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This document is meant to act as a checklist and to provide an explanation of various options available that are commonly used in early-stage equity funding.

It sets out some of the key areas included in a term sheet where management/founders raise external third-party equity investment. Please refer to the heads of terms letter agreement accompanying this questionnaire for an example.

Information Required	Notes	Relevant Information
Company – Name, Number and Registered Office		
Current Share Structure and Shareholdings/Options		
Current Directors of the Company		
Company Secretary		
New Investor(s)		
Terms of Service of Executive Directors	Salaries; terms of contract and appropriate intellectual property (IP) protections and restrictive covenants will be incorporated.	
Contractual Comfort for Investors – Warranties/Indemnities	<p>It is relatively uncommon for all representations and warranties to be set out in the term sheet. Instead, it is more usual for reference to be made to customary representations and warranties. These representations and warranties are often given by both the company and the founders and address key issues in relation to the company. Each founder's liability is often capped at a percentage value of the investment or a multiple of their salary. Other information in due diligence and in director declarations will be warranted.</p> <p>Founding shareholders/executive directors will warrant to the investor that the business plan is fairly presented and that the answers given in the due diligence questionnaire and the directors' declarations are true and correct.</p> <p>The warranties will often be subject to customary limitations, including:</p> <ul style="list-style-type: none"> • A <i>de minimis</i> limit (e.g. trivial claims of less than a fairly low amount will be ignored) • That claims cannot be made until they reach an aggregate limit of £[typically 5%-10% of the amount of the investment] whether the full amount can be claimed and not merely the excess will need to be decided 	

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	<ul style="list-style-type: none"> • A maximum limit of £[usually equal to the amount of the investment] • A maximum limit per individual warrantor as follows – [usually in proportion to shareholders or, in the case of managers, capped to a multiple of salary] • A time limit for making claims [usually seven years from completion where the claim relates to taxation and two years typically for other claims] 	
Loans and/or Shares	Will the investments be made entirely as subscription of shares or will some of the money be provided as debt with a prior right to repayment?	
Type of Shares	Should management/new investors get separate classes of shares?	
Preference Shares	<p>Some investors request that shares issued to them are to have preferred rights. The preferred rights are generally economic and include:</p> <p>Fixed dividend – Fixed dividend rights are typically in the region of 6% to 12% of the amount invested. The right to a fixed dividend is not universal. If there is a fixed dividend, there is often discussion at the term sheet stage concerning whether it accumulates (as accumulation can have a significant effect on the total return if exit occurs a number of years after the investment).</p> <p>Liquidation preference – A liquidation preference ensures that an investor is at the top of the list to receive cash in the event of a liquidation or a deemed liquidation. A deemed liquidation typically includes a merger, asset sale and sometimes an initial public offering (IPO). The amount of liquidation preference is a function of perceived risk and the overall valuation of the company.</p> <p>Rights to participate – Investors generally require their preference shares to be participating so that once the liquidation preference is paid, the preference shares participate alongside ordinary shares. There are often caps on the participation element so that an investor receives, for example, a preference multiple of one and participate up to a multiple of three.</p> <p>Rights of redemption – This is a right for the shares to be bought back. If a redemption right exists, it is usually at a price equal to the original purchase price of the preferred shares plus all accrued but unpaid dividends. Redemption rights, particularly if coupled with a preferred dividend, can be problematic under certain accounting standards as they may be required to be treated as debt on the company's balance sheet.</p> <p>Reserved matters/veto rights – Typically, external passive investors will require veto rights on (or the right to vote on and block) certain matters, including changes to share capital and the creation of new share classes, but can extend to key management decisions, e.g. disposing of capital assets or taking on debt. The relevant percentage consent as between investors or whether individual shareholder consents will be required will need to be considered. The extent of contractual or specific shareholder rights required will depend upon the relevant shareholdings held.</p>	

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Ordinary Shares	<p>Founders (and any employees holding shares) are generally issued ordinary shares. These shares have voting rights and a right to receive dividends declared (if there are no preference rights in favour of the investor) but no other specific rights. For tax reasons, growth shares (which are often nonvoting) are sometimes issued to employees instead. Growth shares participate on an exit (alongside ordinary shares) if the exit has a value above a set level. Ordinary shares generally have an issue price below the preference shares, given the rights attaching to them.</p>	
Conditions Precedent	<p>Are there any preconditions to investment being made? E.g. due diligence, directors' declarations?</p>	
Use of Investment Proceeds	<p>Will there be any restriction on the use of investment proceeds?</p>	
Anti-dilution/Future New Issues of Shares	<p>Although there is no standard position, most term sheets include some form of anti-dilution protection for investors. The mechanics for effecting the anti-dilution protection vary between a full ratchet or a weighted average (either broad-based or narrow-based). Full ratchets, while providing the greatest protection to the investor, are generally resisted and less common.</p> <p>If anti-dilution protection is not agreed, it is still usual for a funder to have the benefit of a right of preemption and a veto on any changes in such rights by a change of the articles .</p>	
Matters Requiring Minority Consent – Reserved Matters	<p>If an investor holds a minority position, it will want to agree a list of key areas/matters that the company will be restricted from carrying out without its consent. If investors are to have a majority holding, founders/management should consider incorporating suitable "Reserved Matters" to protect their minority position, although it is unlikely that investors holding a majority of shares will allow these to be extensive.</p>	
Founders and Leaver Provisions/Good/Bad Leaver	<p>The general trend is for founders to own their shares outright with an option for the company or other shareholders (depending on local law issues) to buy back the shares in certain circumstances; for example, if the founder becomes a leaver. If the founder is a bad leaver (which could amount merely to leaving within a given timescale), the price set for the transfer in a bad-leaver situation is often nominal value.</p> <p>In addition to buyback provisions, founder/manager shares are often subject to a lock-in for a set period. The more important the manager, the more likely that a lengthy lock-in period is required.</p> <p>A bad-leaver situation often includes the employee justifying their removal through conduct, but will also often include leaving employment without such reason by merely resigning within a given period. Matters such as prolonged illness, redundancy and unfair dismissal are not usually classified as bad-leaver events.</p> <p>In both good- and bad-leaver situations, the terms will usually require the departing employee to offer their shares on a <i>pro rata</i> basis to the remaining shareholders, but the price will be different (often lower of market value and nominal value in bad leaver situations and fair market price in good leaver situations).</p>	

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Other Compulsory Transfers	A shareholder may be obliged to offer their shares at fair value to other shareholders in proportion to their shareholding in certain circumstances, including that shareholder becoming insolvent, suffering from incapacity, dying, ceasing to be an employee of the company or suffering a change of control (if a corporate shareholder).	
Permitted Transfers	May be permitted to family and relatives, and to family trusts and trust companies where the beneficiaries are family members. In the case of a corporate shareholder, intragroup transfers may be permitted (while the company stays in the group).	
Rights of Preemption on Issue and Transfer	<p>Investors generally have a right of first refusal in relation to:</p> <ul style="list-style-type: none"> • Any further issue of shares (except for approved issues such as to employees under a share option plan). This right is separate from anti-dilution protection. • Any transfers of shares by founders, before a founder can sell their shares, must give the investors an opportunity to participate in the sale. Certain exceptions are usually negotiated, such as estate planning or <i>de minimis</i> transfers (see permitted transfers). Transfers are sometimes also prohibited to competitors or to other parties to protect confidential information. If investors/ the other shareholders do not wish to participate, the investors may wish to nominate a third party to take the shares to avoid a sale to an unknown third party. 	
Drag-along and Tag-along rights	<p>In the vast majority of arrangements with outside investors, investors insist on including drag-along rights under which an agreed percentage of the shareholders can force a 100% share sale. Any exercise of the drag right is usually also subject to investor majority consent.</p> <p>A drag-along right is typically coupled with tag-along rights enabling minority investors to exit at the same time as the investor.</p>	
Board of Directors/ Observers	<p>It is common for investors to request a right to appoint someone to the board of directors.</p> <p>In addition, investors often request the right to appoint a board observer who attends board meetings and receives the materials provided to the board, but does not have a right to vote on matters before the board. Where there is more than one investor with such rights the balance of the board will need to be considered.</p> <p>Although often resisted by founders, certain corporate acts (relating to, for example, debt obligations, related party transactions and employment matters) are often subject to the approval of the investor board appointee. However, in structuring any director consent (rather than investor consent), potential conflict issues for the director must be considered.</p>	

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Rights to Information	<p>In addition to an investor's statutory right to information, information rights for investors may be incorporated. Information rights typically include an obligation to provide monthly, quarterly and annual financial statements and a budget. Budgets are usually subject to the prior approval of investors.</p> <p>Information rights are negotiated in relation to whether they remain in effect while the investor holds any of the company's shares or whether the investor must maintain a specific level of ownership to have such rights.</p>	
Exits	<p>An investor will invest with a view to a return and will need to see a path in the business plan to exit. Exit terms are often around five years.</p> <p>It is commonplace to see a reasonable-endeavours obligation on founders and management to procure an exit within this timescale.</p> <p>Exit events typically consist of IPOs and M&A transactions (mergers and acquisitions).</p>	
Confidentiality	<p>Investors will perform due diligence on a company before investing, including verifying that the company owns its intellectual property. As part of this process, the investors are likely to require company founders, employees and consultants to execute a confidentiality and invention assignment agreements in a form acceptable to as a condition to investment. Such agreements typically provide for protection of the company's confidential information, including:</p> <ul style="list-style-type: none"> • Nondisclosure • Noncompetition/ nonsolicitation obligations (in some cases) • Disclosure of prior knowledge, inventions and commitments that conflict with obligations to the company • Disclosure and assignment of inventions to the company (typically those related to the company's business or made with use of the company's resources) 	
Noncompete Obligations	<p>The founders are likely to be required to enter into noncompetition (and nonsolicitation) undertakings. Noncompete provisions often apply while a founder holds shares and for a period of six-to-12 months to two years after ceasing employment.</p>	
Employee Share Option Pool	<p>To incentivise employees, many companies adopt share option plans or employee share ownership plans, under which the company grants key employees the right to acquire shares in the company.</p> <p>It is typical to set aside a share option pool for this purpose, e.g. 5% to 10% of enlarged share capital after investment.</p>	
Key Man Insurance	<p>Insurance policies on key management may be required.</p>	
Termination of Existing Shareholder Agreements	<p>These will need to be terminated.</p>	

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Other terms	<p>There are a number of other terms often included in the term sheet itself, including:</p> <ul style="list-style-type: none"> • Exclusivity provisions • Payment of investors' fees and expenses – an arrangement fee may be payable • A condition that D&O insurance is obtained in relation to officers. 	
Governing Law	The term sheet should provide that both negotiations and documentation are subject to English law.	
Legal Process and Timetable	It is advisable for the detail of who will draft initial drafts and the timetable for the process to be set out.	