PRIVATE EQUITY AND VENTURE CAPITAL COMMITTEE // SPRING 2023

PREFERRED RETURNS

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The Development of Delaware Public Benefit Corporations and Their Access to Capital

Ruth Jin, Partner at Moses & Singer LLP.

Introduction

Traditionally, an entity was required to make a choice to pursue either for-profit or non-profit purposes; it could not do both. In fact, directors of a corporation could be subject to a lawsuit for breach of fiduciary duty for pursuing activities unrelated to maximizing the corporation's profit.

However, answering increased demand for socially responsible enterprises, on August 1, 2013, Delaware amended its General Corporation Law (the DGCL) to allow entrepreneurs to incorporate a new form of entity known as a public benefit corporation (PBC) under subchapter XV of the DGCL (the Delaware PBC Act) and to pursue both for-profit and non-profit purposes. The number of PBCs grew significantly ever since. Many of these dual-purpose entities have received not only significant investments from private funds but also have successfully gone public.

Formation, Operation, and Termination of Delaware PBCs

The Delaware PBC Act requires a PBC to specify in its certificate of incorporation that it is a public benefit corporation and identify one or more specific public benefits under the purposes' provision. For example, Warby Parker, was founded in 2010, as a Delaware public benefit corporation, with the goal to provide consumers with affordable eyeglasses. Warby Parker's certificate of incorporation provides that the purposes of the corporation are (1) to engage in any lawful for-profit activity; and (2) "to provide access to products and services that promote vision and eye health and to work towards positively impacting the communities in which the corporation operates." Warby Parker's slogan is "Buy a Pair, Give a Pair - For every pair purchased, a pair of glasses is distributed to someone in need. So far, that's 10 million pairs and counting."

A Delaware PBC is required to conspicuously specify in its notices to stockholders and on its stock certificates that it is a public benefit company pursuing dual purposes. PBCs often add provisions to their bylaws that further detail their specific public benefits and assessment and reporting methods.

One of the greatest advantages offered by Delaware PBCs is a distinct marketing advantage and a unique customer and investor base who feel aligned with the PBC's specific impact on society.

A PBC is subject to an ongoing reporting requirement under the Delaware PBC Act. PBCs must provide stockholders, at least every other year, a report assessing the PBC's success in fulfilling its purposes, standards established by the board, and evidence relating to the attainment of those standards and objectives. A PBC can choose to provide the report more frequently or use a third party to certify or assess the attainment of its goals.

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PREFERRED RETURNS

// Spring 2023 EDITION

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CONTACT INFO: PAGE 12

Message from the Chair

The weather is turning warmer, the sun is setting later and law students are finishing up their exams and getting ready to start their summer positions… all sure signs that Spring is in the air, and along with it, the ABA Business Law Section's Spring Meeting. This will be my first meeting as Chair of the Private Equity and Venture Capital Committee. I, along with the rest of the Committee's leadership, am looking forward to seeing everyone, in person and online, in Seattle later this month. We're really excited to share what we have in store. After the turmoil of COVID, the unprecedented deal flow of 2021, and the market instability and geopolitical unrest of 2022, you might have expected that we would be running out of market changes to discuss. But 2023 has brought novel challenges along with it including a banking crisis spurred by the collapse of Silicon Valley Bank, rising interest rates raising the cost of capital and a funding drought amid recession fears. Through it all, VC and PE firms still have heaps of dry powder to deploy. It has many wondering what the next two years will have in store. Over the course of our Committee and Subcommittee meetings and CLEs, we'll explore many of these market dynamics and other topics of interest to our committee members.

Our main committee meeting with be held from 9:30 – 11:30 a.m. PT on Thursday, April 27th. At it, we'll be hearing from our generous sponsors Kroll on the private equity continuation fund market and Houlihan Lokey who will be giving us their always anticipated PEVC market update. Lisa Stark (K&L Gates) will be providing a hot topics update on some recent 242(b)(2) cases and their impact in the industry. Each of our subcommittees will give us a quick briefing of what they have planned for their respective subcommittee meetings and we'll be highlighting our International Private Equity subcommittee, led by William McIntosh (Brodies) and Katrien Vorlat (Strelia), who will provide us with a sneak peak of the session they have planned on on current trends for private equity funds seeking to exit their investments in the context of economic and geopolitical headwinds, increasing cost of debt, the fallout from SVB and volatile valuations.

Our Committee is sponsoring two great CLE programs in Seattle. Please join us bright and early at 8:00 a.m. PT on Thursday, April 27th, for ESG Considerations for PE Investments, chaired by Elliot Greenstone (Davies) and at 8:00 a.m. PT on Saturday, April 29th for Current Issues in Corporate Venture Capital: New Deal Structures and Documentation, chaired by Sandi Knox (Sidley). In addition, our Committee is proud to be co-sponsoring 5 other CLE programs: Mergers & Acquisitions in the Fintech and Crypto Asset Sectors, at 4:00 - 5:30 p.m. PT Thursday, April 27th Introduction to the Changing World of Fund Finance at 10:00 - 11:30 a.m. PT on Friday, April 28th; Becoming a General Counsel: An Insider's Guide at 4:00 -5:30 p.m. PT on Friday, April 28th; Creative Philanthropy: Impact (ESG) Investing, Donor Advised Funds, Program Related Investments and More at 10:00 -11:30 a.m. PT on Saturday, April 29th, and the very timely Showcase CLE Program: The Collapse of Silicon Valley Bank and Signature Bank: What it Means for the Financial Ecosystem taking place at 12:00 – 1:30 p.m. PT on Thursday, April 27th.

But it's not only about the content. In addition to these fabulous substantive meetings and programs, Seattle promises to offer lots of great social and networking opportunities for our membership. The Committee will be hosting a new members breakfast at 9:00 a.m. PT on Thursday April 27th leading into our main Committee Meeting. Don't let the name fool you - all are welcome to attend, including current, new and future members alike. Please join us there. We are also very much looking forward to having an evening out at our SOLD OUT Committee Dinner being held at Aqua on Thursday evening. Thank you to everyone who bought their tickets, we love the enthusiasm for what promises to be a great evening. With very special thanks to our generous sponsors Kroll and Houlihan Lokey for helping to make this event possible.

The final countdown is on. If you haven't registered for the meeting, be sure to do so, it's going to be filled with great content that you won't want to miss.

Safe travels and see you in Seattle!

Kind regards,

Brett Steward,
Chair

PEVC Mission - The mission of the Private Equity and Venture Capital Committee is to leverage its diverse, active and experienced U.S. and international membership and relationships with other Business Law Section Committees, to provide a unique and highly education forum for private equity and venture capital practitioners of all experience levels to exchange views and information on current and emerging legal and practical issues, trends and developments and practice considerations of specific interest or relevance to private equity and venture capital funds, and their investment transactions, portfolio companies and investors.

Looking Ahead to What the Committee Has in Store

CLE PROGRAM
ESG CONSIDERATIONS FOR PE INVESTMENTS

Thursday, April 27, 2023
8:00 AM - 9:30 AM (PT)
Columbia D, Level 3

ESG has been a focus for public companies and their disclosure requirements for several years. Distinct from these legal requirements, certain PE and VC funds have started focusing on companies that satisfy certain investment criteria for this space. This session, will, while acknowledging the significance of the foregoing, address the legal issues related to managing ESG issues across portfolio companies as well as ESG requirements of limited partners. The session will also address the legal issues related to conducting ESG due diligence and drafting of ESG provisions in purchase agreements.

PRIVATE EQUITY AND VENTURE CAPITAL
COMMITTEE MEETING

Thursday, April 27, 2023
9:30 AM - 11:30 AM (PT)
Elwha, Level 5

Our main Committee Meeting will include a presentation by Kroll on what they're seeing in the private equity continuation fund market as well as the always anticipated PEVC market update from Houlihan Lokey. Lisa Stark (K&L Gates) will be providing a hot topics update on some recent 242(b)(2) cases and their impact on the PEVC industry. Our subcommittees will give us a quick briefing on what they have planned for their respective meetings and we'll be highlighting our International Private Equity subcommittee, led by William McIntosh (Brodies) and Katrien Vorlat (Strelia) who will provide us with a sneak peak of the session they have planned on current trends for private equity funds seeking to exit their investments in the context of economic and geopolitical headwinds, increasing cost of debt, the fallout from SVB and volatile valuations.

FINANCIAL SERVICES TECHNOLOGY
JOINT SUBCOMMITTEE MEETING

Thursday, April 27, 2023
1:30 PM - 2:30 PM (PT)
Room 403 - Cispus, Level 4

Join a virtual panel on "Navigating the Legal Challenges of Crypto Winter" including: Jed Weiner (moderator), Olta Andoni, GC, Enclave Markets, David Kirk, Kirk & Ingram, Pratin Vallabhaneni, White & Case, and Justin Herring, NYDFS. These experts on the blockchain / crypto industry and its regulation will examine recent developments and the myriad legal challenges facing the industry with relevance to practitioners, including the fallout from the bankruptcies of FTX and centralized crypto lenders, continued questions regarding the legal status of crypto tokens, the curtailment of banking services to the industry and more.

ANGEL VENTURE CAPITAL
SUBCOMMITTEE MEETING

Thursday, April 27, 2023
2:30 PM - 3:30 PM (PT)
Room 403 - Cispus, Level 4

"Secondary Sales -- What's the deal with those?"

Join an interactive discussion of the ins and outs of secondary sales, including guidance and discussion from one of the leading secondary sale providers and businesses in the U.S. (Nasdaq Private Market), a seasoned company executive that has experienced secondaries firsthand, and two law firm partners that guide companies on these from the legal side of things.

How to "Join" us at the Hybrid Annual Meeting

We are excited to catch up with our membership, in person in Seattle and virtually online at our hybrid meeting. Committee meetings, subcommittee meeting and CLE programs will be hosted in person and online. Meeting room information is included on pages 3 & 4 of *Preferred Returns* for those members attending in person. Links for virtual attendees will be available directly from the Virtual Meeting site.

PRIVATE EQUITY AND VENTURE CAPITAL JURISPRUDENCE

SUBCOMMITTEE MEETING

Thursday, April 27, 2023
3:30 PM - 4:30 PM (PT)
Room 505 - Queets, Level 5

The Private Equity and Venture Capital Jurisprudence Subcommittee will present a panel on blocking /contractual consent rights and the potential fiduciary duty issues for minority VC and PE investors and creditors in exercising those rights in a distressed market. Will also discuss strategies for portfolio companies, investors and lenders in navigating those fiduciary duty issues as well as potential breaches of consent rights and other contractual obligations owed to investors and lenders. Co-Chairs Lisa R. Stark, K&L Gates and Helen Reeves, Gunderson Dettmer, will be joined by Jacqueline Brooks, Saul Ewing, Claire White, K&L Gates, Stephanie Norman, Richards Layton and Mary Scott Kennedy, K&L Gates.

VENTURE CAPITAL FINANCING

SUBCOMMITTEE MEETING

Thursday, April 27, 2023
4:30 PM - 5:30 PM (PT)
Room 505 - Queets, Level 5

The Venture Capital Subcommittee will present "The State of the Venture Capital Market and Key Legal Trends"

The panel will discuss the current state of venture capital transactions and the industry at large with recent deal data presented by PitchBook, the impact on the industry and venture lending of the Silicon Valley Bank takeover, and a look at key legal trends in venture capital transactions.

INTERNATIONAL PRIVATE EQUITY & VENTURE CAPITAL

SUBCOMMITTEE MEETING

Friday, April 28, 2023
9:00 AM - 10:00 AM (PT)
Room 403 - Cispus, Level 4

Our panel on "Private equity exit strategies in the current economic environment: an international perspective" will examine current trends for private equity funds seeking to exit their investments – all in the context of economic and geopolitical headwinds, increasing cost of debt, the fallout from SVB and volatile valuations.

Topics include: Techniques for re-incentivizing management amidst lower valuations; How to attract buyers and make the deal more appealing, including bridging funding and valuation gaps; Trends in rollovers, earnouts, secondary buyouts and vendor loans; Which buyers are still active; and Extending exit horizons – changing investor demands (down-round protections, pay-to-play, removal of non-participating rights).

The panel will share experiences from an international perspective – comparing trends in Germany, Mexico, Spain, Belgium and the UK.

Co-chairs and moderators: Katrien Vorlat (Strelia, Belgium) and Will McIntosh (Brodies, UK)

Panelists: Annika Clauss (Hengeler Mueller, Germany); Ignacio Lacasa Valls (Across Legal, Spain); Luis Gonzalez (Perez Correa Gonzalez, Mexico).

PRIVATE EQUITY & VENTURE CAPITAL FUNDS

SUBCOMMITTEE MEETING

Friday, April 28, 2023
11:00 AM - 12:00 PM (PT)
Room 507 - Sauk, Level 5

The Funds Subcommittee will provide an update on the proposed Private Fund rules, the Corporate Transparency Act and other developments. Look forward to having a discussion regarding the implications of these new rules on Private Fund Advisors.

PRIVATE EQUITY M&A

JOINT SUBCOMMITTEE MEETING

Friday, April 28, 2023
1:30 PM - 2:30 PM (PT)
Elwha, Level 5

Our program will include a panel discussing the impact that the Biden Administration's proposals to prohibit non-compete agreements might have on Private Equity M&A. David Albin will be joined in that discussion by Andrew Capitman, Managing Director at Kroll (formerly Duff and Phelps) in New York, New York, and Amanda Linett, partner at Stikeman Elliott in Toronto, Ontario. That presentation will be followed by Alexander Farr, a partner at McDermott, Will & Emery in Dallas, Texas, discussing Current Tax Considerations in Private Equity M&A transactions.

CLE PROGRAM

CURRENT ISSUES IN CORPORATE VENTURE CAPITAL: NEW DEAL STRUCTURES AND DOCUMENTATION

Saturday, April 29, 2023
8:00 AM - 9:00 AM (PT)
Columbia D, Level 3

As the corporate venture capital model continues to gain traction, participants increasingly are asked to make use of financing instruments such as performance warrants and corporate structures such as project finance vehicles and joint ventures, where there is not yet an industry-wide model set of documents to draw upon. Our panel of experts will discuss when and how to think about adapting concepts from the venture capital world to alternative business structures and financing vehicles becoming more common in corporate venture capital.

(The Development of Delaware Public Benefits Corporations - continued from page 1)

A traditional corporation can change to a Delaware PBC by a simple majority vote of stockholders and board approval unless its existing governing documents provide otherwise. Any amendment to the specific public benefit provided in the certificate of incorporation can also be done by a simple majority vote of stockholders and board approval. For example, two public companies, Veeva Systems and United Therapeutics, converted to the PBC form. For public companies, this must be done by filing a proxy statement with the SEC and following all related federal securities laws governing takeovers.

A PBC can terminate its designation as a PBC by amending its articles of incorporation to remove the language that identifies its specific public benefits. Termination of its PBC designation requires an affirmative simple majority vote by stockholders and board approval unless its certificate of incorporation provided for a higher threshold, such as requiring a super majority vote by stockholders.

Access to Private Capital, IPOs, Acquisitions, and Takeover Threats

For example, Zymergen, a PBC and a biotechnology company specializing in machine learning and artificial intelligence, received at least 5 rounds of funding (including $130 million in 2016, $400 million in 2018, and $300 million in 2020, each from Softbank's Vision Fund) before conducting an initial public offering in 2021 with a valuation of over $2.9 billion.

Another example is Warby Parker, which raised a total of $535.5 million over nine rounds, and went public in September 2021 with a valuation of around $4.5 billion. With the prevalence of social media, investors and consumers are more aware than ever of the impacts these companies make on society and these companies' stocks have benefited from social media campaigns.

It is likely that some pre-IPO candidates may choose to convert to a PBC to stand out from the crowd and attract investors. In fact, to attract investors, there have been SPACs who agreed to merge with a target with a provision that post-merger, the board would be permitted to convert the company to a PBC without stockholder approval. CF Finance Acquisition Corp, a SPAC, is an example. In addition, a growing number of large corporations have formed or acquired PBCs or converted into a PBC. For example, Procter & Gamble has a PBC subsidiary named New Chapter (US); and Danone North America, a subsidiary of Danone S.A., converted to a PBC in 2017, following the combination of the Danone U.S. dairy business and Whitewave Foods.

For startup PBCs, private capital is available. For example, organizations such as the Acumen Fund, Bridges Fund Management, Root Capital, and Social Finance help PBCs gain access to capital markets.

For public PBCs, this author believes that the possibility of a change of control or a takeover transaction might be greater than traditional corporations. A bidder could contend that the board failed to balance for-profit purpose and non-profit purposes and failed to maximize values for the stockholders. If one accepts the argument that a PBC must forgo some profits to pursue its social or environmental mission, then a PBC is inefficient in the eyes of a profit-maximizing investor and may be acquired by a bidder who then simply converts it to a traditional corporation and removes its social mission entirely. If the bidder makes a cash offer with a price per share much higher than the share price in the public market, it would be difficult for the board to defend this takeover without the risk of a derivative lawsuit. Accordingly, publicly traded PBCs may become prime acquisition targets because of their perceived lack of profit maximization or for having social or environmental goals contrary to a bidder's own social or environmental goals.

Director Liabilities and Risk of Derivative Actions

Pursuant to Section 365(a) of the DGCL, the board of a PBC is required to manage or direct the affairs of the PBC in "a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation." However, under Section 365(b), like in a traditional corporation, a director of a PBC does not owe any fiduciary duty toward any person other than the corporation.

Stockholders of a PBC may bring a derivate action against a director for a failure to either (i) act in the stockholders' interests, (ii) pursue a public benefit, or (iii) balance the dual purpose.

The Delaware PBC Act provides directors with a certain degree of cushion against liability. Section 365(c) provides that any failure by a director to satisfy the balancing requirement "does not constitute an act or omission not in good faith or a breach of the duty of loyalty for purposes of Section 102(b)(7) (exculpation of directors) or Section 145 (indemnification) of the DGCL, unless the certificate of incorporation so provides." This means that a PBC's certificate of incorporation could opt out of this provision and could hold a director liable for failure to balance the company's dual purposes.

In addition, pursuant to Section 367 of the DGCL, an action to enforce the balancing requirement may not be brought unless the plaintiffs in such action own individually or collectively, as of the date of instituting such derivative action, at least 2% of the corporation's outstanding shares or, if the PBC's shares are publicly traded on a national exchange, the lesser of such percentage of shares or shares with a market value of at least $2 million as of the date the action is initiated. For activist investors, these thresholds could be easily met.

Conclusion

Sustainable, publicly traded PBCs are no longer an illusion. Now, there are at least 10 publicly traded PBCs (such as Vital Farms, Lemonade Insurance, and the examples above). Because stockholders of a PBC are put on notice that the corporation pursues a dual purpose, directors' fiduciary duties may be deemed to be relaxed and there is a risk of a derivative action. In addition, publicly traded PBCs may become prime acquisition or take-over targets because of their perceived lack of profit maximization or for having social goals contrary to a bidder's own social goals. Even so, PBCs have been successful in raising capital and have become attractive targets for venture investments. If we have faith in the market's pricing ability, we should encourage more PBC incorporations and their IPO.

Tech M&A in Central and Eastern Europe: Common IP Shortcomings Identified in Due Diligence

Jan Juroška, Partner, Petr Bratský, Managing Associate and Matěj Večeřa, Senior Associate at Kinstellar

It is hard to argue these days against the ever-increasing importance of intellectual property (IP) to both sides in any M&A deal. A company's IP is often the real target of the buyer and the main value driver of the transaction. In addition, IP factors can often determine the structure of a deal (share/stock deal versus asset deal, going concern transfers, employee transfers, non-compete and non-solicitation covenants, etc.).

Most IP-related issues that we see in our practice stem from a combination of a seller's failure to identify core IP assets and a lack of knowledge of the particular legal requirements for the protection of IP. This can then lead to a failure to adopt an initial IP strategy, or to the adoption of a strategy that does not utilize the correct legal instrument(s) to best protect the given title, rights, and interests of the particular IP asset. Some of the most frequent IP deficiencies on the market include:

1. Inadequate identification of a company's IP

Target companies often fail to identify their IP assets. If the target does not have well-mapped IP, this gives the buyer an opportunity to exploit any deficiencies identified during the due diligence process and to subsequently push for a reduction in the purchase price, or to reduce or negate the investment. Years of effort and development can quickly become worthless.

2. Inadequate protection of a company's IP

In Central and Eastern Europe (CEE), we often see situations where tech firms have an incorrect understanding of how IP protection works. Virtually all creations relating to a target enjoy some form of legal protection. For example, certain creative works (e.g. software, graphic works, etc.) are protected by copyright. Some are subject to related rights (e.g. a database-maker's right in relation to a database) or personality rights (e.g. photographs of influencers for advertising). The target company should have a proper knowledge and understanding of the various legal protection regimes for its IP and ideally have at least a basic internal manual to manage its IP rights. As well as reducing the purchase price (or reducing or negating an investment), inadequate IP protections can often lead to disputes over the infringement of third-party rights.

3. Insufficient title to developed software

In all such cases, where the development of IP-related work is carried out in-house by company employees and/or carried out by external contractors/freelancers, we often find a lack of IP clauses, or IP clauses that are incomprehensible or fail to provide sufficient title to developed software. The lack of a proper license and the related documentation for externally-developed software can leave the target dependent on the external firm. The absence of internal open source policies and the infringing use of external software implemented in the final product can expose the target's key products to litigation – meaning lawsuits, court cases, and considerable expense.

4. Lack of wording in IP-related agreements on database-maker rights

The creation of new technologies often leads to the creation of databases. Databases can form part of computer program codes, e-shop goods databases for inventories or placed orders, customer or business contact databases, or machine learning models for training data. The content of databases is therefore a valuable target in technology-oriented M&A transactions. We often find that contracts with employees and external contractors creating IP for a target do not expressly provide for database creator rights. This is risky – because if the target company is unable to prove that a given database was created by a developer at the direction or under the responsibility of the target company, the developer could potentially claim that it is the maker of that particular database. This may lead to a potential dispute between the developer and the target company over database-maker's rights.

5. Employment agreement issues

Employment agreements very often fail to contain appropriate protections for the employer (i.e. target). In particular, they are found to contain misleading IP clauses, fail to protect the employer against employees requesting additional remuneration, or fail to correctly describe the scope of the given job position. Such failures can lead to employers not being transferred sufficient IP rights for a given employee's creation.

(continued on page 7)

(Tech M&A in Central and Eastern Europe - continued from page 6)

6. **Lack of trade secrets and know-how protections**

As part of our due diligence, we also encounter companies that lack internal policies, processes and/or procedures for identifying and protecting trade secrets and know-how. This can, in fact, adversely affect the company's ownership or use of valuable information/data that is not otherwise protected, e.g. by copyright, patent or trademark, etc.

7. **Failure to maintain up-to-date details of IP-related registrations**

We also often find that target companies fail to maintain up-to-date details of IP-related registrations, such as domain names or trademarks. Whilst not necessarily a material IP issue, this can nonetheless delay a transaction due to the additional registrations required.

8. **Domain portfolio registration**

In some cases, we have also found that the target does not have a registered product domain name for a particular product or, in the worst case, another person or even a domain speculator has already registered it. Again, this causes serious problems for the target in the transaction.

The following methods can be used to address the above-described IP deficiencies:

- **Conditions Precedent** – for material findings that can be remedied prior to closing (e.g. amend/enter into material IP contracts to address any identified deficiencies).
- **Indemnity** – for material findings that cannot otherwise be rectified (typically breaches of personal data laws).
- **Representations & Warranties** – for cases where a lack of documentation exists (typically a lack of agreements with software developers) and where no specific findings have been identified.
- **Post-closing covenant** – for immaterial findings that can be rectified after closing (e.g. amendments to non-core IP agreements).

In this article, we have sought to focus on the basic deficiencies that we most frequently encounter in our tech-based M&A transactions across CEE. However, as ever-evolving technologies and digital transformations impact both our personal and professional lives, a proper knowledge of the above topics will soon become standard for any technology company operating in the region.

Private Equity M&A Joint Subcommittee

The Private Equity M&A Joint Subcommittee last met at the Montage in Laguna Beach, California, on Friday, January 27, 2023, at 10:45 a.m. pacific time, as part of the Mergers and Acquisitions Committee's Standalone Meeting. It was great to get to enjoy the hotel and area with so many of you for the first time since COVID.

We had two programs in Laguna Beach. First, I was joined on a panel by Bill Monat, Global Head of Transactional Liability for Mosaic Insurance, Julia Papastavridis, a Managing Director for Aon, and Caitlin Rose of Fasken in Toronto, Ontario, to discuss "Trends and Updates on Representation and Warranty Insurance." Representation and Warranty Insurance has become an important part of the toolbox of Private Equity M&A practitioners, and as we do periodically we revisited the product and discussed recent trends. Then, as has become an annual tradition, Andrew Morrow of Houlihan Lokey provided us with a review of the state of the Private Equity Markets.

The next meeting of our Joint Subcommittee will be held during the ABA Business Law Section's Spring Meeting in Seattle, Washington on Friday, April 28, at 1:30 p.m. pacific time. As always, I hope to see as many of you there in person as possible.

We will start our program in Seattle with a panel discussing the impact that the Biden Administration's proposals to prohibit non-compete agreements might have on Private Equity M&A. I will be joined in that discussion by Andrew Capitman, a Managing Director at Kroll (formerly Duff and Phelps) in New York, New York, and Amanda Linett, a partner at Stikeman Elliott in Toronto, Ontario. That presentation will be followed by Alexander Farr, a partner at McDermott, Will & Emery in Dallas, Texas, discussing Current Tax Considerations in Private Equity M&A transactions.

In addition, the day before our meeting, on **Thursday, April 27, between 2:00 and 3:30 p.m. PT,** I will be chairing **a CLE Program entitled "A Comprehensive Look at Representations and Warranties Insurance."** The program will include, but will go beyond, the discussion we had on representations and warranties insurance at our Laguna Beach meetings, and will include a mock negotiation of both a deal that is using representations and warranties insurance and a representation and warranties insurance policy. I will be joined on the panel by Bill Monat of Mosaic Insurance and Caitlin Rose of Fasken, who both participated in the program we did in Laguna Beach, as well as Joanna Lin, a partner at McDermott Will & Emery in Dallas, Texas and Wendy Knoble, a Managing Director at Aon, San Francisco, California.

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. And, 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 Albin, *Chair*
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Alphabet Shares in Luxembourg – Case Law Update

Michaël Meylan, Partner at Strelia Luxembourg

For many years, practitioners have advised and used the so-called “alphabet shares” mechanism in Luxembourg.

The position of the legal and tax practitioners was that it was possible to divide the share capital of a Luxembourg company in classes of shares as long as the guidelines laid down by the Luxembourg Tax Authorities (“LTA”) were respected: (i) limitation to ten different classes of shares (commonly A shares, B shares… until J shares), (ii) existence of the classes as from the inception of the company (or at least as from the first capital injection after incorporation) and (iii) different economic rights between the various classes.

The alphabet shares are offering to investors the flexibility to repatriate profits free from withholding tax by redeeming a full class of shares in ten different instances. Indeed, the implementation of alphabet shares allows the shareholders of the company to repatriate profits through a share class redemption. Such redemption is construed from a legal standpoint as a partial liquidation and is, from a tax standpoint, not subject to the withholding tax normally applicable to dividend distributions. In the silence of the law, the alphabet shares tax treatment was confirmed by advance tax agreements (the so-called “rulings”) and the practitioners kept following the rules set even after the end of the rulings (which were practically abolished further to the LuxLeaks scandal). However, the mechanism was in a grey area as it was not foreseen by law and no longer periodically confirmed by the rulings issued by the LTA.

In this context, the lower Administrative Court of Luxembourg issued an interesting judgment on January 27, 2023, in a case involving the purchase of an entire class of its own shares by a Luxembourg resident company, followed by their cancellation.

In the case at hand, a Luxembourg company had organised its share capital in ten different classes of shares (from A to J) in addition to one class of ordinary shares. The alphabet shares had been put in place after the incorporation of the company, had all the same economic features and were all held by a single shareholder. At some point, shortly after the realisation of its participation in a subsidiary (not being followed by the reinvestment of the proceeds of the sale), the company redeemed the entire class J to the profit of its sole shareholder for a price exceeding the nominal value of the shares. The company treated the redemption followed by the cancellation of the class J shares as a partial liquidation not subject to withholding tax in Luxembourg (as liquidation proceeds are not subject to such tax).

The LTA considered that the positive difference between the redemption price and the nominal value of the shares could not be considered as liquidation proceeds in the scope of a “partial liquidation” assimilated to a tax-exempted liquidation. The reason given was that the shares in each different class did not attract different economic rights. As a consequence, such allocation was re-characterised as a distribution and subject to 15% withholding tax. The taxpayer appealed to the Administrative Court

The Administrative Court reminded the existing possibilities for a company to repatriate proceeds to its shareholder(s): dividend distribution (subject to withholding tax), reduction of share capital (which requires economic justification for the withholding tax exemption) and partial liquidation (free of withholding tax) and the Court ruled that, in the case at stake, the redemption by the company of a full class of shares and its subsequent cancellation was to be construed as a partial liquidation (hence not subject to withholding tax).

However, given that the redemption price paid by the company was excessive compared to the number of shares redeemed, the Court considered that the said redemption price did not match the fair market value of the shares redeemed (i.e., the price a third party would have paid for these shares). The Court ruled that the qualification of hidden dividend distribution (subject to withholding tax) claimed by the LTA was justified but only for the part of the redemption price that exceeded the fair market value of the redeemed shares.

Although specific to this case and subject to appeal, this judgment has many merits, the main one being that it confirms that the alphabet share mechanism (share class redemption followed by its cancellation) must be construed as a partial liquidation and not as a profit distribution.

There are however a few blind spots remaining. The Administrative Court did not rule on how the fair market value of a class of shares shall be determined and in which situations there might be an abuse of law.

It is therefore recommended that Luxembourg companies willing to implement alphabet shares properly document them and assess the fair market value of the shares prior to the share redemption.

Places to Go in Seattle

Restaurants:

The Walrus and the Carpenter
Amazing oyster place in Ballard which is a 15 minute Uber ride from downtown.

Stateside
French Vietnamese fusion place in Cap hill.
Make reservations as it's on all the "best places to eat" lists.

Six-seven restaurant
Located in the Edgewater hotel. The hotel is built on a dock above the puget sound. It is famous because the Beatles and other famous bands stayed their when visiting Seattle. Recommended for brunch as you can have a great view of the sound.

Tilikum Place Cafe
Great food and a laid back vibe.

Bars:

Mbar
A very trendy rooftop bar on the top floor of an Amazon office building.
Gets crowded at happy hour and on the weekend.

Deep Dive
A sophisticated cocktail bar beneath the Amazon spheres. Feels like a Manhattan bar in Seattle. Decor feels like you're in the ocean.

Foreign National
Next door to stateside. Rated one of the best cocktail bars in the nation.

Things to Do:

1) Space Needle and Chihuly Museum
2) Mopop - museum of pop culture
3) Pike Place Market
4) Gum Wall
5) Ferry Ride to Bainbridge Island
6) Visit Ballard

Schedule of Events

> Business Law Section's Hybrid Spring Meeting | April 2023

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

Thursday, April 27, 2023		Time (PT)
CLE Program: ESG Considerations for PE investments	Columbia D, Level 3	8:00 AM - 9:30 AM
New Member Breakfast - Please join us!	Elwha, Level 5	9:00 AM - 9:30 AM
Private Equity & Venture Capital Committee Meeting	Elwha, Level 5	9:30 AM - 11:30 AM
Financial Services Technology Joint Subcommittee Meeting	Room 403 - Cispus, Level 4	1:30 PM - 2:30 PM
Angel Venture Capital Subcommittee	Room 403 - Cispus, Level 4	2:30 PM - 3:30 PM
Private Equity & Venture Capital Jurisprudence Subcommittee Meeting	Room 505 - Queets, Level 5	3:30 PM - 4:30 PM
Venture Capital Financing Subcommittee Meeting	Room 505, Queets, Level 5	4:30 PM - 5:30 PM
Private Equity & Venture Capital Committee Dinner	Aqua	7:30 PM - 10:00 PM
Friday, April 28, 2023		**Time (PT)**
International Private Equity & Venture Capital Subcommittee Meeting	Room 403 - Cispus, Level 4	9:00 AM - 10:00 AM
Private Equity & Venture Capital Funds Subcommittee Meeting	Room 507 - Sauk, Level 5	11:00 AM - 12:00 PM
Private Equity M&A Joint Subcommittee Meeting	Elwha, Level 5	1:30 PM - 2:30 PM
Saturday, April 29, 2023		**Time (PT)**
CLE Program - Current Issues in Corporate Venture Capital: New Deal Structures and Documentation	Columbia D, Level 3	8:00 AM - 9:00 AM

FOLLOW US ON LINKEDIN & FACEBOOK!

ABA Private Equity & Venture Capital Committee Social Media Pages

www.linkedin.com/groups/2395267

www.facebook.com/ABABLSPEVC

Our committee is sponsoring two great CLE programs!

ESG Considerations for PE Investments
Thursday, April 27, 2023 | 8:00 AM PT | Columbia D, Level 3

Current Issues in Corporate Venture Capital: New Deal Structures and Documentation
Saturday, April 29, 2023 | 8:00 AM PT | Columbia D, Level 3

And co-sponsoring five more!

Showcase CLE Program: The Collapse of Silicon Valley Bank and Signature Bank: What it Means for the Financial Ecosystem
Thursday, April 27 | 12:00 – 1:30 p.m. PT | Columbia A, Level 3

Mergers & Acquisitions in the Fintech and Crypto Asset Sectors
Thursday, April 27 | 4:00 - 5:30 p.m. PT | Columbia A, Level 3

Introduction to the Changing World of Fund Finance
Friday, April 28 | 10:00 - 11:30 a.m. PT | Columbia C, Level 3

Becoming a General Counsel: An Insider's Guide
Friday, April 28 | 4:00 -5:30 p.m. PT | Columbia D, Level 3

Creative Philanthropy: Impact (ESG) Investing, Donor Advised Funds, Program Related Investments and More
Saturday April 29 | 10:00 -11:30 a.m. PT | Room 302 - Beckler, Level 3

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NEXT MEETING

Business Law Section Fall Meeting

September 7-9, 2023
Chicago, IL

ARTICLES & AUTHORS NEEDED

The Committee is collecting articles for future newsletters which are circulated to our members world-wide. Please send your submissions to Lawrence Dempsey and Layla Lumpkin at lawrencedempsey@icloud.com and Layla.Lumpkin@ThompsonHine.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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