Corporate venture capital ("CVC") is on the upswing and playing an increasingly important role in venture finance and the strategies of emerging tech companies. The recent Q4 Venture Monitor report showed that in 2018, CVC groups participated in 1,443 venture capital deals, or 16.1 percent of all the U.S. transactions. CVC transactions raise a range of special considerations, both from the perspective of the CVC as well as the issuing company and its existing shareholders. This CLE will examine a select set of issues that arise in this context with the goal being to improve the general awareness of these issues and to provide a framework for working through them efficiently in the context of quickly moving and often complex financing transactions. More specifically, the panel will focus the discussion on the following three topics: control rights, information rights, and special notice and other rights related to an acquisition of the company.

General Overview

Companies raising CVC consistently express the concern that the CVC investor may not look at the investment in the same manner as traditional venture capital firm would where the sole measure of success is return on investment. This is particularly true with strategic CVC—that is CVC groups that invest because of a clear strategic interest but for which the CVC would not make the investment. In such transactions there will frequently be commercial agreements that confer specific rights on the CVC, and that are critically important to the investment rationale of the CVC. These need to be negotiated with care by both the CVC and the company to ensure that the rights granted do not have downstream consequences to the company that could impair shareholder value in a variety of circumstances. While perhaps not as pronounced, many of the same concerns could be said to apply for CVCs for which the incentive is ostensibly a straight return-on-investment similar to any venture capital firm. These non-strategic CVC's may not require any commercial terms and conditions beyond what a traditional VC firm would require. But nonetheless, questions may linger as to whether a non-strategic CVC's interests can ever be as pure as a traditional VC firm due to the potential for conflict of interest. The practical concern this raises is that in a variety of circumstances, a CVC acting in its own best interests, and irrespective of whether it is a strategic CVC or not, may not act in a manner that is in the best interests of the company and its other stockholders. The implication is that certain CVCs are likely to be conflicted in certain scenarios by the very nature of who they are. Conceptually this inherent conflict is not unlike the conflict that a financial investor may confront in pricing an inside round. Try as it may to be objective and fair, the CVC's institutional judgment may simply be impaired when it comes to certain decisions. So even in the absence of a separate commercial agreement that a strategic CVC would require, this dynamic makes CVC transactions more complicated than a traditional VC transaction. This panel will examine the different aspects of a CVC transaction that make impact the complexity of the financing process, more

1 © Jon Gworek, Morse, Barnes-Brown & Pendleton, P.C., 2019.
2 For strategic CVC, the strategic interest takes many forms. At the far extreme, the CVC might be interested in an investment which gives the CVS a path to control and ultimately acquire the company. Alternatively the strategic benefit could be in the form of a commercial agreement such as a supply or distribution agreement. The strategic benefit could also be simpler and more indirect in nature than an acquisition or commercial agreement, such as an opportunity to invest in a company, which if successful, will increase demand for the investor’s products or services. It might even be a sufficient enough benefit that the investment allows the CVC access to information and insight into an emerging technology or product category by virtue of its lens as an investor in the issuing company.
3 These non-strategic CVCs have investment groups that operate very much like financial investors and may even be separated within the organization so that the interests of the strategic investor’s R&D or other operating business units will not impact the investment strategy of the corporate venture team.
specifically: control provisions and in particular the ability of a CVC to exercise "negative control"; access
to proprietary and confidential information through information rights and participation at meetings of the
company's board of directors; and additional commercial agreements and rights including in connection
with an M&A event.

Control Rights

Investors in VC transactions can influence corporate actions through either “positive control” rights or
“negative control rights”. Positive control rights allow investors to make certain major decisions outright
and cause the company to take actions, whereas “negative control” rights don't allow the investor to
impose their decisions on the company, but do allow the investor to block certain corporate actions by
withholding their consent. It is unusual for a CVC to obtain positive control rights. Such rights would
typically be limited to situations in which the CVC is the lead and dominant investor in a round, or through
a series of rounds, and by virtue of this has the ability to control the board of directors and the stockholder
votes required for most major corporate decisions. In such situations, the main issue confronting the
company will be a desire to ensure that this level of positive control does not allow the CVC to make
decisions that could compromise shareholder value, including by directing an opportunity to itself or an
affiliate. Delaware corporate laws, and the fiduciary duties imposed on controlling stockholders, offer
significant protection and protections to minority stockholders in these circumstances. But rather than
relying on such fiduciary duties, it is prudent to also seek additional contractual protections in the
financing documents, such as supermajority voting thresholds that apply in a variety of circumstances
(financing, M&A) in the even the company is to be sold to the CVC or an affiliate.

It is more typically the case that negative control rights are at issue in a CVC financing, and much care,
time and attention is often applied to negotiating these rights in a manner that satisfies the CVC’s
requirements and are commensurate with the level of financial commitment the CVC is making, while at
the same time ensuring that the negative control rights of the CVC can’t be used in ways that could impart
shareholder value. The main provision in a venture financing transaction that invokes concerns about
such negative control is the shareholder blocking rights in the charter. This provision requires that some
percentage of the investor stockholders, either by class or as individual series of preferred, consent to a
number of corporate actions in order for them to be taken. The list of actions typically include most
fundamental transactions that a company might consider including, for example, financings, a sale of the
company or its assets, stock dividends and recapitalizations. When a CVC owns a majority of a series, if
that series has a majority blocking right over these types of actions then the CVC is in a position to
unilaterally block these actions. Recent Delaware case law suggests that even stockholders exercising
negative control need to be increasingly mindful of fiduciary duties, and this again affords some comfort to
the company and the other stockholders. Care is usually taken on the company side to ensure that this is
not the case. In order to avoid this scenario while still providing the investors a level of customary control,
the company may attempt to greatly cut back on the blocking rights that the CVC series of preferred
enjoys, or to structure the block as a class right where all preferred series are combined for voting
purposes, thereby reducing the influence of the CVC and allowing the company a path forward to
approval without them.

While the stockholder level blocking rights are an obvious place to focus in managing and containing CVC
control rights, there are a number of other provisions in that must be aligned with the blocking rights
provisions. These provisions can allow a strategic investor another level of control, and in some cases
depending on the nature of the transaction and the specific actions that are required to consummate the
transaction, levels of control that are tantamount to the very control rights that were carefully avoided
through in the blocking rights provision. For example, if a CVC controls a series of preferred with no
explicit blocking rights, but the consent of a majority of the series is required to waive anti-dilution
adjustment rights, then the CVC may effectively have a veto over a financing where the waiver of anti-
dilution protection is a condition to the new investment. These secondary provisions need to be carefully
drafted and negotiated as well, and also need to contemplate the DGCL 242(b)(2) to the extent possible to ensure that the intent of the parties is achieved. Care also has to be paid to the ancillary financing documents where rights may only be amended or waived with the consent of a majority of a particular series. So while balance of control and voting rights may be squarely addressed in the stockholder blocking provisions of the charter, the company and investors must also pay close attention to a variety of other provisions that might inadvertently create unintended blocking leverage.

**Information Rights**

Another aspect of a CVC transaction that typically draws a lot of attention is the extent to which the CVC will access to highly confidential or proprietary information of the company. The CVC may have the right to this type of information through contractual information rights or through the right to participate in meetings of the board of directors as either a director or an observer. The company may not be comfortable affording the CVC the same level of access to information as other financial investors for two main reasons. First, there may be risk that CVC’s access to this technical or business plan information may leak back over into the R&D or operations side of the CVC and potentially harm the company as a result. Second, there is often concern that a matter of strategic importance may arise that requires board level deliberation and which poses a direct or potential commercial conflict between the company and the CVC. Examples include a possible trade sale or other strategic alliance with a competitor of the CVC, or a modification to any existing relationship that may exist with the CVC that was implemented either as part of or prior to the strategic investment. In these situations, the company often seeks to have the discretionary authority to withhold certain types of information from the CVC and its representatives that would otherwise be the subject of information rights or board discussions and deliberations.4 This translates to the right on behalf of the company to be selective about information that it shares with the CVC, and the ability of the company to excuse the CVC representative from meetings of the board of directors when necessary.

**Additional CVC Commercial Rights and Rights of First Offer**

A strategic CVC round will typically have some commercial agreement between the CVC and the company that is a condition to the investment and that allows the strategic CVC some ability to leverage the investment in a manner that goes beyond a financial return. This can take as many forms as the creative business or corporate development officer can imagine, but most typically involves a license on technology, a right to distribute the technology or at the extreme a right to buy the company. While rights to buy a company are unusual, corporate investors will often insist on at minimum some right to advanced notice regarding a prospective sale of the company so that the CVC may at least participate in a negotiation or possible bidding process before the company is sold.5 This type of provision should be manageable to the company provided that is drafted in such a way so that it does not interfere with a process or effort that might be run to sell the company. For example the period of the right to negotiate needs to either be short enough or have some escape clause that would allow the company to enter into an exclusive no-shop with another possible acquirer on customary terms.

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4 The company may also try to control the flow of information that is delivered to the CVC by very narrowly circumscribing who may have access to the information. When CVC has operations that cleanly separate out the investment group from core operations, the company may request that the information be contained within the investment group and be used for purposes of monitoring the investment only.

5 Officers of the CVC may say that while they are not looking to interfere in an M&A process, for internal reasons they can not risk the scenario they may pick up the WSJ one morning and read about the sale of the company after the fact.