Capital Club Dubai

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Term Sheets for early stage investment

2021

Understanding Term Sheets for early stage investment

For Founders of businesses seeking to raise capital, gaining a full understanding of what a Term Sheet is should be a top priority to ensure their discussions with potential Investors get off on the right footing.

The purpose of this guide is to help Founders and Investors understand Term Sheets, why we use them, and what provisions are commonly negotiated in Term Sheets. This will help guide how Term Sheets are to be drafted and negotiated. It is also useful to recognise that in the early stage investment rounds, having a balanced Term Sheet between the Founders and Investors will help to keep all parties happy, motivated and focussed on their common goal: making the startup a great success.

This guide covers:

— A basic introduction to Term Sheets – why we use them and what they do; and

— An overview of some of the most commonly seen provisions in Term Sheets, including what a "Founder-Friendly" and "Investor Friendly" version of each term might look like.

We hope that this guide offers some helpful insights to Founders and Investors and helps support early stage investment rounds to proceed on the right footing. If you have any ideas for improvements or queries, please do drop us a line – we'd be delighted to hear from you.

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Investment Rounds

The Middle East is experiencing huge growth in the development of new businesses. Governments around the region are supporting this by reducing the cost and administrative burden on entrepreneurs wishing to start new ventures, while accelerators, incubators and sandboxes are now a common feature of the regional startup ecosystem.

Helping fund this wave of new startups is a healthy and growing range of early stage investors buoyed by some notable recent success stories, such as Souq.com, Careem and Dubizzle. This range of Investors includes venture capital arms of global media corporations and regional telcos, traditional venture capital funds, public, semi-public and private sector investor-incubators, family offices, high net worth individuals and even specific sector-based groups such as real estate developers supporting prop-tech startups.

When a startup reaches a certain stage of development, it may require external cash to help support the next phase of its growth. At that point, the owners of these startups – the Founders - will need to tap into this wide array of potential Investors to bring in the cash it requires.

What is the process?

It is common for successful startups to raise cash from Investors on a regular basis. A typical progression might look something like this:

Start Operations
Initial funding from the Founders, friends & family. Founders own 100% of the Company.

Seed Round
Founders raise their first external cash from Investors. Often a "seed" round is made in the form of a Loan Note (e.g. a SAFE Note, KISS Note or Convertible Loan Note). These are essentially loans that will be converted into shares when the Company raises it's first equity fundraising - "Series A".

Series A
This is the Founders' first equity fundraising, where they issue shares in the Company to external Investors. At this stage, any loan notes issued at the Seed Funding stage would also normally convert into shares in the Company at a 15-20% discount to the price that other Investors in the Series A round pay

Bridge Round?
Inbetween a Series A and Series B round, the business may require some additional cash in the short term. This is often structured as a Loan Note (on similar terms to the Seed Funding round), where the notes issued in the "Bridge Round" would convert into shares issued in the next round - the "Series B" round.

Series B, C, D...
The Company can then continue raising capital in future rounds B, C, D and so on, often until the Company achieves an "Exit" which is typically a sale of the entire Company to a private equity investor, a trade buyer, or floating the Company via an IPO on a stock exchange.

Although there are a lot of variations, as a general rule a Seed Round and a Bridge Round would involve the business raising cash by way of “debt” (i.e. loan notes) that can be converted into equity later on, whereas Series A, B, C etc are “equity” rounds, i.e. shares are issued in return for cash from Investors.

Where do we start?

There are often a lot of open questions to address at the start of any investment round – whether it is a Seed Round, Series A, B, C etc, or a Bridging Round. Common questions can include:

- How much cash does the business need to raise and what will it be used for?
- What kind of Investor(s) does the Founder want to bring in? Also, does the business need any strategic “value adds” from its Investors, e.g. experience/ability to help the business expand into new territories?
- When does it need the cash? This might help influence whether a small Bridging Round is appropriate, or a larger equity round.
- What reassurances will the business/company give to the Investors about the state of affairs of the Company? Typically, an Investor would want some reassurances that the Company is being run professionally and in compliance with the law, that it owns everything it says it owns, that it doesn’t have any major liabilities and so on.
- What rights will the Investors want in the business in return for their investment, for example, will they want a seat on the Board?
- What rights will the Investors want in relation to future investment rounds – will they want the right to participate in those rounds, and if so, on what terms?
- What happens if the business fails – does the Investor get their money back first?

All of these questions would be addressed in the detailed transaction documents that would be agreed between the Investors and the Founders (and the Company) which form the basis of each investment round. Those transaction documents will often comprise the Company’s Articles of Association, a Subscription & Shareholders Agreement (which sets out the commercial terms between the Founders and Investors about how the Investors will invest into the Company, and then how the Investors and Founders will manage the business together afterwards), and various ancillary documents.

However, before drafting the full transaction documents, Founders and Investors need to discuss and agree the major principles of the investment round first. To do that, we use Term Sheets.

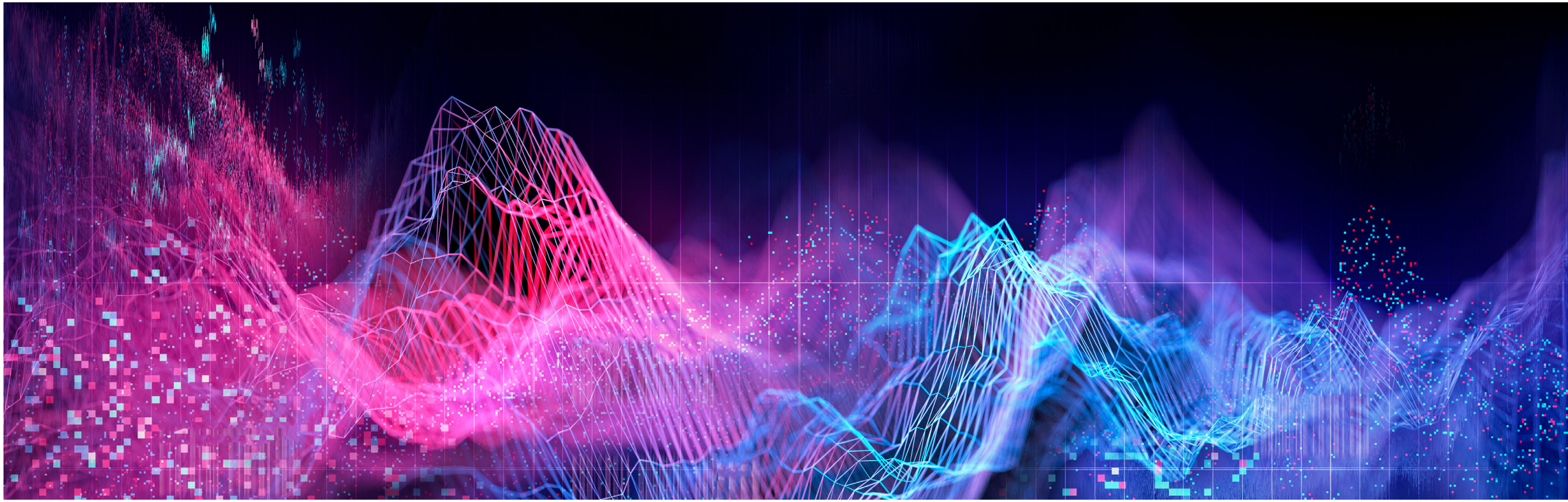
Term Sheets

The purpose of Term Sheets is to enable the Founders and Investors to reach agreement on the main principles of an investment round first, before committing to drafting the full transaction documents. If the parties are too far apart on the main principles, it will be very unlikely that negotiating full transaction documents will be successful, so the Term Sheet helps ensure all parties are broadly on the same page from the outset.

Although the commercial provisions in the Term Sheets should not be *binding* on the parties, it is quite uncommon (and unwelcome) for parties to materially deviate from an agreed Term Sheet when they progress to drafting the full transaction documents. So there is a lot of commercial common sense and value in drafting and negotiating a comprehensive Term Sheet at the start of an investment round.

The length of a Term Sheet can vary. Some Investors/Founders prefer shorter Term Sheets – this allows the parties to sign up to a Term Sheet quicker, but it runs the risk that the parties fail to agree some key points at Term Sheet stage, which then need to be negotiated from scratch at a later stage – this can sometimes be problematic. On the other hand, if a Term Sheet was drafted with ***all*** of the terms that you would expect to appear in the full transaction documents, then the parties will spend so long negotiating a Term Sheet that it removes the main benefit of a Term Sheet. As ever, a sensible balance is required.

Deciding what terms to include in a Term Sheet can be difficult. However, the early stage investment market is quite global in nature – the expectations of Founders and Investors in North America or Europe will be largely similar to those in the Middle East and Africa. As such, Founders and Investors in the Middle East can take guidance from how Term Sheets are commonly structured around the Middle East, but also in other more mature markets, for example the UK or US.



Commonly used terms

Here we describe a selection of the most commonly negotiated provisions in a Series A investment Term Sheet, highlighting founder- versus investor-friendly positions to help investors and founders identify what an acceptable and reasonable position might be for them.

This summary reflects typical positions taken for early-stage investments, but every financing should be considered on its own merits and this summary should not be taken as legal or financial advice. Certain provisions may or may not apply or be relevant to a particular financing and additional provisions may be appropriate in certain circumstances. It is strongly recommended that both Founders and Investors seek professional advice in connection with any fundraising transaction.

This summary has been prepared on the basis that the incoming Investor is offered a separate class of shares (e.g. the “**Series A Shares**”) to the Founders, as is typically the case.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
1.	**Conditions to Completion**	Completion of the Series A fundraise ("**Completion**") is defined as the moment where the Investor's funds are sent to the Company, and the Company issues shares to the Investor. This is the final step in the process, but the Term Sheet often provides information on certain steps to be taken **before** the parties can reach Completion. These steps are of fundamental importance and are called "Conditions to Completion". This basically means that if any of these specific steps are not taken, then the parties may have the right to walk away from the transaction. Some of these 'conditions' are based upon the transaction documents being executed such as Subscription and Shareholders' Agreement, the Investor completing its due diligence on the Company, and the Company obtaining the required consents to allow it to issue the shares to the Investor. In early stage investments, often the Investors might require the Company to take certain steps to tidy up its affairs prior to them making an investment. Some of these steps include putting in place proper directors' service contracts with key directors or transferring relevant intellectual property rights (which often (unintentionally) legally remain with the Founder) into the Company. Depending on the jurisdiction involved and the activities of the Company, regulatory consents may also be required as conditions to Completion. These can include change of control consents or approved by regulators of a revised set of articles of association for the Company.	Fewer Conditions! Founders want to reduce the risk of the transaction failing to reach Completion. Therefore, Founders prefer to limit the list of conditions to Completion to only those matters which are legally required, are fundamental for the fundraise to complete and for the shares to be issued to the Investors. It is important to keep in mind that due diligence by an Investor on the Company will take up a lot of the Company management's time and resources. Therefore, if Completion is subject to the Investor finishing its due diligence, this should be limited to the Investor acting reasonably. Founders may want an obligation by the Investor to complete its due diligence within a specific timeframe (e.g. 3-4 weeks), which should correspond to the timeline for the fundraise as a whole. The reality is that it will take as long as it takes, unless there are multiple investors competing for the investment in a structured process.	More Conditions! The Investor may want a longer list of conditions so that it can have more confidence that when it is required to invest its capital into the Company, the Company is in the strongest position possible to make the Investor's investment as safe as possible. This can include conditions on the Company such as a satisfactory outcome of its due diligence (legal, financial, commercial etc.) and potentially also a requirement that the Company secures a certain amount of investment as part of the fundraise. It could include directors' service contracts for key management staff on terms that the Investor approves, transfers of intellectual property rights held by the Founders to the Company, "keyman" insurance, and approval of the investment by the Investor's investment committee. If the Company is located in a jurisdiction where the corporate laws do not lend themselves well to a fundraise scenario, the Investors may also require the Company to restructure itself into a jurisdiction/form that is more accommodating to a fundraise.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
2.	**Confidentiality**	Early-stage companies are often built on novel ideas, technologies, routes to market or ways of delivering a product or service that might give the Company an edge over the competition. This means that the Company in our scenario would be teeming with highly valuable information that the Company (and the Founders) will want to ensure is well-protected. Similarly, an Investor is likely to be an investor in multiple startups. Sometimes, the Investor does not want the market to know what provisions it is willing/able to accept in one fundraise, in case other companies seek to insist on similar positions in other fundraises where that might not be appropriate. So, both the Company (and Founders) and the Investors are motivated to keep the business of the Company and the terms that the Company and Investors are negotiating, strictly confidential. To do this, both sides will undertake not to disclose information that is confidential to the Company's business or the terms of the fundraise, other than to their professional advisors. A separate non-disclosure / confidentiality agreement (often called an "NDA") may be entered into between the parties separately to the Term Sheet. This would contain more comprehensive obligations on the parties with regards to confidential information. Some venture capital funds resist this as a matter of policy.	Generally, both parties recognise the benefits of tightly drafted mutual obligations of confidentiality, but there are some nuances to this. Non-disclosure of confidential information is a key point for the Founders, as the Investor will view and obtain substantial information about the Company throughout the course of its due diligence and discussions with the management of the Company. The Founders will want disclosure of this confidential information to be limited to the Investor's affiliates, to those the investor may be required by law to disclose information to (e.g. their regulators auditor) or to the parties' professional advisors.	The Investor may want to be able to disclose any confidential information to its ultimate beneficiary owners and other affiliates, and in the case of a fund, to its investors and potential investors. But the Investor will want the terms of its investment to remain strictly confidential. This is rarely controvertible.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
3.	**Payment of Consideration**	The "**Consideration**" refers to the cash to be invested by the Investor into the Company in return for which the Company issues certain shares (or warrants, notes or other instruments) to the Investor. The Consideration can be paid either in full at Completion (i.e. the full amount of Consideration is deposited with the Company at the time of Completion) or sometimes it can be staged in tranches over a period of time. Generally, it is more common for Consideration to be paid in full at Completion.	The Founders will want as much of the Consideration paid in full at Completion, even if all the cash may not be needed immediately. The Founder will therefore aim to negotiate 100% of the Consideration to be paid at Completion. As far as possible, investment in tranches should be avoided. If the Founders agree that one Investor can pay their Consideration in tranches, then it may be hard to avoid all Investors having the same right, and the impact of this can be very significant. How can the Company be confident that the future tranches will be paid in accordance with the agreed timetable? COVID-19 has illustrated this challenge, where tranches of investment had been agreed for some startups, but after the COVID-19 impact began to be felt, the Investors couldn't afford to meet their follow-on obligations. This resulted in the startup companies experiencing a shortfall in working capital, and a negative reaction from other Investors who had paid up their entire capital at Completion. Founders must consider what happens if one of the Investors fails to pay a future tranche of Consideration. Do their shares get diluted/forfeited? Do they lose rights? What does the Company do to plug the working capital gap? How does the Company manage its other Investors (bearing in mind that it is commonly required for a Company to treat all of its shareholders of the same class equally)? It is much better for the Founders/Company to have all of the Consideration paid in full on Completion by all Investors to avoid these headaches.	An Investor will typically assess its investment on a fully diluted pre-money valuation of the Company, which will include any employee share options (both granted or committed) equal to a set percentage of the Company's issued share capital post the fundraise. The Investor will also want clarity on how much capital the Company is planning to raise, to get an understanding of its percentage share of the fundraise. This often determines the Investor's bargaining position. Whilst not very common on Series A fundraises, an Investor may want its investment staged, with a first tranche of investment payable on Completion and other tranches subsequently invested upon the Company achieving certain targets / milestones. This may be the case if the Company is yet to obtain certain key authorities, consents or licences to operate its business, or is waiting for a key contract to be put in place. In such cases, the Investor will want the right (but not the obligation) to invest any subsequent tranches at the same price per share as the first tranche.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
4.	**Exclusivity**	In return for the Investor spending time and costs in evaluating in the Company to determine whether it wishes to invest (i.e. its "due diligence"), the Founders usually agree to give the Investor "exclusivity" for a certain period of time. This means the Founders agree not to solicit other investors and will not negotiate with any other party for a period of time. The period of exclusivity granted normally expires on a set date or the date on which the Investor notifies the Company that it will not proceed with the investment. This gives an Investor confidence that after spending time and money performing its due diligence, it will have a clear opportunity to then conclude a deal.	If the Founders are reaching out to several Investors for a fundraising round, granting exclusivity to one Investor is typically inappropriate and exclusivity should not be granted without appropriate carve-outs. If the Founders are only in discussion with one potential Investor, an exclusivity period may be granted to show that the Founders are serious about the potential Investor and are willing to build a relationship with them. Founders should however seek to minimise the exclusivity period to the extent possible as it will restrict them from speaking to other potentially interested parties. Founders should also consider requiring the Investor to meet certain deadlines during the exclusivity period. For example, the Founders may require the Investor to complete its due diligence and agree on the transaction documents by a certain date, failure of which will lead to the exclusivity period being waived.	The Investor may require that the Founders inform the Investors of any third party who contacts the Founder and/or the Company with a view to acquire shares in the Company, or any part of the business.

No.	5.
Provision	**Warranties**
Description	Warranties are legally binding statements that the Company (and often the Founders) need to make in the transaction documents, which confirm certain facts to the Investor related to the past and current state of the Company and its business. The warranties appear in the transaction documents, **not** the Term Sheet, but the Term Sheet typically gives some guidance as to what kind of warranties might be given, who would give the warranties (which in a Series A will often be the Company and one or more of the Founders), and what liability might apply to the Company or Founders who do give the warranties. This is a critical point, so it may be helpful to explain what impact warranties have on the fundraising transaction as a whole. The Investor will invest based on the results of its due diligence exercise and the matters disclosed to it by the Company and the Founders, but it will also invest based on the warranties given to it in the transaction documents. Provided an Investor has performed a thorough due diligence exercise, there should be no "surprises" in the warranties that would be given by the Company/Founders. All of the statements should already be known to the Investor, but it's important for the Investor to have those statements given in writing. The warranties will be tailored to the particular business activity of the Company and will often depend on the history of the Company, its size and complexity – for example, whether it is a startup without much trading background (in which case just a short list of warranties is required), or if the Company has been active and trading for a number of years (which can often lead to a more extensive list of warranties). A reasonable set of warranties for a Series A fundraise for a simple business could be between 6-10 pages long and would include statements covering (for example) the basic corporate and licensing information of the Company, its accounts/financial position, employees, real estate, IP/IT, current and non-current assets, material customers/suppliers, any known litigation/claims involving the Company, its tax position and filings, and relevant regulatory matters. For bigger fundraising and more complicated businesses, the warranties can be longer. The size of investment from the Investors can also be relevant to the extent of warranties to be given. Warranties create legal obligations on whoever gives the warranties - typically the Company and some or all of the Founders. If any warranty that is given to the Investor is later found out to be untrue, the Investor may have the right to bring a legal claim against the Company and the Founders. So, it is very important that the warranties given in the transaction documents are carefully considered and negotiated, and that the Company and Founders conduct a thorough "disclosure" exercise. The warranties should be stated as being given "subject to matters fairly and accurately disclosed" to the Investor - in other words matters which the Company and/or Founders have brought to the Investor's intention prior to signing the transaction document. An online data room is commonly used in which the Founders upload documents related to the business of the Company and which the Investors (and their advisors) have access to. Disclosed matters are commonly the list of documents contained in such a data room, which will be deemed to be "disclosed" against the agreed list of warranties. If any matter is "disclosed" then this effectively reduces the scope of the relevant warranty by excluding the matter that has been disclosed. (E.g. a warranty might state "The Company has not terminated any employee in the past 12 months". If, in fact, the Company has terminated an employee within that period, then the Company/Founder should "disclose" this fact, plus the underlying details/documents about that termination, in the data room. This means that, if the data room and disclosed information are managed correctly, the Investor should not be able to bring a claim against the Company/Founders in relation to that matter at a later date.) Disclosure is therefore the primary method for the Company/Founders to reduce the risk of being exposed to any claim for breach of warranty.

Warranties: Founder-friendly position	It is important to first consider ***who*** will give the warranties – is it the Company, is it the Founders (in their personal capacity) or is it both? The Founders will prefer that only the Company will give the warranties so that the Founders will not bear any personal liability to the Investors, but this can be difficult to agree with Investors at Series A. At Series A stage, the Company is unlikely to have much capital to meet any claims, and in any case Investors will not want to sue a Company they have invested in. The Investors will prefer to know that the Founders have 'skin in the game', in other words they will be on the hook for the warranties, which in turn means that the Founders will have a vested interest in ensuring that the disclosure exercise has been completed thoroughly. This gives the Investors some confidence that they are investing based on a full picture of the Company and its business. Sometimes, for a well-subscribed fundraise, Founders have better negotiating power and can insist that only the Company gives the warranties. If that is the case, then this also sets the precedent that for any future fundraises, again, only the Company would give the warranties rather than the Founders. Also, if some of the Founders are not actively involved in the running of the business anymore, then there can be a good argument that they should not be giving the warranties either. The Founders and the Company should seek to limit the warranties that are given to cover only the most important matters relating to the business. Founders should also ensure warranties are only given in relation to matters of which the Founders/Company are actually aware to avoid being found in breach of the Warranties for matters relating to the Company which the Founders did not know about. The Founders' liability for any potential claim by the Investors under the Warranties should be limited, both in terms of monetary amounts and the timeframe within which claims may be brought. The Founders will want to keep these as low and short as possible.
Warranties: Investor-friendly position	The Investor will want warranties to be given by the Company and all of the Founders. In addition, the Investor will want to ensure that the Founders' cap on liability is high to ensure that they take the disclosure process seriously (and therefore the Investor finds out as much as possible about the business to enable it to evaluate its investment). Investors expect the Founders' liability capped at 1x their annual salary, though this depends on the circumstances in question and the Founders' remuneration package The Investor would want the Company's liability capped at the total amount of capital raised in the Fundraise (or at a certain percentage of such proceeds).

No.	Provision	Description	Founder-friendly position	Investor-friendly position
6.	**Liquidation preference**	A liquidation preference is a provision in a Term Sheet that sets out the order in which the surplus profits/assets of the Company will be allocated between the shareholders if the Company falls into insolvency and is liquidated (a "**Liquidation Event**"). This clause gives the Investor a preferred position to be paid out first before the other shareholders in the case of a Liquidation Event. This order (commonly referred to as the "waterfall") typically also applies to dividends and returns of capital on an exit.	The Founders will want to rank high up the order on a Liquidation Event. Therefore, the Founders will want to ensure that their ordinary shares and the Investor's Series A shares carry an equal right on a Liquidation Event.	In case of a Liquidation Event, the new Investors will want to rank ahead of the Founders and other existing shareholders. Note that the Investor's interest and those of the Founders are opposite. An Investor will want a liquidation preference that allows it to get back (assuming there are sufficient capital proceeds) the purchase price it paid for its shares or commonly even a multiple of the purchase price plus any accrued but unpaid dividends on those shares, before any other funds are paid out.

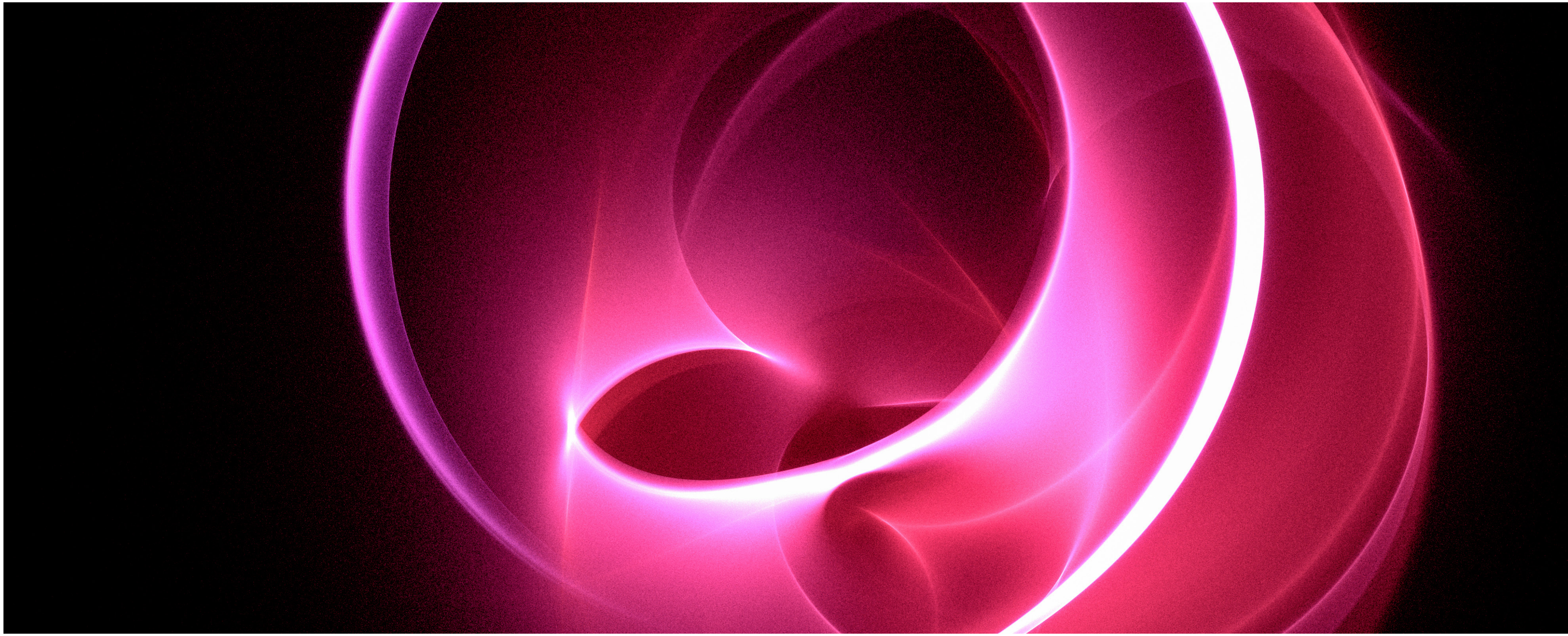
No.	**7.**
Provision	**Anti-dilution and pre-emption**
Description	Series A Investors typically want protections against the value of their investment and/or their shareholding percentage interest in the Company being reduced in the future through further capital raises. This protection can come in a number of forms. The least controversial of those protections is a "pre-emption right". A pre-emption right is granted to all existing shareholders of a Company so that if the Company plans to issue new shares in future (e.g. Series B), they Company must invite the existing shareholders to subscribe for those new shares in their existing proportions. So if an Investor in Series A has a 10% shareholding in the Company, the Company would need to offer that Investor 10% of any new shares issued in Series B. This gives that Investor the right to maintain its overall 10% stake in the business. These rights might also enable the Investor to buy up excess shares in Series B that are left over as a result of other existing shareholders deciding not to subscribe for their full entitlement in Series B. Investors can also seek protection through "anti-dilution provisions". In essence, these apply where new shares are issued at a lower price per share than the previous funding round. Where that applies, the Investor is protected from excessive dilution by being placed in the position it would have been in if it had received shares at the new (lower) price per share instead of the prior (higher) price, or somewhere in between. This is achieved by issuing new shares to the Investor at no additional cost. There are a few ways that this kind of antidilution can work. A so-called "full ratchet" anti-dilution provision will result in additional shares being issues based on the new lowest price per share and, as the anti-dilution mechanisms generally do not apply to the Founders' shareholding, this approach will be highly aggressive against the Founders. As a result, this mechanism is increasingly uncommon in current markets. A reasonably balanced middle ground has developed called a "broad based weighted average adjustment". This effectively takes the average price across both the Series A and the (lower) Series B rounds and applies that to the new issuance at no cost to the Investors. This effectively creates a more balanced result as between Investors and Founders. Not all Issuances will justify an anti-dilution clause kicking into effect though – sometimes Investors (and Founders) must expect some dilution. For example, shares issued as part of an employment incentive scheme (shares which are normally pre-approved in the investment documentation up to a fixed percentage threshold of the Company's share capital) should not trigger any anti-dilution mechanisms, as the Founders and Investors will recognise there is a mutual benefit to ensuring that the key talent is correctly incentivised to make the business a success.

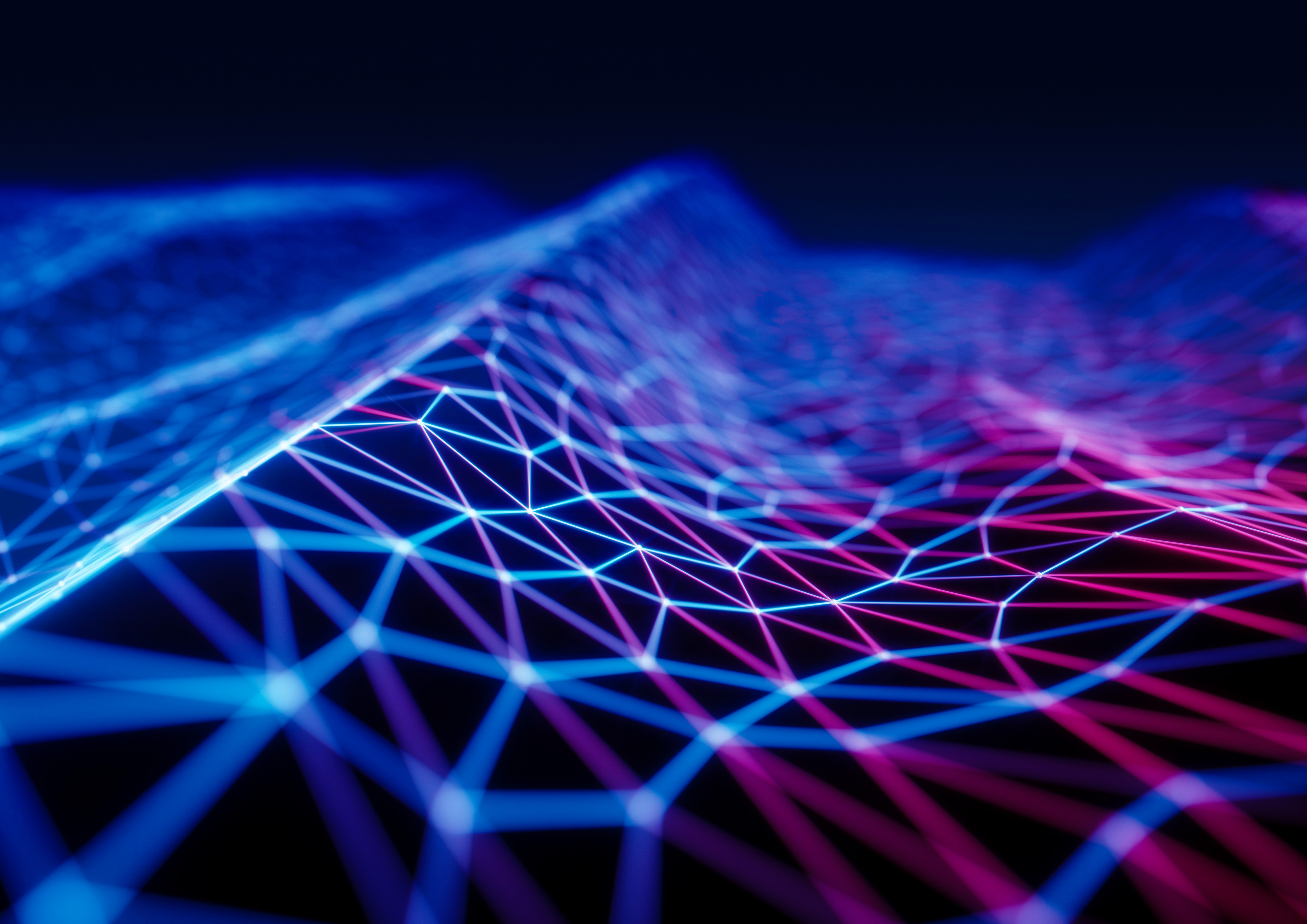
Founder-friendly position	Founders will want to ensure that any anti-dilution provisions are reasonable to ensure that in a "down round", the Founders are not unduly diluted. The fewer instances where anti-dilution can apply, and the lower the potential number of additional shares that could be issued to existing Investors, the better as far as Founders are concerned. The Founders will also want to ensure that various carve-outs are specified to the anti-dilution mechanism to enable them to implement an employee incentive scheme for example. They will also want to have some flexibility to utilise a portion of the Company's capital with some discretion without triggering pre-emption rights or anti-dilutive provisions.
Investor-friendly position	The Investor will want the anti-dilution protection rights as watertight as possible and based on a calculation which gives them the maximum anti-dilutive protection as possible, with minimum carve-outs. This is harder to achieve where the Company is attracting multiple Investors, since a broad-based weighted average provision is effectively market standard for early-stage investors. Upon an issuance of shares involving tranches or other multiple closings, the anti-dilution adjustment should be calculated as if all shares were issued at the first closing.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
8.	**Protective covenants / Lock-ins**	**Protective / restrictive covenants** As the Founders often know the business of the Company inside and out, including details about its customers, suppliers, know-how, routes to market and USPs, they are often required to give certain non-competition and non-solicitation undertakings. These are intended to ensure that while the Founders are "in" the business, they give their focus, time and efforts on the business, and if the Founders ever exit the business, they do not immediately go and set up in competition with the Company. In accordance with UAE law (and the laws of many other jurisdictions), to be enforceable, restrictive covenants must be reasonable and aimed at protecting the Company's and Investors' legitimate business interests. Any restrictions that are too vague or broad should be resisted, as they are less likely to be enforceable. Generally restrictive covenants should be specific to particular countries in which the Company/business is active; it should be limited in terms of the sector/type of business and limited in time. These restrictions focus on a few common areas: — Non-solicitation: The Founders agree not to poach any key employees, officers, customers, suppliers, etc. that are (and have been) involved with the business of the Company. — Non-competition: The Founders agree to not compete with the business of the Company for a period after they cease to be involved in it - this is typically tied to the period of the Founders' employment with the Company. **Lock-ins** Once the Investor has invested in the business of the Company, the Founders may be required to stay on with the business for a certain minimum period. Such lock-in periods are common where the Founders are actively involved in the management of the Company and where their departure would have an adverse effect on its prospects.	**Protective / restrictive covenants** It is standard for some covenants to be placed on the Founders, but it is in the Founders' best interests for those covenants to be as limited as possible. — Non-solicitation: should be limited to 'key' employees and personnel. Equally 'key' customers and suppliers should be those that the Company has actively traded with, either at the time of Completion or in the past 12 months. The Founders should seek to limit the period of the non-solicitation obligation to as short a period as possible following termination of their employment/service with the Company. — Non-competition: The Founders will want to limit this covenant to the specific industry/sector in which the Company is doing business, specific countries/territories and for a limited time after termination of their employment/service with the Company. **Lock-ins** The Founders may want to limit the number of shares that the lock-in period applies to. For example, the Founders are restricted from transferring X% of their shareholding but can still transfer a minority part during the lock-in period. The Founders should also carefully consider if they may need to transfer shares to relatives, affiliates, trusts etc. which can be included as a category of 'permitted transferees' to which the lock-in period does not apply.	**Protective / restrictive covenants** Whilst remaining conscious of the enforceability of restrictive covenants, the Investor will want to capture as wide of a net as possible over the Founders to ensure that they are sufficiently tied-in with the business and do not use their inside knowledge of the Company to solicit away any personnel/customers/suppliers or compete with the business after termination of their employment/service. — Non-solicitation: should capture all personnel, customers and suppliers that the Investor considers important to the business. — Non-competition: should capture each territory in which the business is active any territory in which the business may be active in the future. **Lock-ins** The length of the lock-in period that the Investor may ask for depends on a number of factors, including (but not limited to) the importance of the Founders to the operation and management. The Investor will want to restrict the category of any 'permitted transferees' of the Founders as it will want the Founders tied into the business for the duration of the lock-in period.

No.	Provision	Description	Founder-friendly position	Investor-friendly position
		Lock-ins mean that the Founders cannot transfer their shares in the Company during the Lock-in period to any party and cannot leave the employment of the Company without breaching the terms of the transaction documents. If they do leave or transfer their shares in breach of the restrictions in the Lock-in, the Founder is commonly referred to as a "bad leaver" (see the next section below).		
9.	**Leaver provisions**	Leaver provisions are designed to protect the Investors in the event that key personnel leave the Company in early stage investments, when Investors place large emphasis on the strength of the Company's management team and the Founders. The Investors will want to ensure that the Founders and management team are incentivised to stay with the Company, and that if they do leave, that they do not take the full benefit of any shares they might hold at the time of leaving. Therefore, it is common to see provisions included in the Term Sheet and transaction documentation which incentivise the Founders to stay in the business by putting their shareholding at risk if they leave the Company. What happens to a Founder's shares if they leave the Company is dependent upon whether the Founder is classified as a 'Good Leaver' or a 'Bad Leaver' or sometimes 'Intermediate Leaver' or 'Very Bad Leaver'. The Term Sheet and transaction documents will often list the specific situations which would constitute the Founder as a Good Leaver or a Bad Leaver, and the implications of each scenario. These provisions are very personal to the Founder and therefore are usually carefully debated.	**Good/Bad leaver** The Founders will want a specific and narrow list of circumstances in which they might be classified as a 'Bad Leaver'. Common Bad Leaver situations include the Founder's employment being terminated as a result of fraud/gross misconduct, voluntary resignation or breach of share transfer restrictions during the Lock-in period. Any other circumstance of departure from the Company would be classified as a 'Good Leaver'. **What happens to a Founder's shares on departure?** Founders will want the option to keep their shares in the Company upon departure, whether falling within the Good Leaver or Bad Leaver bucket and not be forced to forfeit or sell their shares upon departure. **Price of the Founders' shares** If the Founders sell their shares upon departure, the price they can get for their shares will depend on whether they have been classified as a Good or a Bad Leaver. The price payable for a Founder's shares in such circumstances is not typically heavily negotiated and is fairly standard market practice. In Good Leaver circumstances, the Founder should receive the fair market value of the shares as at the time of sale. In Bad Leaver circumstances, the price is typically the lower of fair market value and the nominal value of the shares. Sometimes the Founder may negotiate that the shares would be purchased back by the Company at (e.g.) a 25% discount to fair market value in the event of them being a Bad Leaver.	**Good/Bad leaver** For the Investors, they would prefer the definition of Good/Bad Leaver to be reversed. In other words, Investors would prefer to specify the Good Leaver circumstances, whereas all other circumstances would be classified as Bad Leaver. Good Leaver circumstances proposed by the Investor are typically narrow and include death, incapacity and if the Company/board of directors agree that the Founder should be deemed to be a Good Leaver. In addition, the Investor will want the Founders' shares to "vest" over a period of time, ideally over as long a period as possible. Vesting in this context refers to the Company's right to acquired a certain % of the Founder's shares back. For example, if the Founder held 100 shares with a four-year vesting period, on day one the Company would have the right to buy back all 100 shares in case the Founder is deemed a Bad Leaver. After year 1, the Company's rights to buy back the Founder's shares reduce to 75, and after year 2, it reduces to 50 and so on. This means the risk borne by the Founder of being deemed to be a Bad Leaver reduces proportionately during the vesting period. **What happens to a Founder's shares on departure?** The Investors' preference as to what the Founders are required to do with their shares (keep them or be obligated to transfer them back to the Company) often depends on the relationship between the Investors and the relevant Founders. However, Investors will typically require Founders who have left the business to sell their shares back to the Company allowing the Company to reallocate those shares to a new management team. If the Founder is entitled to keep his/her shares on departure, such shares can be disenfranchised (i.e. they lose their voting rights and only keep the economic rights attaching to the shares).

No.	Provision	Description	Founder-friendly position	Investor-friendly position
				The Investors may also want the Founders' shares to be offered for sale first, to any existing Investor and then to the Company. **Price of the Founders' shares** If a vesting schedule has been agreed for the Founders' shares, to the extent that such shares have vested, in the absence of e.g. fraud, those shares would typically be treated as 'Good Leaver' and the Founder would receive fair market value for such shares. Any unvested shares to be treated as 'Bad Leaver'.





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