If the term sheet is the engagement, I want to make sure that you're not looking out for someone better before you get married. That's what the no shop clause is.

Clint: As an entrepreneur, what does the no shop clause restrict me from doing?

Jason: The no shop agreement restricts you from shopping the deal around once we've signed a term sheet. While the term sheet itself is non-binding, there are actually a few terms in the term sheet that are and this is one of them.

This basically says that once this term sheet is signed, you're not allowed to go talk to any other venture capitalist about doing this deal. We are done. If I am going to spend the time, the money and the effort to do the diligence and pay the lawyers, unless something happens between you and me, the deal is getting done. You're not allowed to bring someone else into our relationship.

These agreements have been around forever in the M&A context, given how large those deals are, how many lawyers are involved and what the cost and time are. They were not in venture deals until 2000 when our partner, Ryan McIntyre signed a term sheet with a company that ended up shopping itself. The deal went away before we closed it.

Now, the company was actually purchased by another company. They didn't go with another venture firm, and they did the honorable thing of giving us some compensation which was really nice. We had zero money in and got some positive money out. As Ryan would like to tell you, it's the greatest venture return of all time because it's infinite.

But we decided in 2000 that we were going to start putting no shops in our term sheets which now have spread throughout the industry. It basically said that once this thing is signed, we are working together to close this deal. We are not looking around at other things.

Clint: Help me figure out this works operationally. I'm talking to a bunch of VCs trying to get funding. You give a term sheet with a no shop. What do I tell all these other folks?

Jason: You tell these other folks. "I just got a term sheet from Foundry Group. Please get your term sheet in ASAP," and you do not sign the term sheet. No one should be signing a term sheet with a no shop until you have decided that you are going to go with this person because we really figure that as a commitment.

And it's okay, by the way, to come back to me and say, "Hey, Jason. Love the term sheet. It's going to take us a little bit to go over everything and by the way, we might have a couple of other ones coming in," if that is true. Don't oversell, again. It's okay. I'm a big boy, I understand how this works.

Clint: Okay, so I think I get this. I get a term sheet, I use that as leverage to get other term sheets. I have a window when I can do that. How wide is that window? How much time do I have?

Jason: I would probably for most firms, not more than a week. I think after a week I start thinking, "Okay, either you love me or you don't. If you love me, let's get married. If you don't, that's cool too." You've got about a week but once that no-shop goes into effect (that no-shop is usually between 45 and 90 days), you are locked out from talking to anyone else.

Clint: Okay, so I sign the no-shop with you. The next day, my dream VC gives me a call.

Jason: It wasn't me.

Clint: Sorry.

Jason: All right, won't take it personally.

Clint: Two questions. What do I do if I want to be honorable to the no-shop? The second one is do I have any recourse if I really want to go with this other firm?

Jason: If you want to be honorable to the no-shop, you would tell your dream VC, "I'm sorry. Too little, too late." If you really need to go with your dream VC, the next thing you could probably do is to come talk to me and say, "Hey look. I really would like to bring this other VC in." Maybe you can get another deal where we'll both be co-leads and life is great.

The worst case scenario is that you tell me to go pound sand and go away and you consummate a deal with the other VC. That leaves me in a position where my only recourse is to sue you.

You have to make the calculus, "Is Foundry Group willing to sue an entrepreneur? Would this play well on TechCrunch? Would Brad and Jason want it out in the world that we were going to force a deal to happen that an entrepreneur didn't want to happen?"

The answer is, “Probably not.” But then again, there are a lot of VC firms who might act differently and I can’t tell you how they would be under the situation.

Clint: Questions?

Student: Why the discrepancy in the timeframes? You said that some firms would ask for 45, some would ask for 90. Why is there such a big range there?

Jason: Well, there are couple things. There are two things that slow down closing. We get a term sheet signed. What are the two things we have to do? We have to negotiate the documents and I have to call money from my investors to get it into my account. So those are the two gating items.

Oh wait. The third gating item is lawyers. But depending on how fast you normally do deals, I would say that on average a month is kind of quick. You figure, “I have no control over the company’s lawyers. Maybe they’re slow. Maybe they’re on vacation, maybe until August.

It might take three weeks to get the diligence information. We want to build in padded time to make sure that the no-shop doesn’t run out before the deal gets closed. So that’s why there’s a discrepancy.

Student: Assuming you sign the term sheet, is there anything in there that could void the no-shop clause?

Jason: Not that I’m aware of. I’m the one who drafted it, so if there is, then I screwed up 13 years ago. It’s not impossible.