

# Due Diligence for Acquisitions of Mobility Targets

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As the mobility sector continues to evolve at an unprecedented pace, driven by innovations in technology and a global shift towards sustainability, businesses looking to invest or acquire companies or technology within this dynamic landscape are confronted with a vast array of challenges and opportunities. Whether a seasoned investor, an established business seeking a strategic acquisition or a startup navigating partnerships, a potential investor must conduct thorough due diligence in order to mitigate a wide range of risks, some of which are inherent to early-stage investing and others that are specific to the mobility sector.

A fulsome due diligence process is likely to include an assessment of a target's commercial potential, financial performance and projections, and its legal structure and status. While this article will touch upon elements of all of these forms of diligence, it will focus on the most important topics covered in legal due diligence for those considering investments in mobility targets.

## Corporate Structure, Governance and Capitalization

### ***Choice of Entity and Tax Elections***

Early-stage companies come in all shapes and sizes and may be formed as corporations (either C-chapter or S-chapter), limited liability companies, partnerships or incorporated associations. More mature companies seeking large-scale investment often choose to incorporate as a Delaware corporation, as the Delaware General Corporation Law and Delaware state courts provide a business-friendly, stable and predictable body of law for the adjudication of disputes. Although a corporation may elect to be taxed in a number of different ways, most select to be taxed at the corporate level (i.e., taxation as a C chapter corporation) in order to maximize the company's flexibility when seeking investors. If the target company is organized in another form or under a different body of law, the investor may wish to inquire about the reasons behind that decision.

### ***Board of Directors and Management***

Investors may also wish to review the composition and activities of the company's board of directors (or similar governing body). As a company matures, investors will customarily require it to have a board of directors that reflects the interests of all of the major parties on the capitalization table. A board of directors made up solely of founders and their friends and family or a board that rarely

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meets to discuss business may signal an aggressive founder or an underdeveloped governance function. Conversely, if the board is active but dominated by a strategic partner or a major existing investor, then a new potential investor may wish to consider whether it has the leverage to demand its own seat at the table or “veto” rights over certain key decisions.

## ***Advisory Boards***

As they develop, mobility companies may also have advisory boards that meet from time to time or simply provide advice on an as-needed basis to founders and management. Reviewing the makeup and function of these boards can help a potential investor get a sense of the types of relationships that the company has in the mobility space and the quality of advice that management solicits in making key decisions.

## ***Capitalization Table and Governance Documents***

Finally, potential investors will review the capitalization table and governance documents of the target company to understand their economic and governance rights, the preferences and priorities associated with their investment and distributions, and their ability to influence decisions and prevent dilution in future rounds of investment. The capitalization table should demonstrate that the founders have an appropriate equity stake in the business to align their incentives with those of investors, that key employees are invested in the success of the company through grants of derivatives or other financial considerations, and that major investors have not purchased equity on terms that place them at odds with other investors.

## **Financial Information**

### ***Financial Statements and Projections***

A potential investor should expect to review at least basic financial information about the operations of the company to date and its future projections over the next few years. Early-stage companies without a track record of performance may be able to provide only projections, in which case the investor should review the assumptions that underlie those projections and consider whether those assumptions are reasonable. Some companies may provide financial statements, but the quality of those financial statements and related assurances will likely depend on the stage of development and maturity of the operation.

### ***Debt***

If the company has material debt to commercial lenders, suppliers, or third parties, the investor should be reasonably comfortable with the terms upon which it has been extended. If the company is a party to any convertible notes, the investor should review them in connection with its evaluation of the capitalization table.

### ***Personnel and Reporting***

Potential investors must also consider the qualifications and track record of the company’s chief financial officer and the quality of financial reporting that is due to investors. Investors providing a significant capital investment should negotiate financial information rights into their purchase documentation so that they may track the company’s progress and evaluate their investment.

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## **Technology and Intellectual Property**

The success of companies in the mobility sector is likely to hinge upon the effectiveness of its intellectual property and the company's ability to exploit its value. A potential investor will wish to confirm that all intellectual property developed by founders for use by the company or by employees in the scope of their work has been properly assigned to the company. An investor may also wish to conduct basic intellectual property searches to see if the company's material intellectual property is infringing on the rights of third parties or is likely being infringed upon by others.

If the company is relying upon trade secret protection for its intellectual property, then it is important to confirm that the company's employees, independent contractors and others who come into contact with its intellectual property have signed appropriate confidentiality agreements and restrictive covenants that will prevent them from publicizing or otherwise misusing important intellectual property.

## **Commercial Contracts and Relationships**

### ***Strategic Partners***

Mobility companies are often able to fund startup costs and development as a result of contracts with strategic partners that provide funding, access to licensed intellectual property and commitments to order products and services in exchange for a sizeable equity stake and preferred pricing or other considerations. If possible, investors should review material contracts with strategic partners to determine if they include exclusivity provisions, restrictive covenants or other provisions that are likely to limit the company's options for competitive procurement, sale or other exit.

### ***Supply Contracts***

Material supply contracts are also likely to be an area of interest in due diligence. Investors should be comfortable that these agreements are on reasonable terms with reliable and stable partners and contain sound terms with respect to indemnification and dispute resolution.

### ***Customer Contracts***

If the target company has any material customer contracts, the investor may wish to review these to determine if they are on reasonable, arms-length terms, if they can be easily terminated, and if the agreements include any warranty provisions or KPIs that may be costly for the company to support. If the company has fixed terms and conditions for its customer contracts, these should be reviewed according to similar criteria.

### ***User Agreements***

If the company relies upon access by customers, suppliers or third parties to software (including websites, portals or other similar access points, there should be a suitable end-user license agreement in place that establishes the terms upon which the user is able to access these items. Terms should include adequate limitations of liability and limitations on use. The license agreement should also reference the company's privacy policy and should include, if applicable, consent for the collection of data and the terms upon which user and customer data will be used by the company.

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## **Employment Matters**

### ***Basic Staffing Needs***

Investors should determine whether the target company is properly staffed. Although companies' needs change over time, a maturing company will require capable support in financial matters, technology and product development, sales and marketing, team management, legal and regulatory compliance. If the target company does not have individuals in these roles or adequate outside support, there should be a plan to address these needs.

### ***Key Employees***

Most companies in the technology sector also have one or more founders or key employees whose vision, experience and background are crucial to the success of the enterprise. Ideally, founders' incentives are properly aligned with investors' interests because of their equity position in the company. However, investors may wish to confirm that certain key employees are locked into employment agreements with proper restrictive covenants and financial incentives. In select circumstances, it may be appropriate for the company to obtain key man life insurance policies for important employees. For more mature operations, it may be appropriate to inquire about whether the company has an adequate succession plan in place to prepare for the potential departure of key employees.

### ***Employees and Independent Contractors***

For other employees and independent contractors, investors will wish to ensure that the company has filled positions that are important for operational purposes and that it has the ability to attract and retain talent. Companies in the mobility sector may have an acute need for engineers and other skilled workers, and investors should be comfortable that the company will be able to meet its hiring goals. If the company is employing key talent on immigration visas or expects that it will need to solicit international talent in order to meet its needs, an investor may wish to confirm compliance with applicable law and consider the likelihood that the company will be able to offer the necessary visa support to the individuals it wishes to target.

All employees with access to confidential information or trade secrets or who are involved in the development of intellectual property should have signed confidentiality agreements and documents evidencing the assignment of intellectual property developed in the course of their work.

## **Litigation**

Businesses that operate in the mobility sector frequently require testing in real-world environments and, ultimately, will bring their products and services into direct contact with drivers and existing infrastructure. Accidents are likely to occur from time to time and, given the novelty of new mobility technology, these accidents may receive greater press coverage and attention than ordinary motor vehicle crashes. Litigation is an expensive prospect for established companies, but it can threaten the viability of start-ups with limited runway. Potential investors should inquire about or conduct independent searches for litigation in jurisdictions where the company is conducting operations and seek to understand the company's strategy for managing its legal risk.

## **Government Approvals and Regulatory Matters**

The success or failure of many companies in the mobility sector is likely to hinge on their ability to work with governmental and regulatory agencies approvals for their products and services promptly and to avoid costly or damaging investigations that may affect their ability to conduct business. Companies seeking to provide products or services relating to autonomous vehicles operating beyond certain threshold speeds will need to work with the National Highway Traffic and Safety Administration (NHTSA) and state regulators in which vehicles are to be operated. A company that needs to build or access infrastructure such as charging stations or bike-sharing stations may need local approvals regarding where its infrastructure may be positioned and how its assets may be stored when not in use. Mobility companies that rely on government contracts and integration with public transportation systems will require well-established relationships with those entities in order to succeed. Potential investors should ask a target company to outline how the business interacts with and depends upon government approvals and contracts and what the anticipated cost of establishing, maintaining or extending those approvals and relationships is likely to be as the business moves toward profitability.

## **Data Privacy**

Companies in the mobility sector are likely to collect a significant amount of data in the course of their operations. This data may be a crucial part of the company's business and revenue model or it may present an important opportunity as a future secondary source of revenue or pivot. However, any company that collects personally identifiable information (PII) or other material data about its customers, users, suppliers and partners must dedicate serious attention to the legal obligations associated with these activities.

Except where truly necessary, the company may wish to limit the collection of PII (including any combination of information that can be used to identify users). If PII is or may be collected, the company needs to have procedures in place to obtain proper consent for the collection and maintenance of this data, it must take reasonable steps to protect this data, and it must have privacy and other policies in place that govern how the data is used and stored. These obligations are of particular importance if the company operates in or collects data from users in highly regulated markets such as the European Union, the United Kingdom or the State of California.

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