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Partnering with Larger Corporations

**Plug & Play Tech Center iEXPO
October 28, 2010**

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Reasons to Work With Corporate Partners

- Larger corporations are important partners in the company building process.
- The investment profile and unique incentives for corporates allow for greater flexibility in negotiating some terms that can serve the interests of the entrepreneur, but only if handled with the right strategy.
- It is important to fully assess each parties objectives and set terms that avoid points of conflict in the future.
- Conflicts of interests issues often arise where you should monitor potential corporate governance issues that may involve the corporate partner.

Board Seat

- Generally, CVCs will take a board observer position in lieu of a Board seat due to potential conflicts of interest.
- For VCs, one concern is whether access to company information by the CVCs may be used against the company in customer negotiations or provided to competitors of the Company.
- If the VC is aware of potential concerns vis-à-vis competitors, it is important to negotiate limitations on access to information in the event the Board of Directors determines that the disclosure of the information may create a conflict of interest.

Right of First Refusal

- CVCs are often concerned that the company will be acquired by a competitor, especially in cases where they have co developed technology with the company that ultimately would be owned by a competitor.
- As such, CVCs often ask for a right of first refusal to purchase the company in the event the company receives an offer from a potential suitor.
- From a VC perspective, this may have a chilling effect on potential offers since acquisition candidates will not want to make an offer that can be topped by an entrenched CVC.
- As a compromise, there are a couple of alternatives, including, a right of first negotiation, which provides that the CVC has the right to receive information regarding the offer and to make an offer, but the company is under no obligation to accept the offer, and a right of notification, which provides the CVC a more limited right to receive an notification that an offer has been received.

Protective Provisions

- If the CVC will be a substantial percentage of a particular round, the VC should confirm whether each series of preferred stock have a separate approval right for major corporate actions such as approvals for any future round of financing or a sale of the company.
- If there is a series approval, the CVC may have the ability to block the next round or a sale of the company.
- If this is the case, consider a provision that would combine the approval right with the prior round in order to dilute the voting power of any substantial voting block the CVC may hold, to the extent you are concerned about any blocking rights.
- In addition, adjust any supermajority voting thresholds that may provide the CVC with additional leverage over the approval process if you are concerned about any potential conflicts in the future.

Registration Rights

- While VCs are generally less concerned about registrations rights since it is less likely they will need to rely on S-3 registration rights (even though subject to the Rule 144 volume limitations they can distribute their shares directly to limited partners), CVCs as corporate funds generally do not have the option to distribute a large block of shares to limited partners.
- CVCs are more focused on S-3 registration rights since they will need to rely on the S-3 registration rights to exit the investment.
- As such, VCs should plan for additional potential costs and share overhang for the company following the IPO that may impact the company's financial and stock performance and thus impact the timing of the VCs distribution of its shares.
- To the extent this is an issue, consider trying to limit the obligations of the company in the registration process in the financing documents negotiated at the time of the investment.

MFNS/Covenant Not to Sue/Exclusivity

- The most significant transaction document that is unique to many CVC investments is the commercial agreement that is negotiated in concert with the investment terms.
- Since the commercial agreement covers most of the strategic value proposition, the execution of the commercial agreement should be a closing condition.
- Nonetheless, it is often necessary to close the investment before the commercial arrangement can be finalized.
- In these cases (and for some CVCs as a matter of standard procedure), a side letter is signed as part of the financing that includes the commercial terms or additional requirements.
- These requirements often include the following.
- A "most favored nations" provision typically provides that the company agrees to provide the CVC with the most favorable pricing or terms as provided to similar customers or partners.
- The covenant not to sue provides that to the extent the company and the CVC are co-developing products together, the company agrees to not sue the CVC for patent infringement.
- Exclusivity provisions may limit investments from or partnerships from competitors of the CVC.
- All of these provisions should be considered in view of whether the value proposition of the relationship warrants providing these benefits to the CVC and its affiliates.

Warrants

- CVCs often request warrant coverage in the range of 20-30% as an equity kicker for the strategic value of their partnership with the company.
- This can be in addition to warrant coverage provided to all of the investors.
- VCs should consider milestone limitations so that the warrant is triggered upon the company reaching a certain revenue threshold from the CVC's affiliates as a means to ensure that the equity kicker is tied to tangible benefits for the company.

Publicity

- CVCs often require that any disclosure of the fact of or terms of their investment require their prior approval.
- Generally, VCs would like to use the announcement of an investment from a prominent CVC as a marketing event for the company since it signals acceptance by the larger technology players.
- VCs should define at the outset what can and cannot be disclosed within reason in order to manage expectations on both sides.