Venture Financing Overview

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INTRODUCTION

This practice note discusses venture capital, which is an important source of money for start-up companies that do not have access to the capital markets. It covers what venture capital investors look for as well as the process of seeking and obtaining venture capital support at the various stages of a start-up's growth.

Specifically, this practice note provides an overview of when a start-up might seek venture financing and the common venture financing options, including the structure of the financing and the typical terms applied in:

- Seed-round investments by friends/family or angels
- The initial Series A preferred stock financing round
- Later financing rounds such as the Series B, C, and D preferred stock rounds
- Later-stage bridge financings

For additional information on start-up financing, see Pre-IPO Liquidity for Late Stage Start-Ups and Seed Financing Overview. For forms related to this topic, see Convertible Note (Seed-Stage Startup) and Convertible Note Financing Term Sheet (Seed-Stage Startup).

INITIAL CONSIDERATIONS ON STAGE/SIZE OF THE ROUND

Series Seed

At the early stages, many companies find it necessary to seek a small amount of seed money from friends, relatives, angels, or what are known as seed round venture capitalists. This seed money can support a fledgling company while it writes a business plan or develops a product prototype.

Series A

After the company has developed a firm business plan, it may be in a position to seek investment capital from venture capital funds. At this stage, the business plan should set a demonstrable risk-reducing milestone, such as having a working product ready for production.

In this first round of venture capital financing, the company should try to raise a sufficient amount of capital to fund product development. Given the seemingly inevitable delays in product development and the time it takes to

arrange the next round of financing (at least two to six months), you should build some cushion into the amount you raise. For further information on venture capitalists, see Private Equity Industry Practice Guide.

Subsequent Rounds

Series B

At the next appropriate financing window (when you feel it is appropriate to raise additional venture capital), or as the company begins to run out of cash, you may seek a second round of venture capital to start the next milestone of the company's business plan or to adapt to changed market conditions. How much control the company is able to exercise during subsequent rounds of financing depends largely on how successful it has been in managing the planned development growth with previous funding and the degree to which investment capital is available.

If the company has proven its ability to execute its business plan:

- It should be able to raise money at a substantial premium over the first round, perhaps one and one-half to two and one-half or more times the first-round price.
- The first-round venture investors will participate in the second-round financing, typically providing one quarter to one-half of the money in the second round.
- A lead investor representing the new money generally will set the second-round price and its terms and conditions.

If the company has fallen measurably short of its plan:

- Finding new investors may be more difficult and existing investors may need to fund a greater percentage of the round.
- Since the company will be in a weaker bargaining position, it may need to raise money at a lower price than the first round, triggering antidilution protection and causing significant dilution to founders.
- More onerous preferred stock terms are likely, including accruing dividends, ratchet-antidilution protection (discussed below), and multiple-liquidation preferences.
- Venture capitalists may demand a change in management, a replacement of the chief executive officer (CEO), an imposition of more rigorous controls over company management, or personnel layoffs.

Series C and On

As the company continues to grow, it may seek additional rounds of venture capital to reach the next milestones of its business plan. How much capital is needed will depend on the company's current needs and goals. How much capital investors are willing to fund will depend on the strength of the company's business plan and its performance, growth, and management.

Bridge Financing

The company may consider a bridge financing when it needs a short-term loan to cover capital needs until the next preferred stock financing. For example, if the company runs out of cash before the lead investor is found, the current investors might agree to bridge the gap by extending a bridge loan that will automatically convert into the next round series of preferred stock. Under the terms of a bridge loan, investors typically receive market rate

interest and a discounted conversion price, and may also receive a common stock warrant (a right to purchase common stock in the future). For a form of warrant, see Warrant. Because this type of loan will convert only at the next preferred stock financing, you should remember that the interest will continue to accrue until such time. Once the next preferred stock financing occurs, the principal and accrued interest due on the note will convert to that series of preferred stock at the discounted conversion price.

INVESTORS

Series Seed

Obtaining capital from outside investors during the early stages of a company's development may be difficult. Since only small amounts of money are usually required at this early stage, friends and family may be a realistic source of seed money. Even at the early stages, you should ensure that the company is complying with securities laws when accepting capital from friends and family members. For additional information on the securities laws related to private offerings and exemptions from registration, see Private Placements Resource Kit.

Unless a company's founders or management have had prior success as entrepreneurs or were seasoned executives in a particular space, it may be more difficult to obtain seed money from the venture capital community. For an unproven start-up, it can take six to 18 months to:

- Build venture capital contacts
- Educate the potential investors about the product idea
- Convince an investor of the strength of a company's founding team

Given these difficulties, it may be easier for a start-up company to try to attract angels or advisory investors, such as a successful entrepreneur with self-generated wealth in a related industry. This type of investor will understand the merits and weaknesses of the company's business idea. More important still, these investors can be invaluable in making introductions to the venture community.

Series A

Step 1: Finding a Venture Capitalist

There are various ways to find a venture capitalist. The most common include:

- Consulting available sources that provide basic information about venture capital firms, including published directories and Internet databases (e.g., Pratt's Guide to Venture Capital Sources and the Directory of the Western Association of Venture Capitals)
- Securing an introduction to a venture capitalist through successful entrepreneurs who have been funded by them
- Getting referrals from friends and professional networks (such as advisors, lawyers, and professors)

Step 2: Selecting a Venture Capitalist

Selecting the right venture capitalist can require both time and effort. Here are some tips:

- A company may want to seek out investors who understand the industry and who know the product or market.
- Aim to select a venture capitalist that has the depth and breadth of experience that the company may initially lack.

- Take the time to talk to potential venture capitalists to ensure that you can work well together and develop a personal relationship.
- Where funding is available from several venture firms, ask the CEOs of their portfolio companies about their experience with the respective venture capitalists.

If chosen correctly, venture capitalists can provide a wealth of information on management techniques, problem solving, and industry contacts. They also can offer a broader perspective on a product's market fit, as well as additional funding as the start-up company grows.

Step 3: Making a Pitch to a Venture Capitalist

Most venture capitalists are looking for a company that can be profitable and grow in revenue. They are looking for large and growing markets where there is a demonstrable need for the product the company plans to develop. Therefore, when discussing a potential investment with a venture capitalist, have a firm business plan. This business plan should include:

- A description of the company
- The company's location and history
- The product(s) to be developed and the underlying technology
- The size and growth of the market
- Targeted customers
- Competitors and the company's competitive advantage
- The management team
- Financial summaries
- The amount and structure of the proposed financing

Venture capitalists also invest in people, which is why the strength of a start-up's management team is a crucial element in raising money. For additional information on pitches or other presentations to potential investors, see General Solicitation and Startup Capital-Raising under Rule 506 of Regulation D.

DECIDING ON THE TYPE OF VENTURE FINANCING

This section provides an overview of some of the common types of venture financings, including the structure of each financing and the typical terms that may apply.

Convertible Promissory Notes

A convertible promissory note is a debt security that converts into company equity when certain conversion events occur. Issuing a convertible promissory note can be an effective way for a company to raise capital without the cost, time, and complexity of a preferred stock financing. This method of financing is often quicker, less costly, and more attractive to start-ups than a preferred stock financing because:

- It involves less documentation and negotiation with investors
- It does not necessitate the control provisions investors typically receive in a preferred stock financing
- The issuance of convertible promissory notes does not require a valuation of the company because the notes are debt securities

Keep in mind that convertible promissory notes are typically senior to other equity holders, but because they are generally unsecured, these notes are not senior to other debtors.

Once the company identifies an investor interested in providing capital in exchange for a convertible promissory note, you should prepare a term sheet outlining the agreed-upon terms of the note. Upon receiving the investment, the company would issue the convertible promissory note to the investor. Under the terms of the note, the principal and accrued interest are payable to the note holder upon the maturity date. However, the reason convertible promissory notes are particularly attractive to investors is that the note is convertible into company equity when certain conversion events occur.

Conversion

The most common conversion event is a qualified financing, which is typically an equity financing that involves a certain threshold amount of money. When a qualified financing occurs:

- The principal and interest of each note converts into shares of the series of preferred stock sold in the qualified financing at the applicable conversion price.
- The notes are converted at a price that is lower than the price paid by the investors purchasing shares in the qualified financing.
- The conversion price is calculated based on either a discount rate (which is typically a percentage of the qualified financing's issue price) or a valuation cap (a cap on the pre-money valuation at which the notes may convert).
- The conversion price equals the lowest price calculated based on the discount and the valuation cap, if the conversion terms of a note include both a discount and a valuation cap.

Additionally, a corporate transaction, such as a sale of the company, may trigger conversion of the note. Upon a corporate transaction, note holders can elect to convert their note into common stock. In the alternative, the noteholder may choose to receive the outstanding principal and accrued interest from the company.

If neither a corporate transaction nor a qualified financing occurs prior to the maturity date of the note, the noteholder may have the option of converting its note into shares of common or preferred stock, or leaving the note outstanding in order to convert the note in a later financing. For additional information on convertible promissory notes, see Understanding Convertible Debt Securities and Understanding Anti-Dilution Adjustment Formulas in Convertible Bonds.

Simple Agreements for Future Equity

Alternatively, the company may issue investors a Simple Agreement for Future Equity (SAFE) when it does not know whether it will complete a qualified financing before a promissory note would mature. The process for issuing a SAFE is similar to the process for issuing a convertible promissory note—you would issue a SAFE to the investor as a promise of repayment. A SAFE typically converts in the same manner as a convertible promissory note, but because a SAFE is not considered a debt instrument, it does not accrue any interest and it does not have a maturity date. Rather, a SAFE is left outstanding until a qualified financing or corporate transaction triggers conversion of or payment on the SAFE. When a qualified financing occurs, the SAFE is automatically converted into a number of shares of preferred stock, determined by dividing the purchase price of the SAFE by the applicable conversion price. The conversion price is calculated based on either a discount rate (which is typically

a percentage of the qualified financing's issue price) or a valuation cap (a cap on the pre-money valuation at which the SAFE may convert), whichever calculation results in the greater number of shares. In a corporate transaction, the SAFE holder can typically elect to receive from the company a number of its common stock, calculated based on a pre-money valuation, or an amount in cash equal to the purchase price of the SAFE. For a discussion of SAFEs in the crowdfunding context, see Market Trends: Crowdfunding — Other Key Market Trends.

Preferred Stock Financings

Preferred stock financings are a type of equity financing. Because companies typically sell convertible preferred stock to venture investors at a substantial premium over the price charged to the founders or the seed investors, preferred stock financings can be an effective means to obtain a significant amount of capital. At a minimum, the preferred stock gives the investors a liquidation preference, which is described below, in the event the company fails or is acquired. In addition, preferred stock holders usually obtain certain other preferential rights over the holders of common stock as well as certain voting rights, each described below. From the point of view of the start-up, these preferences justify a fair market value differential between the preferred stock and the common stock. This enables the company to continue to sell common stock to its employees at a lower price than is paid by the preferred investors.

Once a lead investor for the preferred stock is identified, you will negotiate a term sheet outlining the agreed-upon terms and begin preparing the definitive financing documents, which will typically involve several drafts before the parties agree on the terms. Concurrently investors will be granted access to a data room containing information on the company's organization, capitalization, material agreements, and financial statements, so that the investors can conduct their due diligence. When the financing documents are close to final, the company will obtain any necessary board and stockholder approvals. Prior to closing, the company will file its restated charter with the secretary of state, and once the filing is complete, the parties will sign the financing documents and the investors will initiate their wires. For further information on due diligence, see Conducting Due Diligence for a Private Offering. For forms of board resolutions in this context, see Board Resolutions: Unregistered Offering of Preferred Stock (Regulation D) and Board Resolutions: Private Offering of Convertible Preferred Shares Authorization.

Prior to drafting any financing documents, the company and the lead investor in a financing will negotiate a term sheet, which typically includes the terms outlined below. For further information on terms sheets, see Understanding, Negotiating, and Drafting Term Sheets.

Pricing: How to Determine the Company's Valuation

The purchase price of a given series of preferred stock is usually based on a pre-money valuation that venture capitalists will assign the company based on the company's stage of development before giving effect to the investment.

The pre-money valuation is:

- The price per share that the investors are offering to pay the company **multiplied by**
- The outstanding stock, options, and other convertible securities, plus the option pool reserved for future employees

When discussing a pre-money valuation, remember to clarify the size of the post-financing option pool to be required by the venture capitalists. The option pool typically contains an adequate number of shares to provide for grants to service providers and employees for one year or until the next fund raise.

In theory, when determining the value of a company, investors attempt to estimate the value at some time in the future. Investors then discount that value to a present value with a desired rate of return. For example, if the investor is looking for a tenfold return in five years and the company is expected to be worth $50 million in five years, the company may be worth $5 million today. In practice, however, venture capitalists seem to estimate the amount of cash required to achieve some development milestone and equate that amount to a certain percentage of the company (fully diluted for employee shares). The best way to find out how the company is likely to be valued is to look at what valuations venture capitalists are giving to other companies at the same development stage and in the same general market area.

After the venture funding, the company's post-money valuation can be determined by adding the amount of money invested in the financing to the pre-money valuation.

Preferred Stock Preferences and Rights

In addition to the pricing terms, the term sheet for the preferred stock financing will typically include the following preferences and rights.

Liquidation Preference

Upon liquidation of the company, the holders of preferred stock have the right to receive a fixed-dollar amount before any assets can be distributed to the holders of common stock. Typically, the liquidation preference is:

- The purchase price plus
- Accrued but unpaid dividends

However, if the preferred stock holders would receive a greater amount of the proceeds from a liquidation event by converting into common stock, the preferred stock holders will often receive the greater amount as if their preferred stock converted. In addition to actual liquidations, venture capitalists also want to receive their liquidation preference on a company merger. This provision will give the preferred shareholders the right to receive at least their original investment back in the event of a merger, and sometimes a multiple return on their money, before the common shareholders will participate.

In the first round of financing, preferred stock holders will receive their liquidation preference before common stock holders. In subsequent rounds, distribution of a liquidation preference to preferred stock holders is typically structured in either one of two ways:

- **Series by series liquidation preference.** In this structure, the liquidation preference will be distributed by series, with the later series of preferred stock having priority in payment over the earlier series of preferred stock.
    - For example, the Series C preferred stock holders would receive their liquidation preference before the Series B preferred stock holders, and the Series B preferred stock holders would receive their liquidation preference before the Series A preferred stock holders, and the Series A preferred stock holders would receive their liquidation preference before the common stock holders.
- **Pari passu liquidation preference.** Alternatively, the liquidation preference may be distributed to all preferred stock holders on a pari passu basis, meaning that holders of all series of preferred stock have an equal priority on their liquidation preference.

Once the liquidation preference is distributed to the preferred stock holders, a participating preferred stock also participates with the common stock in the distribution of any assets left after payment of the liquidation preference.

Dividend Preference

Most preferred stock is given a dividend preference over the common stock. There are two types of dividend preferences:

- **When, as, and if declared, noncumulative.** This dividend preference means that the company cannot declare dividends on the common stock until a specified dividend is paid on the preferred stock.
- **Mandatory, cumulative.** This dividend preference is more like an interest provision, since it requires the company to set aside and pay dividends on the preferred stock at a designated rate. Mandatory dividends are not frequently used, but if they are, they usually are not paid on a regular periodic basis, but instead in conjunction with mandatory redemption by investors or paid upon the sale of a company.

Redemption

There are two kinds of redemption provisions:

- **Optional.** An optional redemption provision lets the company repurchase or redeem the preferred stock at its purchase price plus a redemption premium. The company can thus force the preferred stock to convert to common stock or face redemption.
- **Mandatory.** A mandatory redemption provision lets the investors require the company to repurchase the investors' preferred stock at its purchase price plus a redemption premium. Investors may want the right to recover their initial investment, plus a profit, if the company fails to meet expectations. Companies dislike mandatory redemption because the investment is more like debt than equity.

For further information on dividends and redemptions in other contexts, see Dividends, Redemptions and Stock Repurchases.

Conversion Rights

Preferred stock issued in venture financings is almost always convertible into common stock:

- At the holder's option
- Automatically, upon the initial public offering of the company's stock or upon the vote of a majority of the preferred stock

To encourage investors to support the company when it is forced to raise money at a lower price than its previous round, a company could also have a:

- **Pay to play provision.** This is a provision that automatically converts preferred stock to common stock if the holder declines to purchase its pro rata share of a lower priced offering.
- **Shadow preferred.** This form of pay to play provision will have the shares of a holder who declines to purchase its pro rata share of a lower priced offering automatically convert to a shadow preferred. The shadow preferred is identical to the original series of preferred, but without antidilution protection.

Typically, the preferred stock will be initially convertible on a one-to-one ratio. The conversion ratio is actually calculated by taking the original purchase price and dividing it by the conversion price. The initial conversion price is normally the original purchase price. The conversion ratio is adjusted for dilutive events or issuances, as discussed in the section on Antidilution Protection below.

In subsequent rounds, in addition to automatic conversion upon an initial public offering, the preferred stock may automatically convert by the vote of either a:

- Majority of each series of preferred stock
- Majority of all series of preferred stock voting together as one class

Under the series voting structure, a series of preferred stock only converts if holders of a majority of that series elect to convert. On the other hand, under a class voting structure, a majority vote of all series of preferred stock (voting together as one class) is all that is required to automatically convert all outstanding shares of preferred stock. The series voting structure protects investors who purchase their preferred stock at a higher price from losing their rights.

Antidilution Protection

Convertible preferred stock always contains provisions protecting it against dilution from stock splits and stock dividends, sometimes called event protection. Frequently, there are also provisions protecting it against future sales of stock at lower prices, called price protection. Note, the antidilution protection provisions typically contain certain exceptions in which the provisions will not apply, including the issuance of stock options to service providers and the issuance of equity in various commercial transactions.

The most typical price protection is a weighted-average adjustment of the conversion price. The weighted-average formula adjusts the conversion price by means of a weighted formula based upon:

- Previously outstanding securities
- The sale price of the shares being sold
- The number of shares being sold

There are two types of weighted-average antidilution:

- **Broad-based.** Broad-based protection includes previously outstanding preferred stock and options as well as common stock in the calculation and will result in a smaller adjustment if there is a down round of financing (i.e., financing at a lower rate than the previous financing).
- **Narrow-based.** Narrow-based protection may exclude previously outstanding options or the preferred and is less favorable to the company. If the investors think they are paying too much for the preferred, they may insist on ratchet antidilution protection, which drops the conversion price to the most recent lower price at which stock was sold, regardless of how many shares were sold at that price. This protects investors who decline to participate in lower-priced offerings.

Some venture capitalists will not include price-based antidilution protection so as to put more pressure on investors to support the company in bad times.

In later stage financings, holders of series of preferred stock may receive antidilution protection in the event of an initial public offering, which provides such investors a minimum conversion price. For example, later stage investors may request a minimum return multiple, such as two or three times the original price of the preferred stock, in connection with a qualified initial public offering. For a discussion of anti-dilution provisions in the context of warrants, see Negotiating Warrant Antidilution Provisions Checklist.

Voting Rights

Preferred stock typically votes with the common stock on an "as if converted" into common stock basis. In addition, holders of the preferred stock may be given additional rights:

- **Designated directors.** Preferred stock holders may have the right to elect a certain number of directors to the company's board of directors, with holders of the common stock and holders of all stock (voting together) electing the remaining directors.
- **Class voting rights.** Applicable corporate law may also give the preferred stock class voting rights on certain major corporate events, such as mergers or the creation of additional authorized preferred stock.
- **Blocking rights.** In later stages, investors in a high-valuation financing may wish to require that certain actions may not be taken without the approval of holders of a majority of the series of preferred stock sold in that financing. These series voting rights give a particular series a blocking right over certain actions that might otherwise be approved by the preferred shareholders as a whole. Actions that might require the series vote might include a sale of the company, waiver of antidilution rights, and waiver of rights to liquidation preferences.

Registration Rights

In addition to the preferences discussed above, venture capitalists require an avenue to liquidity. This is usually achieved by a registration-rights agreement giving the investors the right to require the company register its shares with the Securities and Exchange Commission (SEC). Registration rights can take the form of either (or both) of the following:

- **Demand rights.** Demand rights require the company to register the investor's shares when it receives a request from a certain percentage of registrable securities.
- **Piggyback rights.** The investor may also have the right to require the company to register its shares with the SEC when the company otherwise decides to go public.

In both cases, the company usually pays related expenses.

Typically, later stage investors have a greater focus on the details of registration rights since the likelihood of an initial public offering may have increased. For a form of registration rights agreement, see Registration Rights Agreement.

Typical Restrictions Imposed on Management

Venture capitalists generally require certain commitments from the company about its post-financing management. The covenants that companies are likely to encounter are affirmative and negative covenants, rights of first refusal, and co-sale rights.

Affirmative covenants generally require the company to provide the investors with ongoing financial information and access to the company's records and management, and may grant the investors the right to board representation or board visitation rights.

Conversely, investors may also require negative covenants or company agreements not to take specified actions, often called protective provisions, without the investors' consent, such as mergers, financings, change of business, and dividends. A company's management must carefully evaluate these covenants to ensure that they will not unduly interfere with the board's ability to manage the company.

LINING UP YOUR TRANSACTION DOCUMENTS IN A PREFERRED STOCK ISSUANCE

Financing Documents

The documents in a preferred stock financing typically include the main transaction documents and the ancillary documents described below. For further information, see Closing Checklist (Private Offering of Preferred Shares).

Preferred Stock Purchase Agreement

The preferred stock purchase agreement (SPA) is the main transaction document in a financing. It contains the important provisions surrounding the sale of the stock, including:

- Price
- Representations and warranties of both the company and the purchasers
- What is required to close the financing:
  - Standard conditions to closing include satisfactory completion of financial and legal due diligence, qualification of the shares under applicable blue sky laws, and obtaining a legal opinion of company counsel.

Restated Certificate of Incorporation

Prior to selling any preferred stock, the company must file its restated certificate of incorporation, which amends the company's existing certificate of incorporation to increase the authorized amount of company stock to include the preferred stock being sold in the financing. Additionally, the company may need to increase its common stock, as necessary, to account for the conversion of the additional preferred stock into common stock. Further, the certificate of incorporation includes many of the preferences listed above, including liquidation preferences, dividend preferences, voting rights, protective provisions, conversion of preferred stock, antidilution provisions, and redemption rights.

Voting Agreement

The voting agreement is an agreement among the investors, the company, and usually certain holders of common stock, who are known as key holders. The agreement:

- Provides that the parties must vote all of their shares in compliance with the agreement, which can include maintaining a given size of the company's board of directors and electing certain investor designees as the preferred director(s)
- May require that the parties agree to a drag-along provision, which provides that if certain groups of stockholders vote in favor of consummating a sale of the company, then all stockholders must vote in favor of the transaction

The typical stockholder vote required to trigger the drag-along provisions is the affirmative vote of holders of a certain percentage of all preferred stock voting together as a class plus holders of a certain percentage of common stock.

Investors' Rights Agreement

The investors' rights agreement is an agreement among the company and the investors and generally includes:

- Registration rights
- Lock-up provisions in which investors agree not to sell any shares of common stock of the company for a period of up to 180 days following an initial public offering
- Confidentiality provisions
- Insurance requirements
- Certain rights given to major investors:
  - Major investors include those who hold the most shares and meet a minimum share threshold. These investors are usually given additional rights, such as information and inspection rights and board observer rights. Additionally, major investors may also be given a right of first refusal on further stock issuances by the company. Typically, these provisions will give the investors the right to buy their proportionate share of any new stock offerings prior to the offering.

For a form of agreement, see Investor's Rights Agreement.

Right of First Refusal and Co-Sale Agreement

The right of first refusal and co-sale agreement is an agreement among the company, the investors, and key holders. It provides that:

- If a key holder wishes to transfer his or her stock to a third party, the company has the primary right of first refusal, with the investors having the secondary right of first refusal, to purchase the shares at the price being offered by the third party.
- If the shares are not purchased pursuant to the right of first refusal, then the investors can participate in a co-sale of their shares on a pro rata basis to the purchaser of the key holder's shares.
  - The reason for a co-sale agreement is that the investors generally do not want the key holders to cash out without providing the investors the same opportunity for liquidity.

The right of first refusal and co-sale agreement should terminate upon a public offering or the company's acquisition.

Ancillary Documents

Additionally, certain ancillary documents may be required, including:

- Consents from the company's board of directors and stockholders, exhibiting that the board and stockholders approve of the financing and other related matters
- A legal opinion from company counsel, which provides reassurance to investors that the company has authority to enter into the transaction and is validly existing

- Side letter agreements required by certain investors, which provide the investor additional rights, such as information and inspection rights or the right to have a representative present at board meetings in a nonvoting observer capacity
- Indemnification agreements with each of the directors, including the preferred stock director(s)

For additional information on indemnifying directors, see Indemnifying the Directors and Officers of a Start-Up. For further information on legal opinions, see Legal Opinions for Securities Offerings and Legal Opinions in Securities Offerings Checklist.

Disclosure Schedule for a Stock Purchase Agreement

The SPA typically contains standard representations and warranties of the company regarding its business. For example, the company represents and warrants that it:

- Is a corporation duly organized, validly existing, and in good standing under the laws of its state of incorporation
- Has listed its authorized capital immediately prior to the closing, including the number of authorized shares of common stock and preferred stock and the amounts issued and outstanding of each, and has described the amount of shares reserved for issuance pursuant to its stock plan
- Has delivered to each purchaser its unaudited and audited financial statements for the previous fiscal year and for the most recent period, and that these financial statements were prepared in accordance with generally accepted accounting principles (GAAP)
- Owns or possesses (or can acquire) sufficient legal rights to all of its intellectual property without any known conflict with, or infringement of, the rights of others

These intellectual property provisions are often heavily negotiated.

In addition to providing representations and warranties in the SPA, companies typically draft a corresponding disclosure schedule, which provides certain explanations or exceptions to such representations and warranties. For example, the disclosure schedule would list all of the company's intellectual property in connection with the intellectual property representation contained in the SPA.

In later stages, the representations and warranties in the SPA, and the corresponding disclosures in the disclosure schedule, will often be more complex and larger in scale in comparison to earlier rounds. For example, the intellectual property representations may become more complex as more intellectual property is developed or more expansive based on disclosure requirements of later stage investors.

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Mark Leahy, a seasoned advisor to technology companies on a broad range of corporate transactional matters, focuses on providing legal solutions that advance his clients' business objectives. With a deep understanding of each client's business and competitive landscape, Mark provides practical guidance through the complex legal and business hurdles of company growth. He enjoys learning about each of his clients, understanding their needs, and playing a central role in their business transactions.

Mark's practice focuses on venture capital financings, corporate governance, mergers and acquisitions, and public offerings. His expertise spans a wide range of technologies, including software, semiconductor, internet/e-commerce, and data management and storage.

His client roster consists of companies at all stages of development—from entrepreneurs seeking company formation advice, to startups seeking additional funding, to public company acquirers in search of targets in the technology space.

Mark earned his J.D. and his MBA from the University of Chicago.

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