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More Than Money: Best Practices for Corporate Venture Capital Investing

By Claudia Golden, David Zampa & Asher Funk

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Corporate venture capital arms don't have the same priorities as traditional venture capital firms, and that distinction can make all the difference for long-term value. Here is a road map to navigating these differences effectively.

Adopt a Written Operating and Governance Charter

One of the first steps a corporate venture capital program should take is to adopt a written operating and governance charter. A clear charter helps ensure a cohesive investment strategy and alignment on objectives. The charter may address, among other things:

- Strategic focus by industry, product or service;
- Financing stage and target investment size (e.g., Seed through Series C; typical initial investments of $X–$Y; flexibility for followon investments; minority, noncontrolling positions); and
- Exclusions (such as direct competitors where sensitive information sharing would be unavoidable, or areas presenting heightened regulatory or reputational risk).

Tailor Investment Terms to Your Strategic Objectives

Corporate venture investors operate across a spectrum of objectives—from gaining insight into emerging technologies to positioning for a potential acquisition. These objectives should drive key investment terms, including board representation, information rights, and consent or blocking rights.



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(l-r) Claudia Golden, Dave Zampa and Asher Funk of Alston & Bird.

For example, if the primary goal is insight and collaboration, enhanced information rights and structured interaction between R&D teams may be most important. If the goal includes preferential commercial terms, those terms should be clearly documented in the definitive agreements. Where a potential acquisition is contemplated, rights such as an option to acquire, or at least a right of first offer or right of first negotiation with respect to an acquisition, may be appropriate.

Focus on Key Issues When CoInvesting

In many cases, a corporate venture investor will participate as a coinvestor rather than lead a financing round. In that role, the lead investor typically drives negotiation of terms applicable to all investors. As a result, diligence on the lead investor—its track record, industry knowledge, approach to competitive investments, and experience working with corporate venture investors—is critical.

At the same time, corporate venture investors bring unique value, including industry expertise, commercial channels, regulatory experience and brand recognition. These strengths should inform the issues negotiated for the corporate venture investor's specific benefit, often through side letters.

While a coinvestor can rely on much of the lead investor's general corporate and capitalization diligence, independent diligence should focus on matters critical to the corporate venture investor's strategy, such as product development status and regulatory pathways (including FDA approval).

Evaluate How Closely to Tie Commercial Arrangements With Investment

Corporate venture investors should realistically assess how closely commercial arrangements with a company should be tied to the corporate venture investor's investment in the company. Key questions include whether commercial agreements must be finalized at closing or whether preliminary terms are sufficient, and whether developments under those commercial agreements should trigger investment related rights.

In practice, commercial arrangements are often finalized after the investment closes, in part to accommodate the timing pressures of the financing. One way to address this dynamic is to structure the corporate venture investor's investment in tranches, creating economic incentives for the company to prioritize the commercial relationship postclosing.

Consider the Appropriate Level of Management Involvement

In some cases, declining a board seat may better serve the corporate venture investor's interests. Directors of a Delaware corporation owe fiduciary duties to the company and all of the company's stockholders, including common stockholders, regardless of who appointed the directors.

Board observer rights, combined with tailored information rights—often set out in side letters—can provide access to information and meetings without the fiduciary obligations associated with board membership.

Be Mindful of Antitrust Considerations

Corporate venture investments can raise antitrust concerns, particularly when investing in multiple companies within the same industry. For example, appointing the same representative to the boards of competing companies could result in prohibited interlocking directorates. In addition, you should involve your antitrust colleagues if the commercial agreements will include sensitive provisions such as exclusivity, most-favored-nation protections or prohibitions on the company taking an investment from or entering into commercial relationship with competitors of the corporate venture investor.

Account for the Strategic Investor's Unique Position in VC Terms

Corporate venture investors often require terms that differ from those sought by traditional financial investors. For example, carveouts may be necessary in dragalong provisions to avoid obligations to amend or terminate existing commercial agreements or agree to restrictive covenants such as noncompetes or nonsolicitation provisions.

Additional rights may include limitations on the company entering into commercial arrangements with the corporate venture investor's competitors, enhanced information rights and/or rights of first offer or negotiation for certain

transactions (for example, sale of the company or the company entering into certain kinds of commercial arrangements). Given the importance of talent, corporate venture investors should also seek to avoid provisions that restrict future solicitation or hiring of company employees.

Maintain Confidentiality—Including Internally

Corporate venture investors should limit internal dissemination of a company's confidential information and implement processes to maintain appropriate internal separations. Doing so reduces the risk that confidential information could constrain the corporate venture investor's future business activities.

Similarly, caution is warranted when sharing the investor's own confidential information with the company, as that information could later be disclosed in diligence conducted by other investors or potential acquirors.

Prepare a Standard Side Letter

Many corporate venture and financial investors use side letters to document rights and obligations that sit outside a company's core governing documents. For corporate venture investors, side letters offer flexibility to tailor provisions without broadly disclosing them to other investors or risking such provisions being amended without the corporate venture investor's consent.

Common side letter provisions may include exemptions from competitor definitions, corporate opportunity doctrine disclaimers, board observer rights, enhanced information rights, major investor status, rights of first offer or negotiation, dragalong carveouts and preliminary commercial terms where a full commercial agreement cannot be finalized prior to closing of the corporate venture investor's investment in a company.

Conclusion

A thoughtfully structured corporate venture capital program can deliver strategic insight, commercial opportunity and longterm value. Clear governance, disciplined execution and careful attention to regulatory and competitive considerations are key to achieving those goals.

Claudia Golden *is counsel in Silicon Valley, California, with Atlanta-based Alston & Bird, advising private equity funds and other investors, as well as companies seeking outside investment or to be acquired.*

David Zampa, *is a partner with Alston & Bird in Chicago, representing* medical device clients, life sciences and technology clients, as well as health care providers and health care real estate and infrastructure providers in both public and private M&A transactions, spin-offs, joint ventures and other strategic endeavors.

Asher Funk, *is a partner in Chicago Alston & Bird, advising* health care providers, suppliers and private equity investors on high-impact transactional, fraud and abuse, reimbursement and regulatory compliance matters.

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