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EXIT – LEGAL AND TAX INSIGHTS

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Agenda

- Definition
- Recent Exits in CH
- Exits: Why now..?
- Pre-Exit Phase: The Process
- Exit Phase: The Agreements
- Q&A

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Definition of Exit

- Trade Sale (Asset/Share Deal; BA and VC Focus)
- (IPO; potentially dual track)
- [Liquidation]
- [Bankruptcy]
- [Share Buyback / Redemption]

Recent Exits - Targets



4-Antibody



Recent Exits – Buyers



Recent Exits - IPOs

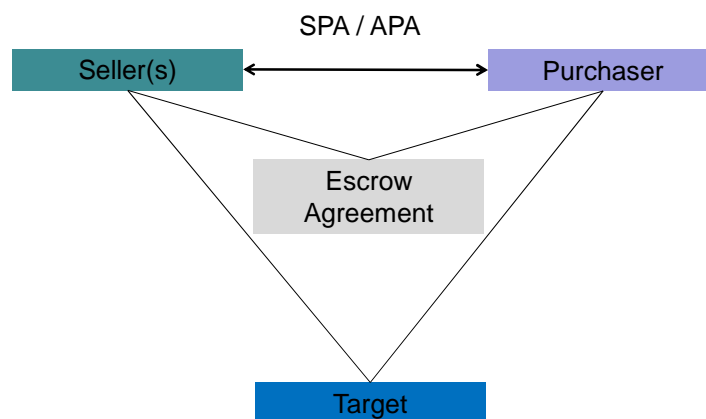


Exits: Why now...?

- Recent success stories / Traction
- Potential (strategic and financial) buyers sit on cash
- IPO channel used to be closed until recently, but...
- EU crisis over (?) / Confidence back
- Topic neglected in the past
- Important for future behaviour in a pre-exit phase

The Process (I)

Overview



The Process (II)

Starts...

... at the financing round(s) (or even earlier)!

Why?

- Deal killers (if any) arise in the early days of a startup
- Purchase price relevant issues may come up
- Indemnity specific matters could be incorporated
- Most of the exit issues have a history..!

Examples

The Process (III)

ROFR (I)

- Swiss Tech Company > 50 Shareholders, running out of cash
- Supply Agreement under US law with a ROFR some years ago

The Process (IV)

ROFR (II)

- “If Company receives an offer from any person to purchase Company or all or any portion of Company's assets (the “Assets”), Company will promptly notify Customer of the terms of the offer and provide Customer with a copy of the offer. [...] Customer shall have forty five (45) days from the date of receipt of such notice and offer within which to give Company notice that Customer agrees to purchase the Assets on the same terms and conditions as are contained in the offer, subject to the results of Customer's subsequent due diligence investigation of the Assets being in good faith satisfactory to Customer in all respects”

The Process (V)

ROFR (III)

- Auction / several binding offers
- Detail: Only Target (but not selling shareholders) as a party to ROFR, BUT: US Law!

Conclusion: Sale to ROFR-Beneficiary, even though preferences were to team up with an other offeror (but no impact on purchase price)

The Process (VI)

ROFR (IV)

- Swiss Tech Company < 10 Shareholders, Break-Even
- Majority Shareholders (Management) intends to exit
- Drag-Along Obligation, but ROFR (at Discount) for minority shareholder
- Third party willing to purchase (including a premium in order to preempt the ROFR) → Term Sheet
- Perfect strategic fit
- BUT: Minority shareholder did not decide whether or not to exercise its ROFR / no waiver of ROFR

The Process (VII)

ROFR (V)

Conclusion: Deal died because potential acquirer was not willing to proceed since it was unclear whether or not the ROFR-Beneficiary would exercise its ROFR.

The Process (VIII)

Tax issues (I)

Transfer of IP at fair market value

If not, risk of (a portion of) purchase price not being a tax-free capital gain

Determination of market salary (no payout, but at least documented and accounted for)

If not, risk of (a portion of) purchase price being requalified as salary

Make all declarations (salary, social security, stamp tax, withholding tax...)

If not, (i) bad impression, (ii) late interest payments (5%)

Early exercise of ESOP (if any at all...)

If not, difference between fair market value and issue price = salary

The Process (IX)

Tax issues (II)

No share transfers among shareholders prior exit

If, difference between fair market value and issue price = salary

The Process (X)

Misc. (I)

- Amendment of SHA only with the consent of all parties to it
- New financing round, subject new type of shares
- Consent of one shareholder missing

Conclusion: bankruptcy of company

- Physically issued shares and share certificates
- One shareholder lost it
- Buyer not willing to buy prior to the end of a «Kraftloserklärungsverfahren»

Conclusion: Deal Killer

The Process (XI)

Misc. (II)

- Swiss VC-backed Company > 50 Shareholders, Break-Even
- Trade sale to strategic investor, cash and shares
- CP: Consent of 95% of all shareholders to sign SPA
- Drag along > 50% at same terms and conditions
- Convertible loan very close prior to exit

The Process (XII)

Misc. (III)

Issue 1: Drag Along

- Some Sellers = foreign based
- Massive tax issue re share swap

Issue 2: Subscription rights for convertible loan

- Issuance of convertible loan 2 months prior exit (NDA and Term Sheet signed...)
- Granting of subscription rights without informing everyone
- No consent of some shareholders > 5%

The Process (XIII)

Misc. (IV)

- Swiss startup < 10 shareholders, Break-Even
- Trade sale to strategic investor, including other (foreign) companies
- Drag along > 50%
- Minority shareholders = Management

Conclusion: SwissCo was sold at a too low price (for the benefit of the purchase prices of the foreign companies) due to the drag along obligation. No protection for minority shareholder; drag along obligation to the terms offered of third party.

The Process (XIV)

Misc. (V)

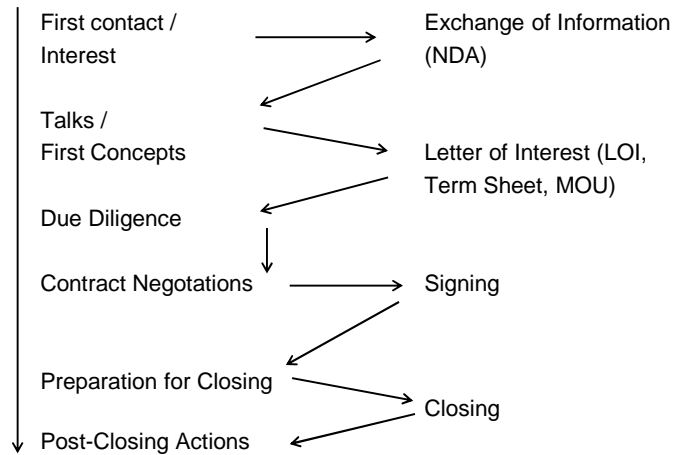
- Swiss startup > 10 shareholders, running out of cash
- Trade sale to strategic investor
- Cash and share offer
- Shares of purchaser are listed, but due to (US) law are not transferrable for a certain period of time (lock-up)
- Massive drop of share price

Conclusion: Factual and considerable Purchase Price adjustment.

How to avoid such pitfalls?

- SHA: «Gouverner, c'est prévoir» (ROFR, Drag along, Tax,...)
- SHA: Dynamic drafting regarding adaptations
- SHA: No issuance of shares
- Good Corporate Governance
- Comply with the (tax) Law (still enough leeway with creative lawyers ...)
- Make an excellent first impression
- Don't sign agreements when being under pressure
- Don't sign agreements if you don't know the benchmark

The Agreements (I)



The Agreements (II)

Overview

- NDA / Confidentiality Agreement
- Letter of Intent (LOI) / Memorandum of Understanding (MoU) / Term Sheet
- Share / Asset Purchase Agreement (SPA / APA)
- Escrow Agreement
- Sellers' Agreement

The Agreements (III)

Is the engagement of a Broker recommended?

Pros	Cons
Proximity to potential Buyers	Costs
Setup of an auction process	Conflict of Interest
Financial know	
Leading the process	

The Agreements (IV)

Confidentiality Agreement

- Parties
- Intended Transaction
- Definition of Confidential Information
- Non-compete / Non-solicitation
- Sanction: Liquidated damages?
- Duration of undertaking: 3-5 years
- Applicable Law / Jurisdiction

The Agreements (V)

Letter of Intent / Memorandum of Understanding / Term Sheet

- Exclusivity
- Transaction
 - Key issues (Purchase Price)
 - (Closing) Conditions
 - Covenants
 - Non-compete
 - Etc.
- Timetable
- Costs / Break up Fees
- Applicable Law / Jurisdiction of TS and Agreements

Legally binding?

The Agreements (VI)

SPA / APA

- Parties
- Shares or Assets?
- Purchase Price (Installments, Escrow, Earn-Out, Share Exchange, Locked Box or Completion Accounts?)
- Closing Conditions (Bring Down, MAC...)
- Representations and Warranties / Indemnities
- Remedies
- Non-Compete
- Indirect Partial Liquidation
- Applicable Law / Jurisdiction / Arbitration

SPA / APA (I)

Liability Regime (Basics)

- (Some) Sellers have to give reps and warranties
- If reps and warranties are untrue, Purchaser may have a claim against Sellers
- OR 200 II (deemed knowledge of purchaser) leads to due diligence (massive management attention!)

PS: Insurability of reps and warranties / Indemnities...

SPA / APA (II)

Limitations (I)

All disclosures against reps and warranties are in favour of the Sellers, such as:

- Data Room Index as Annex?
- Data Room as Annex (DVD)?
- DD Reports as Annex?
- Disclosure Letter as Annex?

Some further exceptions to the rule, such as:

- Change in law;
- Insurance coverage;
- Best knowledge;
- Materiality threshold;
- Etc.

SPA / APA (III)

Limitations (II)

- Right to cure
- Deadlines to claim (knowledge, time-window, ...)
- Calculation of damage (1:1, Multiple, etc.)
- Overall Liability Cap
- De Minimis
- Threshold / Basket
- Statute of Limitation
- Several liability (but not joint)
- Third party claims

SPA / APA (IV)

Tax Issues

- Tax free capital gain – but indirect partial liquidation
- Earn-Out: market salary (if not, [partial] requalification of capital gain as salary)
- Tax retention period (conversion, ESOP, ...)
- Non-compete: could lead to requalification of capital gain as salary
- Tax Findings: Could lead to a full carve out of the «not-tainted» business

The Agreements (V)

Escrow Agreement

- Parties
- Trigger(s)
- Remuneration
- Applicable Law / Jurisdiction

The Agreements (VI)

Sellers' Agreement

- Parties
- Power of Attorney
- Payouts (less Transaction Costs)
- Claim Management
- Termination of internal agreements (SHA, Phantom Stock, ...)
- Applicable Law / Jurisdiction

Summary

- Exit starts earlier than expected...
- Careful consideration of the shareholders' agreement (ROFR, Drag-Along, Tax, dynamic...)
- Comply with the Law
- Build up of an experienced exit team you trust (board committee, broker, lawyer, auditor)
- Make a SWOT-Analysis of both, Sellers and Purchaser
- Negotiate hard where necessary, give up on details