Next up on our long list of terms in a term sheet that don't matter very much are conditions precedent to financing.

Clint: When do conditions president to financing show up in the process? Presumably, before the financing.

Brad: Yes. They show up before the financing. They're usually in the term sheet itself. The best way to think about the phrase "conditions precedent to financing" is it's just lawyerese for things that might come up that would cause me not to do the deal. In fact, a VC can walk away or an investor can walk away from a deal up to the minute before it's signed in all cases with almost no penalty.

It happens. Not that often. In most reputable venture firms, if they sign a term sheet they will follow through on the financing. Interesting, not always for a variety of reasons.

In addition, there are a number of firms who like to "tie up" a deal. They convince the entrepreneur with the term sheet that we're really ready to go and they use a condition precedent to financing or something in that clause to say, "Well, things didn't work out quite the way we thought; therefore, I'm not going to close on the financing."

Clint: What are the conditions? What are some examples of things that might go in there?

Brad: Generally, the conditions are standard due diligence items. They can be as vague as your operating plan and the investor seeing your operating plan and agreeing that it makes sense or having reviewed all of your prior materials checking to make sure that there are no outstanding litigation issues. They can also be things that are totally outside of your control. Things like the investor going to their internal investment committee and getting approval on the actual financing.

Generally, these kinds of terms again don't really matter that much because the investor can walk away at any time for any reason up to that point at which the financing closes. The interesting thing that I found in term sheets is when there are these conditions precedent to a financing, they sometimes set the tone for what you're going to go through in the due diligence process.

They also give you a sense before you agree to the term sheet, how serious that particular investor is. If there's a long list of very detailed things then that investor is probably not as serious as the investor who puts something out that's pretty lightweight and feels generic and relatively standard diligence.

Clint: Questions?

Student: How much push back is acceptable on the part of the entrepreneurs on some of these conditions? For instance, I'm concerned that some of these conditions I'm not totally in agreement with. Is there some back and forth and some leeway flexibility? Is it typically take or leave it?

Brad: The push back is totally fine. Recognize two things. One is your push back is happening before you sign the term sheet or agree to the term sheet. The term sheet will typically have something in it that we'll talk about later, which is a no-shop agreement. That basically says, "Once you sign this term sheet then you the entrepreneur are committed to the deal."

Interestingly, many of the times that's one way, where you the entrepreneur committed to the deal but the investor doesn't feel that same level of commitment. The pushing back prior to signing the term sheet is a little bit of a test of conviction and seriousness.

If you only have one term sheet then pushing back probably isn't that effective. You don't have much leverage anyway so why struggle with it, especially if it's minutia detailed type of stuff. If it's something that the investors is asking for calling out specifically that you know is not something that you can satisfy, just talking about it openly before you sign the term sheet is probably more useful than getting into it and then going down that path.

If you have, two, three, or four term sheets and one of them you like a lot but it has a whole bunch of crazy conditions precedent to the financing, pushing back at that point knowing that you have some alternatives is pretty reasonable.