVC directors