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Term Sheet Memorializing of a Venture Capital Agreement
General Information prepared by the attorneys of DLG Luce LLP*

I. Term Sheet

Generally speaking, once an agreement has been made between a potential company and a venture capitalist, the terms of the investment are to be first memorialized in a Term Sheet. The term sheet is a basic outline of the terms of the VC agreement (not unlike a memorandum of understanding), but it is not as comprehensive as the final stock purchase agreement that must be prepared. It is in the actual stock purchase agreement where the VC agreement can be more specifically tailored to a particular circumstance and business relationship.

The term sheet is essentially an offer letter, the purpose if which is to outline the proposed terms and conditions of the investment. Certain terms are usually standard in a VC agreement, but many can be negotiable.

Generally speaking, a term sheet in a VC agreement will include the following"

1. A valuation of the company. The venture capitolist should place a valuation on the company that is based on, among other things, comparisons to other companies in the marketplace and recent transactions. The venture capitalist will be better able to place a valuation on the company after the opportunity to perform legal and business due diligence on the company.

2. If the venture capitalist makes a decision to move forward with funding, the term sheet should have a timeline for the completion and entering into of a stock purchase agreement.

3. Information regarding the form of the investment: VC investors often prefer to invest in convertible preferred stock. This gives preference over common shareholders in dividends upon the sale of a company. It also gives the option of converting into common stock if the company is successful.

4. Non-Solicitation Agreement: The venture capitol company should consider a lock-up period at the term sheet stage where it has a period of time (usually 30 to 45 days) to complete any additional due diligence and make the investment. During this time, the company would be prohibited from accepting an investment of acquisition proposal from any other party.

5. Protective Provisions: Typically, term sheets will include a list of significant actions that cannot be done without the venture capitalists approval. Provisions of this type that are often considered include restricting the company from issuing stock that has equal rights or preferences that are senior to or equal that of the venture capitol company or restrictions on the sale of the company.

6. Price based anti-dilution protection in connection with future sales of the company's stock.

7. The venture capitol company should consider inclusion of pre-emptive rights to purchase any future stock issuances on a priority basis. This would allow the venture capitol company to maintain percentage ownership of the company.

The term sheet should be regarded as an integral part of the process. It is a good way to arrive at the basic terms of the agreement before proceeding into the more specific stock purchase agreement phase. However, generally it is not a legally binding agreement. Basically, it is a proposed framework that is agreed upon before proceeding to the stock purchase agreement phase.

** the information in this memo is of a general nature and is provide as a primer on the preliminary stages of venture capital agreements The information in this memo does not constitute legal advice, nor should it relied upon,. This memo does not form an attorney-client relationship between DLG Luce LLP and any other person or entity, and it does not serve as a substitute for competent legal advice. The discussions in this memo assume the potential company is a corporation (as opposed to an LLC or partnership)*