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Coping with US-Specific Model Agreements in Swiss Financing Rounds

Swiss start-ups increasingly become targets for US-investors – even without incorporating or moving operations to the US. The challenge involved with this development is that Swiss start-ups are likely to be confronted with legal documents that may not be known or understood the same way in Switzerland. A few of these agreements are frequently treated as prerequisites to receive equity funding from US investors as they are part of the standard documentation for US financing rounds. Swiss start-ups and legal counsel are well advised to familiarize with these agreements and concepts in order to avoid stepping into legal pitfalls in the investment process as early as during the term sheet negotiation phase. A basic understanding of these model agreements also helps to close a financing round with US investors in a timely and more (cost) efficient manner.

Management Rights Letter

US venture funds often require a management rights letter concluded between the fund and the start-up ("MRL"). With the MRL, the US investor seeks different management rights including the ability to advise and consult with management of the start-up, attend board meetings and inspect the start-up's books and records. Venture funds request these rights in order to obtain an exemption from regulation (in the US).

In practice, MRLs often serve a wider purpose: MRLs are frequently used as side letters to cater for a wide array of legal topics. In addition to the actual "management rights", MRLs may for example include provisions with regard to rights of first offer, commercial restrictions, non-compete and non-solicit obligations as well as registration rights or confidentiality. In this sense, MRLs can be used by investors as tools to include certain rights which could not be negotiated for in the main investment documents (such as the investment and the shareholders' agreement ("SHA")). In any case, MRLs should be explicitly included in the shareholders' agreement (in the "entire agreement clause") to ensure consent from all parties and conformity with the SHA.

While MRLs in its originally intended form are rarely controversial, MRLs with an extensive content can create conflicts among the parties of a financing round. Start-ups should therefore seek to limit the number (only investors investing above a certain threshold) and scope of MRLs in order to avoid discrepancies with the main investment documents, in particular the SHA, as well as the unequal treatment of shareholders.

Indemnification Agreement

Indemnification agreements are concluded between the start-up and a start-up's directors and/or officers to minimize potential liability for actions during their office. US investors will usually request that their representatives (and sometimes the shareholder itself) be covered by such an agreement. US laws, in particular Delaware General Corporation Law, allow companies to provide for a relatively extensive indemnification towards its directors and officers. While obligations to hold its directors and/or officers harmless may be sensible to attract and retain the best

MICHAEL BAIER (AUTHOR)
M.BAIER@WENGERVIELI.CH

"decision-makers" in a company, Swiss (corporate) law sets somewhat narrower limits to a company's ability in this regard: Indemnifications in case of bankruptcy of the company or wilful and grossly negligent breach of duties are widely regarded inadmissible; some scholars even regard it as unlawful in cases of slight negligence.

Given the cost and time factor of having indemnification agreements negotiated while ensuring conformity with Swiss law, start-ups may consider pushing back on the request for indemnification agreements and propose to implement a Directors & Officers (D&O) insurance instead.

Registration Rights Agreement

Registration rights, such as "demand registration" or "piggyback registration", are something that US investors will almost always request from a start-up. In the event the start-up "goes public" through an initial public offering (IPO) investors want certain rights to register their shares in an IPO or subsequent registration statement once the start-up is public.

Registration rights agreements are rarely heavily negotiated in US financing rounds. Often such agreements concluded in the early stages of the company life cycle are more of a theoretical nature as the company's investment bank will have a major say on how the public offering will be done when the time has come.

In Switzerland, especially in earlier-stage financings, it is uncommon to find clauses related to an IPO of the start-up. Given that the registration rights typically relate to the registration of shares under the US Securities Act of 1933 and that such agreement is concluded under US laws, Swiss start-ups should not spend a lot

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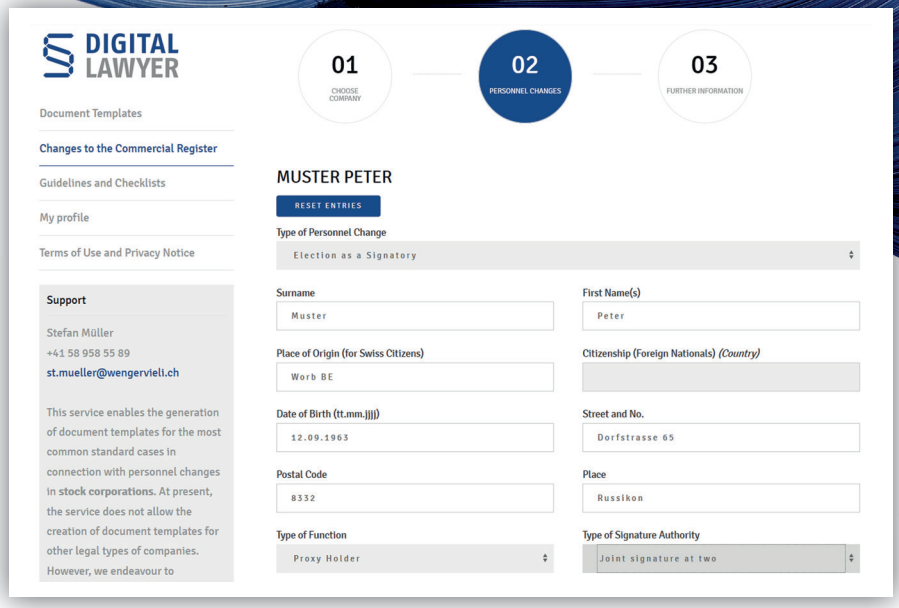

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of time and resources on negotiating registration rights agreements. As alternatives to concluding a registration rights agreement with US investors, the principles of an IPO (if so resolved by the shareholders / board of the start-up) could be set forth in the SHA or implemented in an MRL.

Further NVCA Model Agreements

The US National Venture Capital Association ("NVCA") offers a whole set of uniform documents that are typically the starting point in US venture-backed deals. In addition to the agreements discussed above, these model documents include, among others, stock purchase agreements, investor rights agreements, voting agreements, right of first refusal and co-sale agreements, etc. While these agreements are just as important to US investors when investing in a Swiss target, they usually do not require separate agreements. This is because the essential content of these agreements is already covered by the investment agreement and the SHA most commonly used in Swiss equity financing rounds. Hence, rather than opting for separate US-style agreements, Swiss start-ups should insist on dealing with these legal topics using Swiss-style financing agreements.

Conclusion

It is good news if a Swiss start-up is able to attract US investors, in particular venture capital funds. But the involvement of US investors adds complexity to the (equity) financing round. In most cases, US investors will require a start-up to enter into a MRL, an Indemnification Agreement and a Registration Rights Agreement – concepts that are not common in Swiss financing rounds. While some of these agreements may be cumbersome from a cost/benefit point of view given the financing stage of the start-up, other agreements and concepts may be implemented only in a limited way under a Swiss law. Start-ups should therefore think carefully when being confronted with requests to include US-specific agreements in a Swiss venture capital financing. Also, for the reasons outlined above, start-ups should try to resist the establishment of an US (Delaware) structure for investment purposes because then US investors might require all NVCA Model Agreements to be included in the financing round.

Contact Partners

b.speck@wengervieli.ch; b.brauchli@wengervieli.ch;
p.honold@wengervieli.ch; m.baier@wengervieli.ch
058 958 55 72 (B. Speck); 058 958 53 02 (B. Brauchli Rohrer);
058 958 55 44 (P. Honold); 058 958 55 73 (M. Baier)

www.wengervieli.ch

Facts and Figures

Organization	Wenger & Vieli Ltd.
Foundation	1971
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Employees	Approx. 100 lawyers, tax experts, consultants, paralegals, accountants and assistants
Postal Address	Dufourstrasse 56, 8034 Zürich Metallstrasse 9, 6300 Zug P.O. Box, 8034 Zurich