PRIVATE EQUITY AND VENTURE CAPITAL COMMITTEE // FALL 2024

PREFERRED RETURNS

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Business Law Section

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Delaware Beware: Should VC and PE Lawyers Reevaluate Incorporation Strategies for Tech Firms?

Anat Alon-Beck

Associate Professor, Case Western Reserve University School of Law

Chair, Academic Subcommittee, American Bar Association Private Equity and Venture Capital Committee

When Elon Musk recently challenged the wisdom of incorporating in Delaware, it ignited a debate that resonated far beyond his own companies. His comments, following the Delaware Court of Chancery's decision in Tornetta v. Musk—which invalidated his unprecedented $55.8 billion compensation package—have led many to wonder: Are we witnessing a pivotal shift in corporate governance and the competitive landscape among states?

I have personally received numerous calls from corporate lawyers across the United States, all asking the same question: Should lawyers representing venture capital (VC) and private equity (PE) firms—who often default to recommending Delaware for incorporation—now reconsider this standard advice?

Delaware has long been the go-to jurisdiction for corporate incorporation in the U.S., not only for publicly traded companies but also, as my latest research, Incorporating Unicorns: An Empirical Analysis, reveals, for large privately held firms or "unicorns." Yet, could recent legal developments and political debates suggest that Delaware's dominance is no longer as unassailable as it once was? And for unicorns—privately held companies valued at over $1 billion—might this newfound uncertainty prompt a rethinking of corporate governance and state competition strategies?

The Unique Position of Unicorns in Delaware

Recent empirical data from my research reveals that a staggering 97% of unicorns are incorporated in Delaware, a concentration far higher than any other business category. This overwhelming preference gives Delaware a unique and powerful role in shaping corporate governance for these market-moving entities. For comparison, while 79% of public companies and 67% of early-stage venture-backed firms choose Delaware, only 2% of small private enterprises incorporate there. This discrepancy raises intriguing questions: Why are unicorns so uniquely attracted to Delaware? And should that attraction remain unquestioned?

Unlike smaller firms, unicorns are large enough to have a significant public impact but remain in the private domain, often resisting traditional exit strategies like an initial public offering (IPO). This distinct characteristic means that unicorns present a unique set of challenges and considerations for corporate governance and regulatory oversight. As these firms continue to grow and evolve, Delaware's role as their preferred incorporation venue will only increase in importance. However, some critics are questioning whether recent legal and political developments are prompting a reconsideration of whether Delaware is the best choice for these entities.

Delaware's Evolving Legal and Political Landscape

In my new article, Delaware Beware, I delve into the factors that have long contributed to Delaware's appeal as the premier jurisdiction for corporate incorporation. Its reputation has been built on business-friendly laws, the specialized Court of Chancery, and a stable legal infrastructure that provides predictability and consistency. However, the recent controversy around the Delaware Court of Chancery's recent decision in West Palm Beach Firefighters' Pension Fund v. Moelis & Co. has been deemed controversial in corporate law circles. The Moelis decision has been interpreted by some as an indication of Delaware's growing willingness to scrutinize corporate governance practices more closely, a shift that some see as moving away from its traditionally management-friendly stance.

In a significant development for the startup ecosystem, Delaware Governor John Carney recently signed into law a new measure that permits shareholder rights in venture-backed startups to be redefined by private "secretive" contracts. This legislation arrives at a pivotal moment, as corporate governance rapidly evolves and calls for a renewed focus on shareholder protections.
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PREFERRED RETURNS

// Fall 2024 EDITION

Message from the Chair

And just like that another summer is behind us and we find ourselves gathering again for the Fall Meeting of the Business Law Section. The Private Equity and Venture Capital Committee has been hard at work preparing topical content to deliver another great meeting for our membership. Kicking it off bright and early will be our Committee's CLE program hosted by our Academic Subcommittee. Please join chair Anat Alon-Beck for "Latest Contractual Innovations in the Venture Capital/ Private Equity World " at 8am on Thursday, September 12th. The CLE promises to be very interesting and offers a panel discussion of innovations in contractual terms impacting the venture capital and private equity industries. Panelists will include both academics to address the legal impetus for the innovations and top industry practitioners implementing them.

Immediately following the CLE join the PEVC Committe for our Membership Breakfast from 9-9:30 in the Marriot Grand Ballroom, 8&9, Lobby Level. All are welcome to attend, new, existing and prospective members alike. It's a great opportunity to meet our Committee' leadership, catch up with fellow Committee members and learn about opportunities to get more involved.

Our main PEVC Committee Meeting will follow breakfast at 9:30 on Thursday monring, and we are looking forward to seeing everyone there. We'll have the always anticipated PEVC market update from our friends and sponsors Houlihan Lokey, learn about the Angle Capital Association's new model convertible note and get a brief update on the most talked about subject at our Spring Committee Meeting, Moelis from Lisa Stark, co-chair of our Jurisprudence subcommittee.

Be sure to check out our subcommitee meetings, a full schedule of which are outlined on page 6, for engaging discussions and topical content. Also be sure to attend some of our co-sponsored CLE programs including the Essentials Program: Moelis and the Amendments: Where to We Go from Here? Which is being presented by the Corporate Governance Committee, and co-sponsored by PEVC and Mergers & Acquisitions. This special program will be available 10:00 - 11:30 on Friday both live in the Marriott Grand Ballroom 5, Lobby Level and online through the meting website.

Beyond the formal meetings and sessions, there is still more to look forward to. The PEVC Committee dinner once agian SOLD OUT. If you're one of the lucky ones to get a ticket we look forwad to seieng you at Rustic Root. For those who did not get a ticket and are still looking for one, please feel free to reach out about joiing the waiting list.

Last but certainly not least, a huge thank you to our sponsors, without who we woulnd't be able to host events like this. Houlihan Lokey, Cogency Global and Kroll, each helped to make this event possible, and again to Houlihan Lokey for being so generous sharing their content.

Thank you to all of our meeting and panel participants for sharing their knowledge with us. Thank you to our leadership for all of their efforts, and thank you to everyone who helped pull together the Fall Edition of Preferred Returns but especialliy Lawrence Dempsey and Sarah Anishik the co-editors of Preferred Returns, for all of their efforts turning out another great edition.

I look forward to seeing you soon!

Brett Stewart
Chair

Brett Stewart, McMillan LLP

FAQ: How to Receive SSBCI Government Funding for Your Investment Fund

Matthew Bobrow, Counsel, Nixon Peabody LLP, New York, New York

What does SSBCI mean?

The State Small Business Credit Initiative (SSBCI) is a nearly $10 billion federal program to support small businesses and entrepreneurship in communities across the United States by providing capital and technical assistance to promote small business stability, growth, and success. As of 2023, over $531 million total was expended to support underserved businesses. 43% were minority-owned and 32% were women-owned.

Where did SSBCI funds come from?

Congress first established the SSBCI program in 2010 to promote small business entrepreneurship and provided $1.5 billion in funding for state programs intended to expand access to capital, particularly for small businesses in underrepresented regions and communities following the Great Recession after the financial crisis.

The SSBCI program was reauthorized and expanded by President Biden's American Rescue Plan Act on March 11, 2021, as part of a pandemic relief package.

How does the SSBCI program work and what is the goal?

The federal government does not distribute SSBCI funding directly to small businesses. Rather, it provides SSBCI grant money to participating US states, territories, and tribal governments for those jurisdictions to create tailored programs that offer funding to small businesses and entrepreneurs through equity/venture capital, loan participation, loan guarantee, collateral support, and capital access programs. Those governments then administer the funds as they decide within the parameters set out by the federal program (and the law that authorizes it).

SSBCI investors associated with such government entities (e.g., the State of New York) look to transact with a company that fits certain eligibility standards (e.g., location, number of in-state employees, revenue amounts).

Businesses can apply for SSBCI funding by determining which types of funding programs their state offers and contacting the relevant program offices. While this structure allows each of the states to create programs to address barriers to capital access specific to their jurisdictions, it also means the SSBCI programs all have different objectives and different requirements for eligibility.

Part of the goal is to incentivize private capital to be transacted alongside the public SSBCI dollars so that the amount allocated by the government to the SSBCI program has a much bigger effect on the small SSBCI-eligible companies by bringing in private capital (usually to minority owned local businesses) that can reach 10:1 private dollars for every single public dollar expended.

In addition to capital access, SSBCI funding unlocks access to critical technical assistance (e.g., legal, accounting, or financial advisory services) through SSBCI's formula Technical Assistance Grant Program and the SSBCI Investing in America Small Business Opportunity Program. The Minority Business Development Agency at the US Department of Commerce, through its Capital Readiness Program, also supports technical assistance to improve access to capital, including in traditionally underserved communities, with SSBCI funding.

More information can be found on the US Department of Treasury website.

How do I find out if I am eligible for SSBCI funding?

To check if your business is eligible for SSBCI funding in New York or to check what SSBCI programs exist in New York, you could fill out the online form located HERE. If you are located in another state, please contact us for assistance.

What is the status of SSBCI funding with respect to venture capital investments?

Data for SSBCI-supported venture capital programs is preliminary—but as of July 2024, 54 venture capital funds have received an SSBCI capital commitment, of which 36 are owned/managed by diverse or underserved fund managers or have an investment strategy that includes a focus on supporting companies with underserved founders/leaders.

What are common terms of SSBCI investors?

The SSBCI investor will usually invest through a sidecar entity that has a sperate partnership agreement and separate terms/conditions specific to the state SSBCI fund partnership form. The SSBCI investor's sidecar partnership agreement will be based on the SSBCI investor's form and should largely align the key terms with the main fund partnership agreement. For example, an SSBCI investor is usually comfortable paying the same amount of management fees as any other main fund investor. The SSBCI investor will usually try to have the same economic terms as the main fund investors except where not permitted by law.

Deviations between the sidecar and the main fund terms will be based on (1) requirements to comply with SSBCI rules, and (2) supplemental rights needed to put the SSBCI investor into the same position as a main fund investor. Examples of terms that may need to be changed to comply with SSBCI rules include (i) maintenance of a public/private investment ratio, and (ii) equity investments cannot be used to pay fund-level borrowing costs. The investment ratio is an important point and a key part of the SSBCI program. This can be anywhere from 1:1 to 10:1.

Separate from SSBCI rule requirements, a fund sponsor may need to provide supplemental rights to the SSBCI investor sidecar entity that would put the SSBCI investor into the same position as if the SSBCI investor was a main fund investor. This is to provide that the SSBCI investor is treated substantially similar with respect to economic and other terms as any other main fund investor. For example, voting at the main fund level may preclude a sidecar investor from voting with the main fund. However, in such circumstances where the sponsor will not allow the SSBCI investor to vote with the main fund, the SSBCI investor should maintain a 1-sided consent right over issues main fund investors must vote on (e.g., dissolution) as they relate to the SSBCI investor's sidecar.

Matthew Bobrow is counsel with Nixon Peabody's Corporate practice, where he advises private investment funds, public pension funds, and institutional investors on private equity investments and fund structuring.

Investments in Solar are Subject to Tariffs and Geopolitical Uncertainties

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For the first year on record, solar and wind energy production is on track to surpass coal-fired generation[1]. This growing demand and investment in alternative energy has been supplemented by advancements in technology, the Inflation Reduction Act's amendments to investment tax credits, and certain trade policies intended to promote home-grown manufacturing. The affordability, reliability, and accessibility of solar energy, in contrast to other alternative energy sources, is reflected in its impressive growth this quarter—an increase of 36% compared to the same 2023 quarterly data[2]. However, the solar industry's growth and stability has become more and more reliant on global supply chains and policy.

This article (i) provides a brief background on solar supply chains, (ii) sets out the current manufacturing market, (iii) analyzes the Biden Administration's recent reinstatement of solar tariffs; and (iv) provides insight for private equity and joint venture ("PE/JV") investors regarding the risks and opportunities in the solar industry.

Supply Chain Background

The solar manufacturing market consists of the production and procurement of polysilicon, solar cells, modules, and inverters. While each supply chain stream faces its own challenges, polysilicon production and module/cell production face a significant constraint—a massive monopoly of rare earth elements ("REEs") held by China. REEs, like gallium, polysilicon, tellurium, and indium, are essential in the production of solar cells[3]. Because of their concentration in mainland China, the spot price of each REE is dependent on Chinese mining and production; thus the price of each REE is constantly in flux. Polysilicon, for example, has sold for $5 per kilogram up to $460 per kilogram[4]. Different types of solar photovoltaic ("PV") cells are made of different REEs. 95% of the market uses silicon PV cells, which require polysilicon[5]. Other silicon PV cells, which are more efficient, are made of gallium.

Manufacturing Market

The Inflation Reduction Act's subsidies and grants are meant to close the gap between Chinese and American solar module manufacturing, and those investments seem to be coming to fruition. American module manufacturing capacity grew by 71% in Q1 of 2024[7]. However this increase in domestic capacity has done little to meet domestic demand. In 2024, American manufacturing capacity rose to 2.8 gigawatts[8], while new projects in the first quarter surpassed 11 gigawatts. So while the gap between American and Chinese manufacturing is shrinking, domestic projects remain reliant on Chinese imports.

Currently 80-90% of the entire solar supply chain is controlled by China. As discussed earlier, China's dominance is largely linked to the REEs needed to produce PV cells. Besides the monopoly on REEs, the cost of manufacturing PVs is backed by low labor costs (and possibly the forced labor with regards to products produced in the Xinjiang region), low overhead costs, and technical knowledge. Chinese policies, focused on winning the energy race and subsidizing production, have led PV costs to decline by more than 80%.

Policy and Tariffs

Geopolitical unrest in Taiwan, Section 301 tariffs, antidumping duties, and forced labor concerns are only some of the policy and tariff challenges that could increase costs in the solar supply chain.

The tension in Taiwan has been a constant sticking point in U.S.-China relations, however former U.S. House Speaker Nancy Pelosi's trip to Taiwan in 2022 and President Biden's recent claims that the U.S. would come to Taiwan's defense in the event of an attack by Beijing, have fanned the flames[9]. As a show of force, the Chinese have increased their physical presence and have conducted military exercises around the island. With a grip on the energy supply chain, China now has a strong economic card to play in any future disagreements regarding the independence of Taiwan, which some experts speculate to occur within the next decade[10].

Section 301 of the U.S. Trade Act of 1974 refers to the additional taxes and duties applied to imports from nations that the U.S. regards as violating fair trade practices[11]. Antidumping and countervailing duties ("AD/CVD") are imposed on imports when the Department of Commerce finds that the merchandise was sold in the U.S. for an unfairly low or subsidized price[12]. In 2022, Congress proposed a reinstatement of tariffs on solar panel imports from Southeast Asia, specifically Cambodia, Malaysia, Thailand and Vietnam. Congress and domestic manufacturers accused the Chinese of circumventing AD/CVDs that limit imports from China by rerouting panels to Southeast Asia or by creating foreign facilities that did not perform significant manufacturing operations and claiming a country of origin other than China. On May 16, 2023, the Biden administration vetoed the congressional resolution citing the hundreds of solar projects that would have been abandoned if such a tariff was imposed. The administration also claimed that the delay in tariffs was necessary for the solar supply chain and solar installation market to obtain some certainty in pricing and supply fulfillment. The result of the veto was a stall on the tariff for a period of two years. However, this May, the Biden administration not only reinstated the original 25% tariff on solar cells but increased the rate to 50%[13]. The Biden administration also indicated that any existing inventory of critical solar supply chain items must be installed and operational by December 23, 2024, or be subjected to the additional tariffs. The overall impact will eliminate tariff-free sources of the solar supply chain and dramatically increase costs in the U.S. market, making it even more difficult for American manufacturing to compete with Chinese prices[14].

Many agreements used in utility scale projects include representations stating that no major components of a project will be procured or manufactured through forced labor or modern slavery. The Uyghur Forced Labor Prevention Act prohibits the importation of goods into the U.S. manufactured wholly or in part with forced labor in China, particularly in the Xinjiang region.[15] With these restrictions, certain supplies, like polysilicon, may be entirely prohibited from use in U.S. projects.

Impacts on Investing

The tension remains regarding short term supply chain issues and the desire to grow solar manufacturing within the U.S. The geopolitical issues and U.S. policy are complicating the landscape, but investors understand the significant demand for U.S. investments. Investment strategies are reliant on a constant stream of critical material and the . Con't on page 9

Things to do in San Diego!

Activities:

San Diego Zoo: Interactive zoo featuring diverse wildlife, tours and hands-on experiences. https://zoo.sandiegozoo.org/plan-your-visit

USS Midway Museum: Historic aircraft carrier turned museum featuring an array of aircraft.

Sunset Cliff Natural Park: Coastal park with panoramic ocean views, perfect for sunset watching from cliff-side trails. https://www.sandiego.gov/park-and-recreation/parks/regional/shoreline/sunset

Restaurants:

Hidden Fish
4764 Convoy St Suite A

San Diego, CA 92111
858-210-5056
http://www.hiddenfishsushi.com

Tribute Pizza
3077 North Park Way #100
North Park Post Office building
San Diego, CA 92104
619-450-4505

https://www.tributepizza.com

Botanica
3139 University Ave
San Diego, CA 92104
619-310-6370

http://www.botanicabarsd.com

Private Equity M&A Joint Subcommittee

September 13, 2024

The Private Equity M&A Joint Subcommittee last met during the Business Law Section's Spring meeting in Orlando, Florida on Friday, April 5, 2024 at 1:30 p.m. eastern time. We started our program with a discussion for which I was joined by Vice Chancellor Paul A. Fioravanti, Jr. of the Delaware Court of Chancery, Sara A. Gelsinger of Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Delaware and Joel I. Greenberg of Arnold & Porter LLP, in New York, New York, for a discussion of recent Delaware cases about the enforceability of restrictive covenants and their effect on private equity transactions, Then, Vice Chair Samantha Horn, Andrew Capitman and Ham Crawford of Kroll and Rob Kibbe of Munsch Hardt Kepp & Harr, P.C. of Dallas, Texas discussed Private Equity M&A from the perspective of the investment bankers, and what Private Equity M&A lawyers can learn from them.

Our next meeting will be on Friday, September 13, 2024, at 1:30 p.m., pacific time, as part of the Business Law Section's Fall Meeting at the Marriott Marquis San Diego Marina. We will have two panel discussions. First, Glen West, a retired partner at Weil in Dallas, Texas, and I will have an in depth discussion on RMP Seller Holdings, LLC, f/k/a New Save Mart Corp. v. SM Buyer LLC and SM Topco LLC, a private arbitration under the Rules of the American Arbitration Association and the Delaware case upholding the arbitrator's award (SM Buyer LLC and SM Topco LLC v. RMP Seller Holdings, LLC, f/k/a New Save Mart Corp (Del. Ch. 2024). Then, Lisa Stark, Wilmington, Delaware, and I will be joined by Leo Strine, the former Chief Justice of the Delaware Supreme Court and now of counsel at Wachtell, Lipton, Rosen & Katz, Wilmington, Delaware, to have a chance to learn some of Chief Justice Strine's views on various matters of Delaware M&A law and practice of interest to M&A lawyers. We hope all of you can join us in person, and that those who can't meet with us in San Diego will be joining us virtually.

My Vice Chair, Samantha Horn of Stikeman Elliott in Toronto, Ontario and I continue to seek YOUR feedback as to the meetings and the Joint Subcommittee. We are always looking for ideas for future programs, presentations and projects, as well as volunteers for all of them. We are also looking to make the meetings themselves more interactive, so please do not hesitate to put your hand up and ask appropriate questions. Especially for the discussion with Chief Justice Strine, I'd love for some of you to weigh in with questions and thoughts. Also, as I've said before, if you haven't met me and you attend the meeting, please feel free to introduce yourself in person or shoot me an email afterwards and introduce yourself. Especially as we continue with hybrid remote/in person meetings, I would love to know who is listening (and have a chance to recruit your participation).

David I. Albin, Chair

Finn Dixon & Herling LLP

Schedule of Events

> Business Law Section's Fall Meeting | September, 2024

Links to Meetings for virtual attendees will be located on the ABA Business Law Section's Virtual Meeting Website.

Thursday, September 12, 2024		
CLE Program: Contractual Innovations In Private Equity & Venture Capital World	Marriott Grand Ballroom 2, Lobby Level	8:00 AM - 9:00 AM
PEVC Member & New Member Breakfast - Please join us!	Marriott Grand Ballroom 8 & 9, Lobby Level	9:00 AM - 9:30 AM
Private Equity and Venture Capital Committee Meeting	Marriott Grand Ballroom 8 & 9, Lobby Level	9:30 AM - 11:30 AM
Financial Services Technology Joint Subcommittee Meeting	Pacific Ballroom 21, First Floor, North Tower	1:30 PM - 2:30 PM
Angel Venture Capital Subcommittee Meeting	Pacific Ballroom 21, First Floor, North Tower	2:30 PM - 3:30 PM
PEVC Jurisprudence Subcommittee Meeting	Pacific Ballroom 21, First Floor, North Tower	3:30 PM - 4:30 PM
PEVC Venture Capital Financing Subcommittee Meeting	Marriott Grand Ballroom 8 & 9, Lobby Level	4:30 PM - 5:30 PM
Private Equity & Venture Capital Committee Dinner	Rustic Root 535 Fifth Ave, San Diego, CA 92101	7:30 PM - 9:30 PM Tickets Sold Out!
Friday, September 13, 2024		
International VC & PE Subcommittee Meeting	Pacific Ballroom 22, First Floor, North Tower	8:00 AM - 9:00 AM
CLE Essentials Program: Moelis and the Amendments: Where to We Go from Here? [Presented by Corporate Governance Committee, co-sponsored by PEVC and Mergers & Acquisitions	Marriott Grand Ballroom 5, Lobby Level	10:00 AM - 11:30 AM
Private Equity and Venture Capital Leadership Meeting	Pacific Ballroom 22, First Floor, North Tower	10:00 AM - 11:00 AM *Closed Meeting Committee Leadership Only
PEVC Funds Subcommittee Meeting	Pacific Ballroom 22, First Floor, North Tower	11:00 AM - 12:00 PM
Private Equity M&A Joint Subcommittee Meeting	Marriott Grand Ballroom 8 & 9, Lobby Level	1:30 PM - 2:45 PM

All times are listed in Pacific Daylight Time.

Our committee is sponsoring a great CLE program:

Contractual Innovations in the Private Equity and Venture Capital World
Thursday 8:00AM - 9:00AM
Location: Marriott Grand Ballroom 2, Lobby Level
Presented By: Private Equity and Venture Capital
Co-sponsoring Committee(s): Business Law Education

And our committee is co-sponsoring three more CLEs:

Is Delaware Losing Its Grip on Public Companies? Texas, Nevada and Others Are Making a Move
Thursday | 10:00 AM to 11:30 AM Location: Marriott Grand Ballroom 3, Lobby Level

CLE ESSENTIALS: Moelis and the Amendments: Where do we go from here?
Friday | 10:00 AM to 11:30 AM Location: Marriott Grand Ballroom 5, Lobby Level

Antitrust Compliance for Growth Companies
Saturday | 10:00 AM to 11:00 AM Location: Marriott Grand Ballroom 2, Lobby Level

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The Angel Capital Association Model Convertible Note

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In recent years, there has been a significant uptick in the use of convertible instruments for early-stage financing. The types of securities typically used for these financings are Simple Agreements for Future Equity ("SAFEs") and Convertible Promissory Notes ("Convertible Notes"). SAFEs typically follow standard forms developed by the Y Combinator accelerator, with several variations available. In contrast, Convertible Notes have lacked a widely accepted template, making their review more complex and costly.

While Convertible Notes arguably offer investors more protection than SAFEs, they still fall short of the comprehensive protections and governance standards found in priced equity rounds, which benefit from the established industry-wide templates provided by the National Venture Capital Association. Until conversion, both SAFEs and Convertible Notes afford their holders limited control and fiduciary protections. To address this, sophisticated investors often enhance their protections through additional provisions in side letters and note purchase agreements.

In response to these challenges, the Angel Capital Association assembled a Model Convertible Note Task Force, Chaired by Fox Rothschild Partner and Chair of the Fox Rothschild Emerging Companies and Venture Capital Practice Group, Elizabeth D. Sigety, Esq. This task force includes experienced early-stage investors and attorneys who regularly represent both founders and investors. This task force was charged with developing an enhanced model Convertible Promissory Note and related Term Sheet (the "Model Note") that incorporates both common provisions and "best practice" elements typically found in note purchase agreements and side letters. The objective was to create a balanced form document that equitably addresses the interests of both founders and investors, while providing options and explanations for various provisions. The task force also leveraged industry data, including insights from Carta and the Angel Capital Association database, to assess the prevalence of various terms in the market. The Model Note is structured as a demand note to address two issues. One issue is the recent ruling in Nevada in which the court forced payment at maturity rather than allowing a convertible note to convert. The other issue is to obviate the need for repeated requests to extend the maturity date of a convertible note, though the issuer may choose to request extension of the trigger date in any case. See Toptal, LLC et al. v. Denis Grosz, et al., CV20-00555, Second Judicial District Court, State of Nevada. The case is on appeal.

The Model Note incorporates provisions for conversion into equity based on a discount to the next round and valuation cap. Key features, some of which are summarized as follows, include representations and warranties directly within the Model Note, as well as critical terms such as participation rights, information rights, protective provisions, and board observer rights, all integrated into the Model Note to streamline documentation and enhance clarity. The Model Note aims to balance the interests of both issuers and investors, ensuring fairness and adaptability to market conditions and regulatory requirements.

Conversion upon a Qualified Financing. The Model Note contains a mandatory conversion provision upon a Qualified Financing. Mandatory conversion upon a Qualified Financing is a crucial provision in a Convertible Note that stipulates the automatic conversion of the outstanding principal and accrued interest into equity shares of the company once a specified financing threshold, known as a "Qualified Financing," is achieved. The purpose of this provision is to ensure that the Convertible Noteholders' investments are converted into equity in a timely manner, rather than remaining as debt. This conversion occurs at a conversion price calculated based on a valuation cap or at a discount to the price per share paid by new investors in the Qualified Financing. By facilitating an automatic transition from debt to equity upon meeting the financing criteria, this provision helps streamline the financing process and provides clarity for both the company and its investors.

Conversion Upon Non-Qualified Financing. The Model Note contains a conversion provision upon a Non-Qualified Financing, which provides conversion of the principal and interest of the Note at the option of the "Requisite Holders", which is usually defined as holders of a majority of the principal amount of the Notes, into equity if the issuer raises funds through a financing round that does not meet the criteria of a "Qualified Financing." This flexibility allows the noteholders to evaluate the terms of the Non-Qualified Financing and choose the best course of action, thus providing an additional layer of protection and adaptability in the investment process.

Conversion or Payment after Maturity Trigger Date. If a Qualified Financing or Non-Qualified Financing (as discussed above) does not occur before a Maturity Trigger Date (which the Model Note defines as a certain period of time that is typically 12 months to 3 years from the date of the first Note issued in a series of Notes), the noteholders' right to convert remains valid. The "Requisite Holders" can choose to either (i) demand full repayment of all Convertible Notes on a specified date, which must be at least ten days after notice is given, or (ii) convert the outstanding principal and accrued interest into shares of the most senior class of stock issued by the issuer at a price per share equal to the valuation cap divided by the fully-diluted capitalization of the issuer. This provides flexibility and protection for the Convertible Noteholders to either claim their investment back in priority to the equity holders or convert to equity if the future of the issuing company looks promising.

Sale of the Company. One often overlooked provision concerns what happened in the event of a sale of the issuing company. con't pg9..
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When Portfolio Companies Grow Overseas: Key Legal Issues for Investors

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The latest statistics from the US Bureau of Economic Analysis show that in 2022, $6.58 trillion was invested by the US in overseas jurisdictions, while the US received $5.25 trillion in investment from overseas. Clearly, that indicates a huge amount of cross-border activity, and so US private equity (PE) and venture capital (VC) investors have become more focused on exploiting the opportunity—not only for their own direct investments into overseas assets but also to encourage their portfolio companies to explore international markets to advance their growth.

However, international expansion can also be challenging for the unwary; a local understanding of the overseas market opportunity should be a key prerequisite for a portfolio company board and its investor representative. From a legal perspective, it is key to consider significant issues that may arise in growing overseas to ensure that laws and regulation do not derail the reasons for growth.

We now consider some of the more regional issues applicable to an international growth strategy, exploring examples from four different parts of the world.

United States

Expansion of Non-US Companies to the US: The US is a fairly business-friendly market with low barriers to entry; however, certain types of businesses may be highly regulated by federal and state entities. Companies expanding to the US will often reincorporate by forming a US holding company and having the non-US company become a subsidiary of the US holding company (known as a "Delaware flip"). This structure allows non-US companies to be more attractive to US investors but can create uncertainty for non-US investors. As a US company, the entity may be subject to certain restrictions prohibiting investment of investors from certain sanctioned countries and in certain industries. US investors may also request that the IP be held by the holding company.

The data privacy landscape Is evolving in the US. Certain US states have passed laws that make privacy laws more restrictive, similar to European and Canadian privacy protections.

Additionally, the US is known for being protective of intellectual property rights, primarily through formal contractual protections and/or licensing as well as filing (and enforcing) registrable IP rights. While employment in the US is generally "at will", state laws govern the relationships between employees and employers.

Expansion of US Companies Overseas: US businesses are global leaders when expanding their domestic operations overseas. Investors often have experience in growing revenues outside the US, and many serial entrepreneurs will have had positive experience with significant international customer acquisition. However IP is key, and most investors will insist that IP is retained onshore and transferred to the US parent company if created in another jurisdiction.

Europe

Formal legal processes: One of the differences that companies face when expanding to Europe is the formalities present in some countries, like the role of notaries and the requirement to file certain documents with a commercial registry to make them enforceable. Likewise, a Power of Attorney is mandatory to prove capacity, as it is not valid to sign a document under a premise of apparent authority.

Liability of directors: Since the 2008 financial crisis, the European Commission has introduced a series of recommendations intended to harmonize and improve corporate governance regimes across Europe, based on the "comply or explain" principle. Board members in Europe are subject to increased scrutiny by regulators.

Sanction regimes: Sanctions may be applied differently in the EU than in the US in ways that could potentially be used to structure a business model to enter into new markets without violating any sanction regimes. For example, a European parent holding company and European subsidiaries may be able to do business in Cuba while US subsidiaries cannot.

Foreign direct investment regulation: The EU's Foreign Direct Investment (FDI) Regulation, in effect since October 2020, establishes common criteria to identify risks relating to the acquisition or control by foreign investors of strategic assets.

Antitrust: Analysis can be conducted by national authorities, EU authorities, or both.

Hiring and firing in the EU: One of the biggest conceptual differences for companies expanding overseas is the unique US employment at-will doctrine—which does not exist in European employment law. In some countries, termination without a legally valid reason may be null and void, and it may result in large severance and damage awards for unfair dismissal.

In Europe, there are also laws that relate to a wide variety of employee benefits, including caps on hours worked and allowances for vacation, holidays, sick leave, parental leave, and more.

M&A transactions: A prior consultation with labor unions or work councils might be mandatory in some countries before completing an M&A deal.

India

FDI approval routes: The pivotal aspects for consideration when it comes to expanding your business into the Indian subcontinent are the sector-specific regulations and entry routes for receiving investments into India. Foreign investments in India can be made through one of two means: the automatic route or the government approval route. While most investments fall under the automatic approval route, some may entail prior approval of the Government of India.

Competition law guidelines: In addition to the structuring of a deal, investors must be aware of the compliance framework prevailing in India. Investments that are over certain limits prescribed in respect of turnover, existing asset value, or the criterion of deal value are subject to the regulatory scrutiny of the competition watchdog of the country, the Competition Commission of India (CCI).

Choice of entity: It is important to determine the nature of the entity to be established in India for the purpose of carrying out business objectives. Subject always to the guidelines prescribed by the Reserve Bank of India, foreign companies can operate through a subsidiary, branch office, liaison office, project office, or representative office.

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Rethinking Board Observers: Balancing Innovation and Antitrust Scrutiny in the Tech Sector

Board observers, a relatively recent development in corporate governance, are rapidly gaining prominence. These non-voting participants are strategically positioned to access critical company information without the formal responsibilities and liabilities of board membership. Often appointed through agreements or side letters, board observers are particularly prevalent in sectors like technology, where innovation drives value and competition is fierce. This role offers investors a unique vantage point but also raises significant antitrust concerns. As scrutiny intensifies in the US and EU, particularly regarding Big Tech's use of board observers to gain competitive advantages, it becomes imperative for PE/VC lawyers to understand the implications of this evolving dynamic.

1. The Strategic Allure of Board Observers

For investors, particularly in the tech sector, board observers provide a strategic alternative to board memberships. They enable investors to gain access to key information, understand market trends, and influence corporate strategy without triggering the antitrust scrutiny typically associated with formal board seats. This tactic has become increasingly popular among major tech firms seeking to secure a foothold in innovative startups, as it provides insights into potentially disruptive technologies and business models.

However, this strategy is not without controversy. While board observers circumvent direct regulatory oversight by lacking voting power, they still have access to sensitive competitive information. Critics and regulators argue that this approach could be used to sidestep antitrust regulations, potentially leading to unfair competitive practices. Moreover, it is questionable how often the lack of voting rights truly limits a board observer's influence, especially in situations where consensus within the board is typically achieved without formal voting, rendering the observer's position nearly as powerful as a full board member.

2. Unfair Advantages and Antitrust Concerns

The use of board observers by major technology firms raises significant antitrust concerns. By gaining access to sensitive and potentially competitive information without assuming the formal responsibilities and scrutiny of a board director, these firms can potentially exploit this position to stifle competition. For example, a large tech company could use information gleaned from a startup's board to preemptively neutralize emerging competitors or influence the startup's strategic direction in ways that align with the larger firm's interests. This practice can distort market competition and lead to unfair advantages, which has drawn the attention of regulators and prompted calls for stricter oversight.

The controversy lies in whether these roles serve as a loophole to avoid antitrust laws. While board observers do not have formal voting rights, their ability to influence corporate strategy raises questions about the fairness and legality of their involvement. Given the increasing regulatory focus on maintaining fair competition, particularly in the tech industry, it is crucial for legal practitioners to navigate these concerns carefully, balancing the benefits of board observers with the need to comply with antitrust regulations.

3. Regulatory Attention and Case Studies

The relationship between Microsoft and OpenAI serves as a prime example of these dynamics. After a significant investment, Microsoft secured an observer seat on OpenAI's board, gaining valuable insights into artificial intelligence advancements. This arrangement has sparked regulatory investigations in both the US and the EU, with authorities questioning whether such practices could stifle competition. Responding to growing scrutiny, Microsoft announced on July 10, 2024, that it would relinquish its observer seat, despite its $13 billion investment. Similarly, Apple declined a comparable position, opting instead for periodic meetings to stay informed.

These decisions reflect a broader wave of regulatory attention. The Federal Trade Commission (FTC) and the Department of Justice (DOJ) are currently investigating how Big Tech companies use investments and partnerships to influence competitors. The role of board observers is expected to be a focal point in these investigations and should be a key topic of discussion at the upcoming American Bar Association national meeting.

4. Balancing Innovation with Fair Competition

As regulatory scrutiny intensifies, it is essential to recognize that a combination of existing laws, new guidelines, and updated FTC documents—including the Clayton Antitrust Act, the FTC Act, and recent FTC guidelines—are capable of addressing potential antitrust concerns associated with board observers. The issue, therefore, is not a lack of regulation but the challenges in effectively enforcing these laws in the context of rapidly evolving corporate governance practices.

Board observers, while valuable in corporate governance, must not serve as a loophole to circumvent antitrust laws. The true challenge lies in ensuring that these roles are utilized in a manner that does not lead to anticompetitive behavior. Legal practitioners must focus on mitigating liability risks for their clients, ensuring compliance with existing laws while navigating the complexities of innovation and competition. This requires a nuanced understanding of how board observers can influence corporate decisions and the potential for their actions to attract regulatory attention, even without formal voting rights.

5. Reassessing the Role of Observers in Corporate Governance

Current and future judicial developments may have a significant impact on the role of board observers. The decision in Obasi Investment Ltd. v. Tibet Pharmaceuticals Inc., 931 F.3d 179 (3rd Cir. 2019), remains a critical point of reference in understanding the liability of board observers. The Third Circuit held that a non-voting board observer is neither a director nor a person whose functions are similar to those of directors under Section 11 of the Securities Act of 1933. The Court emphasized that directorship is defined by the formal power to direct and manage a corporation, which board observers lack. Despite their potential influence, observers are not held to the same level of responsibility or accountability as directors. This ruling, although binding only within the Third Circuit, offers comfort to individuals and organizations appointing board observers, reinforcing the need for clear distinctions in the roles and responsibilities of observers versus directors.

6. Key Considerations for Legal Practitioners

To navigate these complexities, legal practitioners must:

- Draft Clear Shareholder Agreements: Explicitly delineate the roles, rights, and limitations of board observers in shareholder agreements. This should include clear definitions of their access to information, participation in discussions, and any restrictions on their influence over corporate decisions.
- Mitigate Potential Liabilities: Ensure that the scope of a board observer's influence is clearly defined to prevent them from being classified as de facto or shadow directors, which could expose them to fiduciary duties and associated liabilities.
- Stay Informed on Regulatory Changes: Keep abreast of ongoing regulatory investigations and evolving antitrust laws, including the new guidelines and updated FTC documents, to ensure that your clients' practices are compliant with the latest legal standards.
- Balance Innovation with Compliance: Help clients find a balance between leveraging the strategic advantages of board observers and maintaining strict compliance with antitrust regulations. This might involve exploring alternative governance mechanisms or adjusting existing practices to align with regulatory expectations.
- Adapt to Evolving Legal Landscapes: Regularly revise agreements and strategies in response to new judicial interpretations and regulatory developments, ensuring that your clients' corporate governance practices remain robust and legally sound.

By focusing on these key areas, legal practitioners can ensure that the benefits of involving board observers in corporate governance do not come at the cost of increased legal and regulatory risks.
The emergence of board observers represents both an opportunity and a challenge for PE/VC lawyers. While this mechanism can provide strategic advantages and foster innovation, it also raises significant antitrust and governance concerns. Navigating this evolving landscape will require a careful balancing act—one that prioritizes compliance, fosters fair competition, and supports the dynamic growth of the tech sector. As regulatory scrutiny intensifies, PE/VC lawyers must be proactive, informed, and ready to adapt to the changes ahead. For more on these issues, please see our new research paper: Board Observers https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4745278. Feel free to contact us with any questions or comments.

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The Committee is collecting articles for future newsletters which are circulated to our members worldwide. Please send your submissions to Lawrence Dempsey and Sarah K. Anischik at lawrencedempsey@icloud.com and Sarah K. Anischik@sanischik@gunder.com

Navigating Delaware's SB 313: What PE/VC Lawyers Need to Know

On July 17, 2024, Delaware's Governor signed Bill SB 313 into law, adding a new dimension to the Delaware General Corporation Law (DGCL) with the introduction of Section 122(18). In short, Section 122(18) broadly validates the terms of agreements entered between a company and current or prospective stockholders that directly or effectively give the stockholder control over various business decisions traditionally left to the exclusive province of the board of directors.

This new provision has triggered a wave of debates and controversy within the corporate legal community. Section 122(18) seeks to override the Delaware Court of Chancery's decision in West Palm Beach Firefighters' Pension Fund v. Moelis & Company ("Moelis"), which invalidated a stockholder agreement giving Ken Moelis, the founder and former controlling stockholder of Moelis & Co., a panoply of pre-approval and veto rights over most meaningful board decisions. The new statutory provision's impact is likely to fall between the two polarized viewpoints articulated by the amendment's corporate bar proponents, on the one hand, and investor advocates and governance law focused academics, on the other. Proponents of Section 122(18) suggest that the new law preserves Delaware's status as a leading jurisdiction in corporate law, while detractors argue that it undermines Delaware's board-centric governance model.

For PE/VC clients and lawyers, understanding the implications of Section 122(18) is crucial, as this amendment reshapes the landscape of stockholder agreements, IPO structures, and fiduciary duties in Delaware. This op-ed offers five key predictions on how this change may affect corporate law doctrine and practice in Delaware.

1. Limited Judicial Review of Stockholder Agreements with Non-Controllers

The Court's ability to intervene in stockholder agreements, especially those involving non-controlling shareholders, appears to be limited. While proponents argue that such agreements will remain subject to equitable review, the breadth of the statutory language suggests that many stockholder agreements may escape judicial scrutiny unless they involve a "controller" or a "conflicted board."

Consider a scenario where an investor challenges a stockholder agreement that transfers significant decision-making powers from the board to a new investor. In light of the statute itself and other recent Delaware Supreme Court caselaw, a so-called "facial" challenge to a stockholder agreement will likely be deemed unripe for challenge or defeated on the merits. Without clear fiduciary breaches or conflicts, courts may feel compelled to defer to the board's judgment in connection any "as applied" challenged to these agreements, making it challenging for public investors to seek redress from the courts. PE/VC lawyers should anticipate these hurdles (or lack thereof, depending on the circumstances) and advise their clients accordingly, preparing for potential challenges in both facial and as-applied contexts.

2. Lower Volume of Dual-Class Capital Structure IPOs

Historically, dual-class structures have allowed founders and significant investors to retain control over decision-making even when their economic stakes are minimal, a practice often criticized by institutional investors and academics alike. One positive prediction for investors may be a decline in dual-class capital structure IPOs.

In short, Section 122(18) provides a new pathway for maintaining control without the need for a dual-class structure. By utilizing stockholder agreements that effectively delegate decision-making authority away from the board, founders and investors can achieve similar (or even more expansive) control benefits without the risk and cost of imposing the much-criticized dual-class capital structure. This statutory endorsement of stockholder agreements may incentivize companies to forgo dual-class structures in favor of more flexible and less controversial arrangements. Companies with existing dual class structures may even look for ways to collapse those structures while preserving the control elements through stockholder agreements.

3. Expanded Definition of "Controlling Stockholder" and "Conflicted Board"

To balance the potential misuse of Section 122(18), and recognizing the impediments to judicial review of these agreements in the normal course, Delaware courts may take a more assertive view of the definitions of "controlling stockholder" and "conflicted board." For instance, an investor holding significantly less than 50% of a company's voting power could still be deemed a controller if a stockholder agreement grants them substantial decision-making authority. Similarly, a board's approval of a Section 122(18) agreement might be scrutinized if there is a perception that the board acted to preserve its own interests in the face of actual or perceived activism risk, rather than acting solely to protect the interests of the company and its shareholders. This expanded approach would allow the judiciary to maintain oversight over corporate governance without undermining the legislature's steps to protect the contractual rights established by Section 122(18). PE/VC clients and advisors should carefully consider the risk that despite a statutory validation of stockholder agreement terms previously considered so aggressive as to cross the proverbial line, a court could find that the aggressive PE/VC players assume the fiduciary obligations that come with controller status.

4. Modified Approach to Fee Awards for Serial/Copycat Governance Cases

The new law may also lead to changes in how the Delaware Court of Chancery handles attorneys' fees in governance cases. One possible explanation for the rush to statutorily override Moelis may have been the speed with which plaintiffs' lawyers brought suits against other companies that had similarly delegated to select stockholders core board decision-making authority. Under existing precedent, these "copycat" suits were likely to cause beneficial changes to the target company's governance profile, and thereby warrant a healthy fee award for the lawyers involved.

Although the Court will likely continue to incentivize and reward investors' counsel who bring novel and meaningful litigations to improve governance practices, it may perceive a need to give corporate advisors a bit more breathing room to process recent caselaw developments and take the initiative to correct or improve their clients' prior governance missteps before having to face an embarrassing and potentially expensive stockholder lawsuit. Thus, the court might adopt a more nuanced approach to fee awards, differentiating between innovative cases that bring about significant governance improvements and "copycat" suits that merely replicate challenges to already-identified issues.

For PE/VC lawyers, judicial adoption of this declining risk and benefit approach to fee awards would mean that early movers in governance litigation would still be rewarded for identifying and challenging problematic practices, with the initially targeted companies facing premium fee awards. However, subsequent suits filed before other corporate players have a reasonable chance to self-correct their sub-optimal governance practices may receive lower fee awards, thus discouraging the proliferation of opportunistic litigation and aligning incentives more closely with the broader policy objectives of corporate governance.

5. Altered Relationship Between the Delaware Bench and Bar

Finally, the rapid passage of SB 313, in general, and the corporate bar's sometimes harsh criticism of the judiciary's handling of recent rulings and the legislative process, in particular, may have strained the historically warm and respectful relationship between Delaware's bench and bar. For years, this relationship has been a cornerstone in creating and sustaining Delaware's reputation as the premier jurisdiction for corporate law.

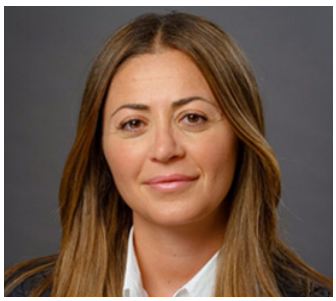
In particular, the judiciary's willingness and availability to listen to corporate constituencies regarding important corporate law issues and problems helps the Court of Chancery stay at the cutting edge of those matters. However, even when a single judge or even the Court as a whole veers away from what one constituency or another believes is the right answer, the Chancery judges' primary role in interpreting and shaping corporate governance norms has traditionally been respected and uncontested. To the extent that the PE/VC community was or is perceived as being a primary force behind the recent legislative amendments, clients and advisors alike may have exposed themselves to the law of unintended consequences.

Going forward, PE/VC lawyers may need to navigate a more complex dynamic, balancing their desire to effect favorable legislative developments with maintaining respect for the primary role of judicial interpretation of Delaware's corporate law. Respectful engagement with the judiciary, including transparent dialogue about perceived problems and adherence to the "Delaware Way," will be essential to maintaining the state's status as the leading forum for corporate governance.

Conclusion

Section 122(18) represents a significant shift in Delaware's corporate law landscape, with implications that extend far beyond the specifics of the Moelis decision. For PE/VC lawyers, these changes necessitate a careful reassessment of how stockholder agreements are drafted, how control structures are implemented, and how governance disputes are litigated. In particular, the perceived benefit of relying on the new statute to demand "aggressive" terms in stockholder agreements should be weighed against the potential cost, both in terms of controller liability or other paths to the loss of business judgment rule protection for such agreements, and in the form of fee awards for successful stockholder challenges, before proceeding. As Delaware continues to adapt its legal framework to meet the evolving needs of the corporate community, proactive engagement with these developments will be key to ensuring effective and compliant corporate governance practices.

For more on these issues, please see Professor Lebovitch's new research paper: Soap Opera Summer: Five Predictions About DGCL 122(18)'s Effect on Delaware Law and Practice, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4929402. Feel free to contact him with any questions or comments.



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(These recent developments suggest a growing debate over whether Delaware's dominance as the preferred jurisdiction for corporate incorporation is as secure as it once seemed. As states like Nevada and Texas position themselves as competitive alternatives, it raises the question: Will Delaware's traditional strengths continue to outweigh the mounting pressures from both regulatory changes and competitive state policies?

While the proponent of the new law emphasized transparency and accountability, critics argue it could lead to increased requirements for startups to provide more detailed disclosures to shareholders. Many of these agreements may be kept secret from non-party shareholders, such as institutional investors, private equity funds and others. Delaware's legislative action signals its intent to maintain its leading role in corporate law while adapting to the needs of modern businesses. However, there are concerns that rushed changes might undermine the state's stability and competitive edge.

While supporters believe that fiduciary duties will continue to take precedence over contractual terms, critics caution that this could overlook significant risks. Furthermore, existing Delaware precedent would seem to contradict this belief. In its 2010 case Nemec v. Shrader, the Delaware Supreme Court held that "any fiduciary claims arising out of the same facts that underlie . . . contract obligations would be foreclosed as superfluous." If shareholders lack transparency and are unable to challenge breaches of fiduciary duties hidden under non-disclosed agreements, their rights could be rendered ineffective.

Moreover, opponents—including many leading corporate law scholars—argue that the new law represents a hasty response that bypasses the proper judicial review process. They worry that it allows companies to change governance structures and board powers without shareholder consent or oversight and creates a separate category of internal corporate claims that could be litigated under non-Delaware law.

What's Next?

While recent moves by states like Nevada and Texas to attract corporations signal a growing ambition to challenge Delaware's dominance, I remain skeptical that they are ready to truly compete on the same level. Delaware's unique combination of a well-established legal framework, the specialized Court of Chancery, and decades of consistent case law provides a depth of experience and predictability that these newer contenders currently lack.

In addition to the stability provided by the judiciary and substantive law of Delaware, the sophistication and interconnected network of practitioners within the Delaware bar is what makes Delaware difficult to replicate for other states. Even if states like Nevada and Texas can establish a body of case law from a legal framework of a similar scale and scope to Delaware, overseen by judges of the same quality as Delaware, the institutional knowledge and interpersonal relationships that those practicing this law and in front of these courts takes decades to establish. Until Nevada and Texas can offer similar stability and legal sophistication, they are unlikely to displace Delaware as the preferred jurisdiction for corporate incorporation, especially for venture-backed startups and complex corporate structures.

In an era where corporate power dynamics are constantly shifting, Delaware's latest legislative move represents a bold stance for the startup ecosystem. As legal professionals, we must closely examine and navigate these changes to ensure we support the growth and success of innovative enterprises while safeguarding the principles of transparency and accountability that underpin good corporate governance.

For more on these issues, please see Professor Alon-Beck's new research papers: Incorporating Unicorns: An Empirical Analysis and Delaware Beware. Feel free to contact Professor Alon-Beck at anat.beck@case.edu with any questions or comments.

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development of manufacturing hubs that can meet the demand and a price point which fuels domestic demand of solar energy. In the past, U.S. policy makers plugged these gaps with tax credits, financial incentives and inexpensive imports. Yet, tensions with significant trading partners, competing demands on government revenue and significant changes in the political landscape, will require investors to reevaluate supply chain risks and determine if the uncertainties and additional costs will significantly impact demand or continued government assistance.

In 2019, the threat of tariffs against Chinese imports imposed by the Trump administration caused panic in the alternative energy markets. A report by the Solar Energy Industries Association estimated a 19 billion dollar loss in private investments due to potential procurement and price related tariffs[16]. In 2022, before Biden's veto on congressional tariffs, uncertainty caused the delay and cancellation of solar projects[17]. Some reports show that these reinstated tariffs may increase the costs of hardware imports by 91-286%[18].

In short supply chain constraints will continue to limit capital investments until the uncertainties are resolved or hedging methods, including government assistance, are developed.

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Industrial policies: The Indian government has established foreign trade zones such as Special Economic Zones and Software Technology Parks (STPs) to incentivize foreign investments, improve the ease of doing business, and reduce the tax burdens on businesses operating in these zones.

Nature of funding: Indian companies can issue equity shares; fully, compulsorily, and mandatorily convertible debentures; and fully, compulsorily, and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA regulations.

Repatriation of funds: Profits from an Indian entity can be repatriated abroad by various means, such as dividends, buyback of shares, reduction of share capital, use towards fees for technical services, consultancy services/business support services, or royalty.

Statutory dues, licenses, and registrations: Other than the aforementioned approvals from the Reserve Bank of India and the CCI, investors in India should also be acquainted with the nuances of the statutory payment such as taxes, levies, and stamp duties.

Hiring of employees and labor law compliance: Foreign companies intending to venture into India must also consider the plethora of labor laws in India. In the absence of a subsidiary, project office, liaison office, or branch office, it is not legally permissible for a foreign entity to directly hire Indian resident employees for running their business operations in India. In such a case, the Indian resident employees can only be hired through an appropriate agency (Professional Employer Organization (PEO) or Employer of Record (EOR)).

Taxation: A company is said to be a resident in India—and therefore, taxable—in any previous financial year if such company has its place of effective management in India.

Choice of law: Choice of governing law and dispute resolution mechanism is of vital importance for cross-border investments and M&A. In India, arbitration is increasingly preferred over traditional dispute resolution through courts due to delays and time consumption in resolving disputes through the court system.

Chile

Taxes and structuring: Chile has undergone several tax reforms in the past fifteen years and is currently discussing the need for a new tax reform. The Chilean tax system is applied on a national level and generally does not have special regimes for different industries.

Intellectual property: IP is a constitutional right in Chile, for both industrial property rights (trademarks, patents, trade secrets) and copyrights. This type of ownership of rights is protected with the same force as regular property under Chile's constitution.

Hiring of employees and labor law compliance: Foreign entities planning to hire employees in Chile need to consider that the country has a strong range of regulations set out on the Constitution, the Labor Code, and different minor legislation regulating the country's social security system. Additionally, the protection of employees' rights has been considered a key principle for employment courts, which decide cases with a pro-employee criterion.
Chile is not an employment at-will country, so employers are required to invoke legal grounds for terminations even in redundancies.

Foreign entities are allowed to hire employees in Chile, provided they designate a local legal representative and address or set up a subsidiary.

Finally, local regulations consider a strong protection of fundamental employment rights, which are a set of constitutional rights protected in the context of employment such as the rights to life, to work, and not to be discriminated against. Litigation related to such rights can allow employees to claim their reinstatement on serious discrimination claims and can involve additional penalties and restriction on the company's participation in biddings with public entities for a two-year period.

Regulatory considerations: Finally, Chile has been a very stable country for the last thirty years. It is now in the process of drafting a new constitution, which likely will end up granting more rights to the Chilean population. Its regulation is sophisticated and provides a number of areas that need to be understood by investors and their portfolio companies who are targeting consumers or who profit from the collection and exploitation of personal data. Chile supports innovation through its regulations and encourages international investment in its forward-looking and established economy.

Renewable energy has become a significant industry since recent governments issued regulations toward promoting foreign investment in this area. Solar and wind projects have been active during recent years, receiving significant amounts of investment from abroad. Now, green hydrogen has triggered interest, since experts consider Chile to have the best conditions for these types of projects.

Conclusion

Opportunities for overseas growth are huge, but navigating the local issues needs to be prioritized. Doing it right is far more likely to lead to a successful market entry and greater profits, ensuring the return on investment for the investor is maximized and keeping everyone happy!

This discussion is a general, high-level summary and not an exhaustive checklist or legal advice. Obtaining local counsel is vital, and adequate time and resources should be allocated to any international expansion projct.

This is an excerpt from the American Bar Association's Business Law Today. It is also related to a CLE program titled "What Legal Issues Should Investors Ask Their Portfolio Companies to Prioritize When Growing Overseas?" from the ABA Business Law Section's 2023 Fall Meeting. To learn more about this topic, listen to a recording of the program, free for members.

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In the Model Note, the noteholder has two options for compensation: (i) receive a cash payment equal to the Sale Multiplier (typically a range between 1x and 3x) multiplied by the total outstanding principal and accrued interest on the Note, or (ii) receive the consideration (cash or securities) they would have received if the outstanding principal and interest had been converted into shares of the company's most senior class of equity securities just before the sale at a conversion price equal to the valuation cap divided by the fully-diluted capitalization of the issuer. This provision ensures that the noteholder can get the benefit of its loan or the risk profile of its early-stage investment in the issuing company.

Representations and Warranties. The Model Note incorporates representations and warranties of the issuer and the investors that are typically found in a Convertible Note Purchase Agreement. Incorporating representations and warranties into the Model Note simplifies the documentation and reduces the need for multiple agreements, which can be beneficial for both the issuer and the investors. The representations and warranties of the issuer in the Model Note directly relate to the terms and conditions of the note itself, such as the issuer's good standing and financial status and ability to honor the note. Including these terms directly in the Model Note aids due diligence and provides added protection and assurance for investors.

Covenants. The Model Note also incorporates provisions that are frequently found in side letters – thus protecting the issuing company from having to negotiate and abide by a variety of side letters with different provisions. These provisions may include participation rights, information rights, protective consent provisions, most favored nations provisions and board observer or board rights. This approach simplifies the documentation and can expedite the investment process.

The Model Note can be found on the Angel Capital Association's website:

https://angelcapitalassociation.org/angel-insights-publications/

Fox Rothschild extends its deepest gratitude to the Angel Capital Association and the dedicated members of the task force assembled by the Angel Capital Association (Mark Friedman, Dror Futter, Esq., Sonu Mirchandani, Clay Rankin, David Sikes, Esq., Joe Wallin, Esq., and Ronald Weissman), who have contributed their invaluable expertise and time to this important project, as well as the many angel groups who reviewed and commented on the Model Note and related Term Sheet. The task force's collective insights, thorough analysis, and commitment to developing a balanced and effective Model Note have been instrumental in shaping this endeavor.

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NEXT MEETING

Business Law Section Fall Meeting

April 24 - 26. 2025

New Orleans, LA

ARTICLES & AUTHORS NEEDED

The Committee is collecting articles for future newsletters which are circulated to our members worldwide. Please send your submissions to Lawrence Dempsey and Sarah Anischik at lawrencedempsey@icloud.com and sanischik@gunder.com.

Articles should be 1500 words or less, and on any topic of interest to practitioners in the private equity and venture capital sectors. From short scholarly articles, to practice tips, reviews/summaries of a Section program, life in the trenches, interesting pro bono projects, humorous looks at life and the law, or even how you balance work and personal life. We appreciate your help in making this newsletter a success.

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