

## VENTURE CAPITAL DEAL TERMS

PLI VENTURE CAPITAL: NUTS AND BOLTS  
March 11, 2010



ELLEN B. CORENSWET, COVINGTON & BURLING LLP  
SARAH REED, CHARLES RIVER VENTURES, LLC

---

---

---

---

---

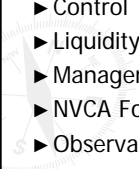
---

---

---

## VENTURE CAPITAL DEAL TERMS

- ▶ Overview
- ▶ Principal Deal Documents
- ▶ Economic Terms
- ▶ Control Terms
- ▶ Liquidity Terms
- ▶ Management/Founder Terms
- ▶ NVCA Forms
- ▶ Observations



---

---

---

---

---

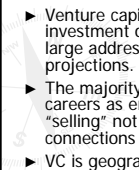
---

---

---

## What is Venture Capital?

- ▶ Money invested in early stage companies with expectation of significant growth in the value of the investment.
- ▶ VCs invest in companies that are too early, too few assets and too high risk to obtain \$ from traditional sources of capital (e.g., banks)
- ▶ If company does not have large capital needs, so-called "angel" or friends and family funding, or even a credit card, might be a better choice.
- ▶ Venture capital funds look for returns of at least 3-5 times investment over a 10-year period, so the company must have a large addressable market and/or credible sizeable revenue projections.
- ▶ The majority of venture capitalists had prior experience in their careers as entrepreneurs, scientists, or engineers: so they are "selling" not just money, but the value-add experience and connections they will bring to the investee company.
- ▶ VC is geographically concentrated: Guess the (only!) six states that had more than 100 VC deals in 2009?



---

---

---

---

---

---

---

---

## Venture Capital Stats

- ▶ In the last 35 years, venture capitalists invested more than \$441 billion in over 57,000 companies in the United States.
- ▶ In 2008, there were more than 1550 seed and early-stage venture capital investments. In 2009, that number fell to 1195. First-time financings fell to the lowest annual levels since 1995.
- ▶ \$27.9B invested in 2008. \$17.7B in 2009, the lowest level of investment since 1997.
- ▶ In 2009, the industries drawing the most VC funding have been biotech, software, medical devices, and energy.
- ▶ The # of VC firms in the US has fallen from 1019 in 2007 to approximately 880 today.
- ▶ \$28.3B raised in 2008. 120 funds raised \$15.2 in 2009, which is the lowest annual fundraising by VC funds since 2003, and the slowest fundraising by number of funds since 1993.
- ▶ Approximately 9,000 companies in the U.S. are backed by venture capital firms; roughly 60% have an investment syndicate.

---

---

---

---

---

---

---

---

## How Do VCs make money for their own investors?

- ▶ They have to exit their investment – either by way of a sale or public offering of the company.
- ▶ Average liquidity horizon currently >8 years.
- ▶ VCs expect, however, that more portfolio companies will liquidate, rather than have a liquidity event. Failure is not only an option, it is an expectation.

---

---

---

---

---

---

---

---

## Speaking of Liquidity: IPO Trends & Data

- ▶ VC-backed IPOs: 86 in '07 / 6 in '08 / 13 in '09.
- ▶ "The fact that many in the media are classifying 3 IPO's [in Q3 '09] as resurgence is evidence of how low our expectations have become." (Mark Heesen, President of NVCA)
- ▶ Median time from initial funding to IPO was 8.3 years in 2008
- ▶ The last two years have been the slowest consecutive years for US venture-backed IPO activity since 1974-1975.

---

---

---

---

---

---

---

---

## Speaking of Liquidity: M&A Trends & Data

- Numbers of M&A Deals

2007	2008	2009
378	348	262

- Total (disclosed) Deal Values

2007	2008	2009
\$29.3 B	\$13.7 B	\$12.3 B

- Avg. (disclosed) Deal Values

2007	2008	2009
\$175 M	\$115 M	\$144 M

- Median (disclosed) deal value for first half of '09 was \$23M. Median amount raised prior to M&A was \$16M. Do the math! These are not "venture returns."

7

---

---

---

---

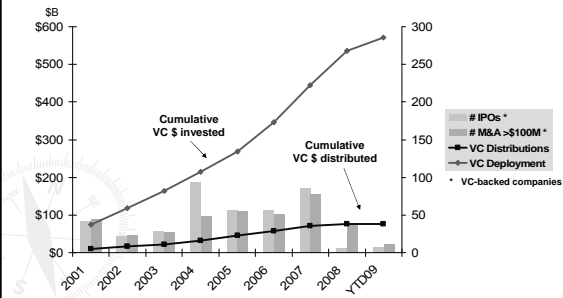
---

---

---

---

## VC Trends Since The "Bubble"



8

---

---

---

---

---

---

---

---

Accordingly, What Trends Might We Expect in the 12 Months Leading up to the 2011 PLI VC Program?

FACT: 10-year VC returns are zero/negative

- ▶ Fewer VC funds/fewer partners in the business
- ▶ Smaller fund sizes
- ▶ Fewer Investments
- ▶ Smaller Investments
- ▶ Lower pre-money valuations
- ▶ What will be the "new new" thing? China, Cleantech, India - - been there, done that. Seed deals?

9

---

---

---

---

---

---

---

---

### Preferred Stock as Investment Vehicle

- ▶ The most common form of security issued in a VC financing is convertible preferred stock.
- ▶ Preferred Stock provides for certain economic and control rights and protections not given to holders of Common Stock (who are typically founders, employees, possibly angel investors).
- ▶ The “bells and whistles” on the Preferred Stock enable the company to issue options at a lower stock price.

10

---

---

---

---

---

---

---

### Typical Timeline for Preferred Stock Investment

Term Sheet:

- ▶ Negotiations can take several weeks.
- ▶ Term sheet should be as detailed as possible – don't assume that jargon-y terms have a defined meaning (e.g. “narrow-based” anti-dilution adjustments) – spell it out!
- ▶ Nonbinding except for confidentiality, no shop, expenses.
- ▶ Importance of lawyer input at term sheet stage

11

---

---

---

---

---

---

---

### Typical Timeline for Preferred Stock Investment (cont.)

Due Diligence:

- ▶ VC may conduct preliminary market, financial and management diligence before term sheet is signed.
- ▶ Legal/IP diligence typically begins after term sheet signed.
- ▶ Diligence process typically 3-4 weeks, following the signing of a term sheet, and simultaneous with drafting, but can take much longer (up to several months).

12

---

---

---

---

---

---

---

### Typical Timeline for Preferred Stock Investment (cont.)

- ▶ Document drafting – typically 2-5 weeks following execution of term sheet.
- ▶ Formation of Syndicate – lead investors will work with company to attract additional investors for balance of funding round (may raise issues of multiple counsel and due diligence efforts).
- ▶ Approvals (e.g. Board, stockholders, amendments to existing agreements).
- ▶ Closing.

---

---

---

---

---

---

---

---

### Summary of Principal Deal Documents

- ▶ Stock Purchase Agreement: A contract between the company and the purchasers (and sometimes the founders as well), that provides for type and amount of securities to be sold, price, representations by company (and possibly founders) and investment representations by purchasers, conditions to closing – stock purchase agreement usually does not contain continuing obligations after closing.
- ▶ Charter: Restated Certificate of Incorporation or Certificate of Designation contains Preferred Stock terms (dividends, liquidation preference, conversion rights/obligations and anti-dilution adjustments, voting and protective provisions, redemption rights). Important: the charter is not a contract. It is a public record on file in the state of incorporation. Because it is not a contract, charter violations result in acts that are void *ab initio* or voidable. Breaches of contract, by contrast, give rise only to claims for damages or equitable relief.

---

---

---

---

---

---

---

---

### Summary of Principal Deal Documents (cont.)

- ▶ Investor Rights Agreement: A contract between the company and the purchasers that contains registration rights, covenants regarding rights to financial and other information, other affirmative and negative covenants, and right of first refusal on new issuances of securities.
- ▶ Voting Agreement: A contract between the company, the purchasers and the "key common stockholders" (founders and management) that contains details on size and composition of Board, drag along rights.
- ▶ Right of First Refusal and Co-Sale Agreement: A contract between the company, the purchasers and the "key common stockholders" (founders and management) primary purpose of which is to handcuff founder/management stock: they must give the company and then the investors (typically in that order) ROFR before they can transfer their shares, and allow investors to sell a pro-rata portion of their shares if a key common holder wishes to sell to a third party.

---

---

---

---

---

---

---

---



## Liquidation Preference

- ▶ Liquidation Preference provides the preferred stock investors a preferred return in the case of a liquidation of the issuer.
- ▶ "Liquidation Event" is defined to include mergers and sales of substantially all assets and may be defined to include a change of ownership of >50% of the shares ("deemed liquidations"), unless a specified percentage of the preferred determines not to treat such a transaction as a Liquidation Event.
- ▶ Under the typical liquidation preference, the preferred investors are entitled to a preference equal to their investment, or a multiple of their investment (e.g. 2x to 4x), before the Common holders receive any proceeds. Alternatively, investors may be entitled to a preference equal to their investment plus a "dividend."

19

---

---

---

---

---

---

---

---

## Liquidation Preference (cont.)

The balance of proceeds, after payment of the liquidation preference, can be distributed either:

- ▶ all to the Common Stock holders ("non-participating preferred") or
- ▶ to the Common and Preferred holders on a pro rata, as converted basis ("participating preferred"), either with no limit on the Preferred's maximum return or with a limit of a multiple of their investment.

▶ *Alternative 1 (non-participating Preferred Stock):* First pay the greater of (i) [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred or (ii) such amount as would have been payable had all shares of Preferred Stock been converted to Common Stock on each share of Series A Preferred. The balance of any proceeds shall be distributed pro rata to holders of Common Stock.

▶ *Alternative 2 (full participating Preferred Stock):* First pay [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred. Thereafter, the Series A Preferred participates with the Common Stock pro rata on an as-converted basis.

▶ *Alternative 3 (cap on Preferred Stock participation rights):* First pay [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred. Thereafter, Series A Preferred participates with Common Stock pro rata on an as-converted basis until the holders of Series A Preferred receive an aggregate of [ ] times the Original Purchase Price per share, at which point each holder of Series A Preferred is entitled to receive the greater of (i) that amount per share or (ii) the amount such holder would receive if all shares of Series A Preferred Stock had been converted to Common Stock immediately prior to such liquidation.

20

---

---

---

---

---

---

---

---

## Conversion

- ▶ **Optional:** Preferred stock is convertible, at the holder's option, into Common Stock initially on a one-for-one basis, subject to adjustment for stock splits and similar events. The conversion ratio/price is also typically subject to adjustment if the issuer later issues securities at a price less than the price paid by the Preferred investors ("price anti-dilution protection"), with an exception for shares issued under the company's stock incentive plan. Other typical exceptions may include securities issued to acquire other companies, and securities issued to strategic partners, lenders and lessors.
- ▶ **Mandatory:** Preferred stock automatically converts into Common Stock upon consummation of a "Qualified IPO" — an IPO of a certain size and per share price (typically 2x to 5x the preferred investor's share price). Preferred Stock may also automatically convert into Common Stock if a certain percentage of the holders of Preferred Stock agree.

▶ The Series A Preferred initially converts 1:1 to Common Stock at any time at option of holder, subject to adjustments for stock dividends, splits, combinations and similar events and as described below under "Anti-dilution Provisions."

▶ Each share of Series A Preferred will automatically be converted into Common Stock at the then applicable conversion rate in the event of the closing of a [firm commitment] underwritten public offering with a price of [ ] times the Original Purchase Price (subject to adjustments for stock dividends, splits, combinations and similar events) and [net/gross] proceeds to the Company of not less than \$ [ ] ("QPO"), or (ii) upon the written consent of the holders of [ ]% of the Series A Preferred.

21

---

---

---

---

---

---

---

---

## Anti-dilution Protection

Price anti-dilution protection can be in one of two basic forms:

- ▶ **Weighted average price protection** adjusts the conversion ratio based on a comparison of (1) the number of shares issued at the lower price, relative to (2) the number of shares of the issuer already outstanding. "Broad-based" v. "narrow-based" formulas refers to what securities are considered "outstanding" for purposes of calculating a weighted average adjustment. The broadest formulation (leading to the smallest adjustment) includes all outstanding common and preferred, on an as-converted basis, plus shares issuable upon the exercise of all outstanding options and warrants. The narrowest formulation only includes Preferred Stock, on an as-converted basis.
- ▶ **Full Ratchet anti-dilution protection** provides that if the issuer issues any shares in a lower-priced round ("down round"), the conversion price of the existing preferred will be reduced to the price in the down round, without regard to the number of shares issued. The ratchet formula may revert to a weighted average formula when the company has raised a specified amount of money at an equal or higher valuation than the current round or after a fixed time period.

*Alternative 1: "Typical" weighted average:*  
 $CP2 = CP1 * (A+B) / (A+C)$   
 CP2 = Series A Conversion Price in effect immediately after new issue  
 CP1 = Series A Conversion Price in effect immediately prior to new issue  
 A = Number of shares of Common Stock deemed to be outstanding immediately prior to new issue (includes all shares of outstanding common stock, all shares of outstanding preferred stock on an as-converted basis, and all outstanding options on an as-exercised basis; and does not include any convertible securities converting into this round of financing)  
 B = Aggregate consideration received by the Corporation with respect to the new issue divided by CP1  
 C = Number of shares of stock issued in the subject transaction

*Alternative 2: Full-ratchet – the conversion price will be reduced to the price at which the new shares are issued.*

---

---

---

---

---

---

---

---

---

---

---

---

## Additional Economic Issues in Venture Capital Investment Transactions

- ▶ **Staggered financings:** multiple tranches at same valuation – importance of defining milestones.
- ▶ **Pay to play provisions:** These provisions are designed to punish existing investors who do not participate in new round and/or reward those who do. Variations include converting non-participants' preferred to common, converting participants' preferred to new preferred with better economic rights, eliminating non-participants' anti-dilution protection.
- ▶ Unless the holders of [...]% of the Series A elect otherwise, on any subsequent down round all [Major] Investors are required to participate to the full extent of their participation rights (as described below under "Investor Rights Agreement – Right to Participate Pro Rata in Future Rounds"), unless the participation requirement is waived for all [Major] Investors by the Board [(including the vote of [a majority of] the Series A Director[s]).
- ▶ **Alternative 1:** [Each share] [applicable portion of the shares] of Series A Preferred of any [Major] Investor failing to do so will automatically convert to Common Stock and lose the right to a Board seat if applicable.]
- ▶ **Alternative 2:** [Each share] [applicable portion of the shares] of any [Major] Investor failing to do so will automatically [lose anti-dilution rights] [lose right to participate in future rounds].

---

---

---

---

---

---

---

---

---

---

---

---

## CONTROL TERMS




---

---

---

---

---

---

---

---

---

---

---

---

## Voting

- ▶ Charter typically provides that Preferred Stock votes with the Common as one class on an as-converted basis, except as otherwise specified in the charter or under Delaware General Corporation Law.



- ▶ The Series A Preferred Stock shall vote together with the Common Stock on an as-converted basis, and not as a separate class, except (i) the Series A Preferred as a class shall be entitled to elect [ ] [ ] members of the Board (the "Series A Directors"), and (ii) as required by law. The Company's Certificate of Incorporation will provide that the number of authorized shares of Common Stock may be increased or decreased with the approval of a majority of the Preferred and Common Stock, voting together as a single class, and without a separate class vote by the Common Stock, irrespective of the provisions of Section 242(b)(2) of the Delaware General Corporation Law.

25

---

---

---

---

---

---

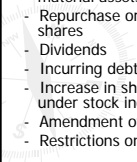
---

---

## Voting (cont.)

- ▶ Preferred stock will have separate class or series voting (veto) rights ("protective provisions") with respect to certain matters such as:

- Issuance of equity securities senior to or *pari passu* with the Preferred
- Liquidation or "deemed liquidation" of the company
- Exclusive license or sale of material assets
- Repurchase or redemption of shares
- Dividends
- Incurring debt over \$X
- Increase in shares reserved under stock incentive plan
- Amendment of charter
- Restrictions on subsidiaries



- ▶ So long as [insert fixed number, or %, or "any"] shares of Series A Preferred are outstanding, in addition to any other vote or approval required under the Company's Charter or By-laws, the Company will not, without the written consent of the holders of at least [ ]% of the company's Series A Preferred, either directly or indirectly by amendment, merger, consolidation, or otherwise:
- (i) liquidate, dissolve or wind-up the business and affairs of the Company, or effect any Deemed Liquidation Event or consent to any of the foregoing; (ii) amend, alter, or repeal any provision of the Certificate of Incorporation or Bylaws (in a manner adverse to the Series A Preferred); (iii) create or authorize the creation of (or issue or obligate itself to issue shares of) any other security convertible into or exercisable for any equity security, having rights, preferences or privileges senior to or on parity with the Series A Preferred; or increase the authorized number of shares of Series A Preferred or of any additional class or series of capital stock (unless it ranks junior to the Series A Preferred); (iv) reclassify, alter or amend any existing security that is junior to or on parity with the Series A Preferred; if such reclassification, alteration or amendment would render such other security senior to or on parity with the Series A Preferred; (v) purchase or redeem or pay any dividend on any capital stock prior to the Series A Preferred; (other than stock repurchased from former employees or consultants in connection with the cessation of their employment/services, at the lower of fair market value or cost); (other than as approved by the Board, including the approval of [ ] Series A Director(s)); (vi) create or authorize the creation of any debt security (if the company's aggregate indebtedness would exceed \$[ ] other than equipment leases or bank lines of credit) unless such debt security has received the prior approval of the Board of Directors, including the approval of [ ] Series A Director(s); (vii) create or hold capital stock in any subsidiary that is not a wholly-owned subsidiary or dispose of any subsidiary stock or all or substantially all of any subsidiary assets; or (viii) increase or decrease the size of the Board of Directors).

26

---

---

---

---

---

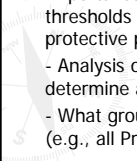
---

---

---

## Voting (cont.)

- ▶ Certain "protective provisions" may be more appropriate at Board level (with investor representatives' approval required) than at stockholder level (e.g., incurrence of debt over \$X, change in management or auditors).
- ▶ Importance of determining appropriate percentage voting thresholds (e.g. majority, 60%, 66⅔%, 80%) for protective provisions.
  - Analysis of post-financing pro forma cap table to determine appropriate thresholds.
  - What groups of stockholders should have veto rights (e.g., all Preferred, each series).



27

---

---

---

---

---

---

---

---

## Voting (cont.)

- ▶ Issues under Delaware General Corporation Law – Section 242(b)(2)

- Unless Certificate of Incorporation provides otherwise, holders of outstanding shares of each class (including common) are entitled to vote separately on any amendment to change the rights of that class or increase authorized shares.

- Unless Certificate of Incorporation provides otherwise, if any proposed amendment would change the rights of one or more series of any class so as to adversely affect such series but not the entire class, then such series has a separate vote.

28

---

---

---

---

---

---

---

---

## Board of Directors

- ▶ Charter may contain provision designating right to elect directors by class/series, with more detailed requirements as to Board size and composition contained in the Voting Agreement.
- ▶ Voting Agreement: This agreement specifies the size of the Board and how particular Board positions will be filled.

- For example, if Series A Preferred is entitled to two directors, Voting Agreement may say that ABC Venture Firm is entitled to designate one director and XYZ Venture Firm is entitled to designate one director, each so long as it owns a specified number of shares; removal and replacement of these directors is subject to same procedure.

- Other designees might include CEO as the "common" director, designated number of outside directors.

- ▶ In addition to Preferred holders, key common holders are required to become parties to Voting Agreement.

29

---

---

---

---

---

---

---

---

## Other Rights Provided to Preferred Stock Investors

- ▶ Contractual Pre-emptive Rights: right to purchase pro rata portion of new securities issued by the company (excluding options, and possibly excluding shares issued in an acquisition or Qualified IPO and shares issued to strategic partners, lenders and lessors).
- ▶ Information Rights (for all investors v. only major investors): monthly, quarterly and annual financial statements, budget.
- ▶ Other Covenants: requirements as to vesting schedules of employee options, key man insurance, D&O insurance.
- ▶ Termination of most special rights upon a Qualified IPO or a Liquidation Event.

30

---

---

---


---

---

---

---

---



## LIQUIDITY TERMS

31

---

---

---

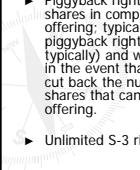
---

---

---

---

---



## Registration Rights

- ▶ Demand rights — typically one or two demands, entitling specified percentage of investors to require issuer to register underlying Common Stock beginning six months after the company's IPO (or by a certain date if an IPO has not occurred).
- ▶ Piggyback rights — ability to include shares in company-initiated offering; typical issues are whether piggyback rights apply to IPO (not typically) and what are the priorities in the event that the underwriters cut back the number of stockholder shares that can be included in the offering.
- ▶ Unlimited S-3 rights.
- ▶ Upon earliest of (i) (three-five) years after the Closing; or (ii) [six] months following an initial public offering ("IPO"); persons holding [ ]% of the Registrable Securities may request [one][two] (consummated) registrations by the Company of their shares. The aggregate offering price for such registration may not be less than \$[5-15] million. A registration will count for this purpose only if (i) all Registrable Securities requested to be registered are registered and (ii) it is closed, or withdrawn at the request of the Investors (other than as a result of a material adverse change to the Company).
- ▶ The holders of Registrable Securities will be entitled to "piggyback" registration rights on all registration statements of the Company, subject to the right, however, of the Company and its underwriters to reduce the number of shares proposed to be registered to a minimum of [20-30]% on a pro-rata basis and to complete reduction on an IPO at the underwriter's discretion. In all events, the shares to be registered by holders of Registrable Securities will be reduced only after all other stockholders' shares are reduced.
- ▶ The holders of [10-30]% of the Registrable Securities will have the right to require the Company to register on Form S-3, if available for use by the Company, Registrable Securities for an aggregate offering price of at least \$[1-5 million]. There will be no limit on the aggregate number of such Form S-3 registrations, provided that there are no more than [two] per year.

32

---

---

---

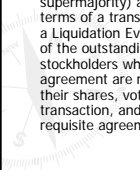
---

---

---

---

---



## Control Provisions with Respect to M&A Transactions

- ▶ Protective Provisions in Charter: preferred holders have a veto over "Liquidation Events" but charter provisions do not give the Preferred the right to force a Liquidation Event to occur.
- ▶ Drag Along in Voting Agreement: if a certain percentage of stockholders (typically a supermajority) agrees to the terms of a transaction constituting a Liquidation Event or a sale of all of the outstanding stock, then all stockholders who sign the voting agreement are required to sell their shares, vote in favor of the transaction, and enter into the requisite agreements.
- ▶ Holders of Preferred Stock and the Founders [and all future holders of greater than [1]% of Common Stock (assuming conversion of Preferred Stock and whether then held or subject to the exercise of options)] shall be required to enter into an agreement with the Investors that provides that such stockholders will vote their shares in favor of a Deemed Liquidation Event or transaction in which 50% or more of the voting power of the Company is transferred and which is approved by [the Board of Directors] [and the holders of \_\_\_\_% of the outstanding shares of Preferred Stock, on an as-converted basis]

33

---

---

---

---

---

---

---

---

## Redemption

- ▶ Preferred stock may be subject to mandatory redemption by the issuer if the issuer has not been sold or gone public within 5 years after the financing. This serves as investors' leverage to pressure management to sell the company or otherwise realize liquidity after a significant investment period.
- ▶ Typical terms are redemption over years 5, 6 and 7, in three equal installments, at the price originally paid plus "dividends."
- ▶ The Series A Preferred shall be redeemable from funds legally available for distribution at the option of holders of at least [ ]% of the Series A Preferred commencing any time after [ ] at a price equal to the Original Purchase Price (plus all accrued but unpaid dividends). Redemption shall occur in three equal annual portions. Upon a redemption request from the holders of the required percentage of the Series A Preferred, all Series A Preferred shares shall be redeemed [(except for any Series A holders who affirmatively opt-out)]

34

---

---

---

---

---

---

---

---

## MANAGEMENT/FOUNDER TERMS



35

---

---

---

---

---

---

---

---

## Equity Participation by Founders/Management

- ▶ VCs may insist that vesting be retroactively imposed on some of founders' shares.
- ▶ VCs will negotiate size of incentive plan reserve, whether founders will be entitled to participate in plan, vesting terms of options (typical reserve is 10% to 20% of fully-diluted shares).
- ▶ Accelerated vesting on change of control: single trigger, double trigger, executives v. all employees.

36

---

---

---

---

---

---

---

---

## Agreements with Founders/Management

- ▶ Employment Agreements – not typically favored by VCs for founders in early stage companies; more common for executives brought in at later stages.
- ▶ Non-competes – enforceability issues – scope, length, compensation, jurisdiction.
- ▶ Confidentiality and Assignment of Invention Agreements – critical that all employees and consultants sign.

37

---

---

---

---

---

---

---

---

## NATIONAL VENTURE CAPITAL ASSOCIATION FORMS



38

---

---

---

---

---

---

---

---

## Venture Capital Financing Model Legal Documents

Available on the NVCA website ([www.nvca.org](http://www.nvca.org))

- ▶ Term Sheet
- ▶ Stock Purchase Agreement
- ▶ Certificate of Incorporation
- ▶ Investor Rights Agreement
- ▶ Voting Agreement
- ▶ Right of First Refusal and Co-Sale Agreement
- ▶ Management Rights Letter
- ▶ Opinion
- ▶ Indemnification Agreement

39

---

---

---

---

---

---

---

---

## Model Legal Documents

- ▶ A best practices set of documents that have been drafted, reviewed and endorsed by an expert working group.
- ▶ Documents that are very "balanced" as between concerns of VCs and entrepreneurs.
- ▶ Where appropriate, options for key provisions that can be reviewed and selected (e.g., broad-based anti-dilution, narrow-based anti-dilution, full-ratchet).
- ▶ Explanatory commentary where necessary or helpful.
- ▶ Each document will be constantly reviewed, updated, and refined (through e-mails to the working group, and through periodic working group review).

40

---

---

---

---

---

---

---

---

## Observations: Keeping Terms in Perspective

- ▶ Company beware!
  - Don't just focus on pre-money valuation and percentage ownership.
  - Other terms matter: liquidation preferences, veto provisions.
  - What else matters: chemistry with VCs, VC ability to fund additional rounds, VC's network.
  - Raise more money now, not later.
- ▶ VCs beware!
  - What's good for the goose..... tough terms in one round may show up from new investor in next round.
  - Make sure management has strong incentives and is aligned with investors.
  - Pay attention to approval thresholds and maintain alliances to achieve approvals.
  - Plan for feasible exits.

41

---

---

---

---

---

---

---

---