

The role of the term sheet in VC transactions

By Rita Khoriaty on December 08, 2015

The term sheet, not binding but crucial.

The negotiation of a venture capital transaction between a startup seeking an investment and a potential investor usually starts with a term sheet.

Although a term sheet is not usually binding, it is a negotiation document that opens the long way towards the closing of the transaction, and should be negotiated carefully by lawyers for both sides, who will try to protect the interests of their respective clients. Negotiation may take weeks or months.

The term sheet is a key document which must be carefully drafted since it helps reduce the time and effort required to finalize the Shareholders' Agreement, the Shares Purchase Agreement or the Shares Subscription Agreement, along with the other documents that are necessary to implement the transaction.

Both parties should make sure the term sheet reflects their agreement on the main conditions that will govern their relationship. They must also be aware of the fact that although the term sheet is known to be a non-binding negotiation document, it might contain some binding provisions.

Contents of the term sheet

It is important that the term sheet includes all key provisions.

However, and in view of its summary nature and the fact that it is designed to be a relatively short document, it cannot contain all the terms and conditions of the transaction. Such terms and conditions will be more fully described in the Final Documents.

The main points addressed in a term sheet are usually the names of the parties, the capitalization of the company (the percentage of shares that will be held by each shareholder before and after the consummation of the transaction), the investment amount (the total amount that the investor is willing to invest in the company, the types of securities that the investor intends to purchase or to subscribe - whether common shares or priority shares, provisions relating to the management of the company, the composition of the board of directors, the applicable quorum and majority in the respective company's

bodies, and matters requiring consent (also called 'reserved matters'), which are actions that require special majorities or the consent of specific persons, generally the investor.

Binding or non-binding?

As stated earlier, the term sheet is a negotiation document.

It is not by itself binding upon either the company or the investor. In other words, by signing the term sheet, the parties do not commit themselves to proceed with the transaction.

The term sheet merely draws the transaction's road map by describing the main points on which the parties have agreed. It therefore remains subject to the agreement of the parties on the final documents.

If the parties are unable to agree on fundamental issues, they end the negotiation process. If they reach an agreement, they proceed with the transaction by executing the final documents.

However, the term sheet might contain binding provisions in regards to the negotiation process. The parties commit themselves to abide by certain provisions regardless of the outcome of the negotiations.

For example, the parties may undertake to negotiate in good faith, to keep confidential the existence of the negotiations and all information gathered during the due diligence process, and to negotiate exclusively with each other during a certain period of time.

In order to differentiate the binding provisions from the non-binding provisions, it is recommended that the non-binding terms be attached to a letter of intent as an annexure. Therefore, the terms contained in the letter of intent will be considered as binding, whereas the terms summarized in the annexure will be deemed as non-binding.

A well drafted term sheet is the key to a successful transaction. It is therefore recommended that the parties negotiate the term sheet with the utmost care in order to avoid unnecessary obstructions.

RITA KHORIATY

Rita is a lawyer member of the Beirut Bar Association, specialized in civil law and corporate law. She advises several startups in venture capital transactions. Rita holds a Ph. D. in Law from Paris 2 Assas

University and is also a lecturer of civil law at the Faculty of Law and Political Sciences of Saint Joseph University.