

**ULTRA LIGHT STARTUPS MODEL EARLY STAGE INVESTMENT
TERM SHEET**



Tedd Lustig
tlustig@seyfarth.com
(617) 946-8317

TERM SHEET
FOR SERIES A PREFERRED STOCK FINANCING OF
[INSERT COMPANY NAME], INC.
[_____, 201_]

This Term Sheet summarizes the principal terms of the Series A Preferred Stock Financing of [_____] Inc., a [Delaware] corporation (the “**Company**”). In consideration of the time and expense devoted and to be devoted by the Investors with respect to this investment, the No Shop/Confidentiality [and Counsel and Expenses] provisions of this Term Sheet shall be binding obligations of the Company whether or not the financing is consummated. No other legally binding obligations will be created until definitive agreements are executed and delivered by all parties. This Term Sheet is not a commitment to invest, and is conditioned on the completion of due diligence, legal review and documentation that is satisfactory to the Investors. This Term Sheet shall be governed in all respects by the laws of the [State of Delaware], and does not constitute an offer to sell or a solicitation of an offer to buy securities in any state where the offer or sale is not permitted.

Offering Terms

Closing Date: As soon as practicable following the Company’s acceptance of this Term Sheet and satisfaction of the Conditions to Closing (the “**Closing**”).

Investors: Investor No. 1: [_____] shares of Series A Preferred Stock, \$[_____]

Investor No. 2: [_____] shares of Series A Preferred Stock, \$[_____]

Amount Raised: \$[_____].

Price Per Share: \$[_____] per share (based on the capitalization of the Company set forth below) (the “**Original Purchase Price**”).

Pre-Money Valuation: The Original Purchase Price is based upon a fully-diluted pre-money valuation of \$[_____] and a fully-diluted post-money valuation of \$[_____] (including an employee pool representing [8-10]% of the fully-diluted post-money capitalization).

Capitalization: The Company’s capital structure before and after the Closing is set forth on Exhibit A.

CHARTER

Dividends:

The Series A Preferred will accrue dividends at the rate of [8]% per annum[, payable only when and if declared by the Board] [or upon a liquidation or redemption.] For any other dividends or distributions, participation with Common Stock on an as-converted basis.

Liquidation Preference:

In the event of any liquidation, dissolution or winding up of the Company, the proceeds shall be paid as follows:

First pay [1X-3X] 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.

A merger or consolidation (other than one in which stockholders of the Company own a majority by voting power of the outstanding shares of the surviving or acquiring corporation) and a sale, lease, transfer, exclusive license or other disposition of all or substantially all of the assets of the Company will be treated as a liquidation event (a “**Deemed Liquidation Event**”), thereby triggering payment of the liquidation preferences described above [unless the holders of []% of the Series A Preferred elect otherwise].

Voting Rights:

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.

Protective Provisions:

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; (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; (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; (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.

Optional Conversion:

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."

Anti-dilution Provisions:

In the event that the Company issues additional securities at a purchase price less than the current Series A Preferred conversion price, such conversion price shall be adjusted in accordance with the following formula:

[*Alternative 1*: “Typical” weighted average:

$$CP_2 = CP_1 * (A+B) / (A+C)$$

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.]

The following issuances shall not trigger anti-dilution adjustment:

(i) securities issuable upon conversion of any of the Series A Preferred, or as a dividend or distribution on the Series A Preferred; (ii) securities issued upon the conversion of any debenture, warrant, option, or other convertible security; (iii) Common Stock issuable upon a stock split, stock dividend, or any subdivision of shares of Common Stock; (iv) shares of Common Stock (or options to purchase such shares of Common Stock) issued or issuable to employees or directors of, or consultants to, the Company pursuant to any plan approved by the Company’s Board of Directors including at least [] Series A Director(s); and (v) shares of Common Stock issued or issuable to banks, equipment lessors or other financial institutions, or to real property lessors, pursuant to a debt financing, equipment leasing or real property leasing transaction approved by the Board of Directors of the Corporation,

including at least [] Series A Director(s).

Mandatory Conversion:

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 \$[] (a “QPO”), or (ii) upon the written consent of the holders of []% of the Series A Preferred.

Pay-to-Play:

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].]

Redemption Rights:

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 .

STOCK PURCHASE AGREEMENT

Representations and Warranties: Standard representations and warranties by the Company. [Representations and warranties by Founders [regarding technology ownership, conflicting agreements, litigation etc.].

Conditions to Closing: Standard conditions to Closing, which shall include, among other things, satisfactory completion of financial and legal due diligence, exemption of the shares under applicable Blue Sky laws, the filing of a Certificate of Incorporation establishing the rights and preferences of the Series A Preferred, and an opinion of counsel to the Company.

Counsel and Expenses: Investor counsel to draft closing documents. Company to pay all legal and administrative costs of the financing at Closing, including reasonable fees and expenses, in an amount not to exceed [____], of Investor counsel.

INVESTOR RIGHTS AGREEMENT

Registration Rights:

Registrable Securities: All shares of Common Stock issuable upon conversion of the Series A Preferred and any other Common Stock held by the Investors will be deemed “**Registrable Securities.**”

Demand Registration: 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).

Registration on Form S-3: 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.

Piggyback Registration: 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.

Expenses:

The registration expenses (exclusive of stock transfer taxes, underwriting discounts and commissions will be borne by the Company. The Company will also pay the reasonable fees and expenses[, not to exceed \$_____,] of one special counsel to represent all the participating stockholders.

Lock-up:

Investors shall agree in connection with the IPO, if requested by the managing underwriter, not to sell or transfer any shares of Common Stock of the Company for a period of up to [180] days following the IPO subject to extension to facilitate compliance with FINRA rules (provided all directors and officers of the Company [and [1 – 5]% stockholders] agree to the same lock-up).

Management and Information Rights:

A Management Rights letter from the Company, in a form reasonably acceptable to the Investors, will be delivered prior to Closing to each Investor that requests one.

Any [Major] Investor (who is not a competitor) will be granted access to Company facilities and personnel during normal business hours and with reasonable advance notification. The Company will deliver to such Major Investor (i) annual, quarterly, and monthly financial statements, and other information as determined by the Board; and (ii) thirty days prior to the end of each fiscal year, a comprehensive operating budget forecasting the Company's revenues, expenses, and cash position on a month-to-month basis for the upcoming fiscal year. A "**Major Investor**" means any Investor who purchases at least \$[_____] of Series A Preferred.

Right to Maintain Proportionate Ownership:

All [Major] Investors shall have a pro rata right, based on their percentage equity ownership in the Company (assuming the conversion of all outstanding Preferred Stock into Common Stock and the exercise of all options outstanding under the Company's stock plans), to participate in subsequent issuances of equity securities of the Company (excluding those issuances listed at the end of the "Anti-dilution Provisions" section of this Term Sheet). In addition, should any [Major] Investor choose not to purchase its full pro rata share, the remaining [Major]

Investors shall have the right to purchase the remaining pro rata shares.

*Matters Requiring Investor
Director Approval:*

So long as the holders of Series A Preferred are entitled to elect a Series A Director, the Company will not, without Board approval, which approval must include the affirmative vote of [one/both] of the Series A Director(s):

(i) make any loan or advance to, or own any stock or other securities of, any subsidiary or other corporation, partnership, or other entity unless it is wholly owned by the Company; (ii) make any loan or advance to any person, including, any employee or director, except advances and similar expenditures in the ordinary course of business or under the terms of a employee stock or option plan approved by the Board of Directors; (iii) guarantee any indebtedness except for trade accounts of the Company or any subsidiary arising in the ordinary course of business; (iv) incur any aggregate indebtedness in excess of \$[_____] that is not already included in a Board-approved budget, other than trade credit incurred in the ordinary course of business; (v) enter into or be a party to any transaction with any director, officer or employee of the Company or any “associate” (as defined in Rule 12b-2 promulgated under the Exchange Act) of any such person [except transactions resulting in payments to or by the Company in an amount less than \$[60,000] per year]; (vi) hire, fire, or change the compensation of the executive officers, including approving any option grants; (vii) change the principal business of the Company, enter new lines of business, or exit the current line of business; (viii) sell, assign, license, pledge or encumber material technology or intellectual property, other than licenses granted in the ordinary course of business; or (ix) enter into any corporate strategic relationship involving the payment contribution or assignment by the Company or to the Company of assets greater than [\$100,000.00].]

*Non-Competition and Non-
Solicitation and Agreements:*¹

Each Founder and key employee will enter into a one year non-competition and non-solicitation agreement in a form

¹ Non-compete restrictions are a matter of state law, and you need to investigate the relevant law in the state where the employee works (e.g., permissible temporal and geographic scope, what constitutes adequate consideration). In California, other than in connection with the sale of a business, they are prohibited.

reasonably acceptable to the Investors.

*Non-Disclosure and
Developments Agreement:*

Each current and former Founder, employee and consultant will enter into a non-disclosure and proprietary rights assignment agreement in a form reasonably acceptable to the Investors.

Board Matters:

The Board of Directors shall meet at least [monthly][quarterly], unless otherwise agreed by a vote of the majority of Directors.

[The Company will bind D&O insurance with a carrier and in an amount satisfactory to the Board of Directors.] The Company shall agree that its indemnification obligations to Series A Directors are primary, and obligations of affiliated Investors are secondary. In the event the Company merges with another entity and is not the surviving corporation, or transfers all of its assets, proper provisions shall be made so that successors of the Company assume the Company's obligations with respect to indemnification of Directors.

Employee Stock Options:

All employee options to vest as follows: 25% after one year, with remaining vesting [quarterly][monthly] over next 36 months.

Key Person Insurance:

Company to acquire life insurance on Founders [*name each Founder*] in an amount satisfactory to the Board. Proceeds payable to the Company.

RIGHT OF FIRST REFUSAL/CO-SALE AGREEMENT

*Right of first Refusal/
Right of Co-Sale (Take-me-
Along):*

Company first and Investors second have a right of first refusal with respect to any shares of capital stock of the Company proposed to be sold by Founders [and current and future employees or consultants holding greater than [1]% of Company Common Stock (assuming conversion of Preferred Stock and whether then held or subject to the exercise of options), with a right of oversubscription for Investors of shares unsubscribed by the other Investors. Before any such person may sell Common Stock, he will give the Investors an opportunity to participate in such sale on a basis proportionate to the amount of securities held by the seller and those held by the participating Investors.

Lock-Up

Founders will not transfer, hedge or otherwise dispose of any capital stock following an IPO for a period specified by the Company and the managing underwriter not to exceed

[180] [210] days.

VOTING AGREEMENT

Board of Directors:

At the Closing, the Board shall consist of [] members comprised of (i) [Name] as [the representative designated by []], (ii) [Name] as the representative designated by [], (iii) [Name] as the representative designated by the Founders, (iv) the person then serving as the Chief Executive Officer of the Company, and (v) [] person(s) who are not employed by the Company and who are mutually acceptable [to the Founders and Investors].

Drag Along:

All stockholders of the Company shall be required to enter into an agreement 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.

OTHER MATTERS

Founders' Restricted Stock:

All Founders to own restricted stock outright subject to Company right to buyback at cost. Buyback right for []% for first 12 months after Closing; thereafter, right lapses in equal [monthly][quarterly] increments over following [36] months.

No Shop/Confidentiality:

The Company agrees to work in good faith expeditiously towards a closing. The Company and the Founders agree that they will not, for a period of [] weeks from the date these terms are accepted, take any action to solicit, initiate, encourage or assist the submission of any proposal, negotiation or offer from any person or entity other than the Investors relating to the sale or issuance, of any of the capital stock of the Company or the acquisition, sale, lease, license or other disposition of the Company or any material part of the stock or assets of the Company and shall notify the Investors promptly of any inquiries by any third parties in regards to the foregoing. The Company will not disclose the terms of this Term Sheet to any person other than officers, members of the Board of Directors and the Company's accountants and attorneys and other potential Investors acceptable to [], without the written

consent of the Investors.

Expiration:

This Term Sheet expires on [_____, 201_] if not accepted by the Company by that date.

EXECUTED THIS [] DAY OF [], 20[].

[SIGNATURE BLOCKS]

EXHIBIT A

Pre and Post-Financing Capitalization

Security	Pre-Financing		Post-Financing	
	# of Shares	%	# of Shares	%
Common – Founders				
Common – Employee Stock Pool				
Issued				
Unissued				
[Common – Warrants]				
Series A Preferred				
Total				