



WILSON
SONSINI

VC Financing Fundamentals

Demystifying and Negotiating the Legal Documents

Melinda Douglass

Welcome

Introductions

- Who am I?



Melinda Douglass

mdouglass@wsgr.com

By the end of this class, you should be able to . . .

- Identify each of the main financing documents.
- Have a sense of the main purpose of each agreement.
- Understand the terms of art used to refer to different provisions.
- Understand some of the key points of negotiation.
- Understand the practical implications of different terms.

Different ways to raise money

■ SAFE (Simple Agreement for Future Equity)

■ Convertible Note(s)

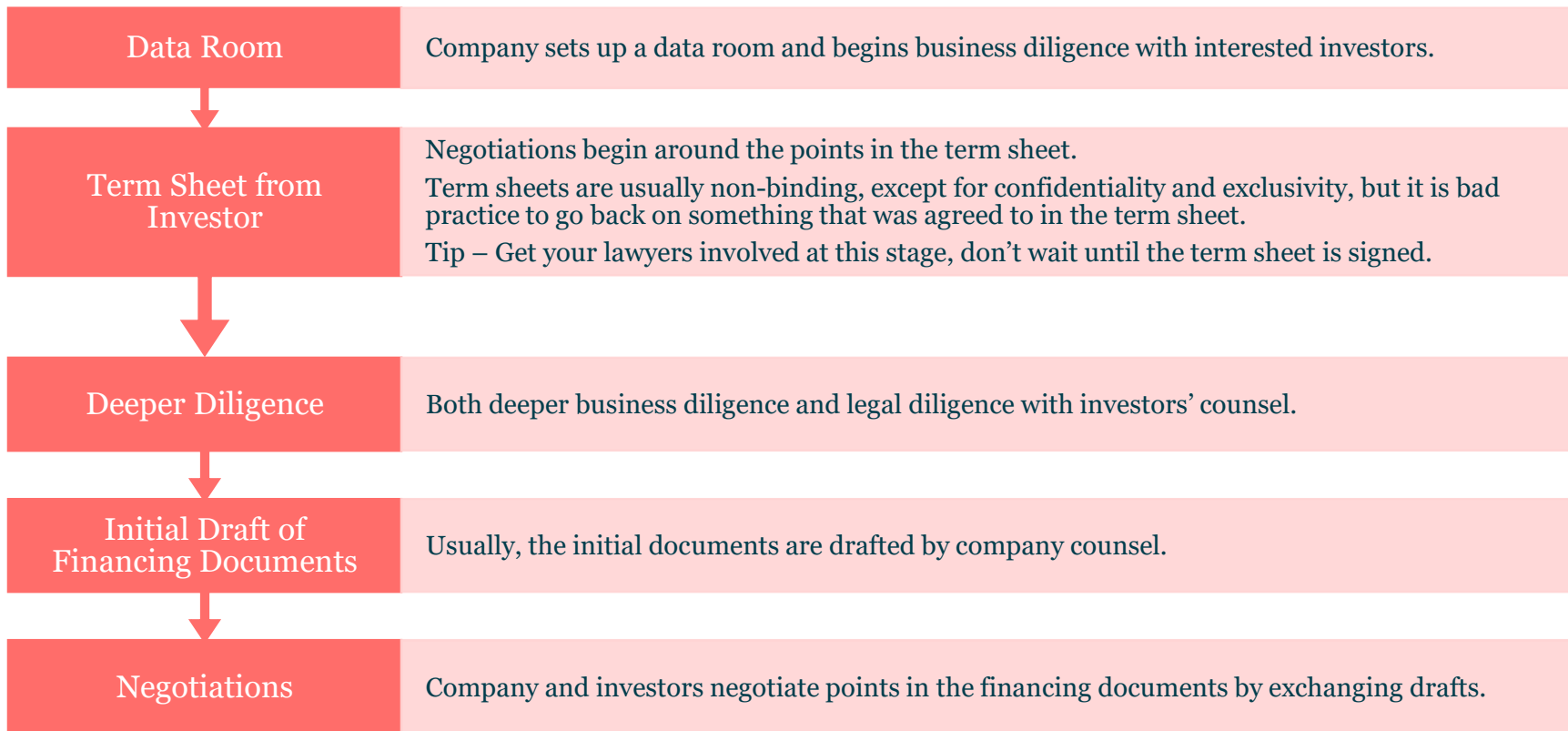
- Usually a series of notes up to a certain amount authorized by the board.
- Debt, but includes conditions under which it converts into equity.
- Often used as a “bridge” to an anticipated equity round.

■ Seed Round

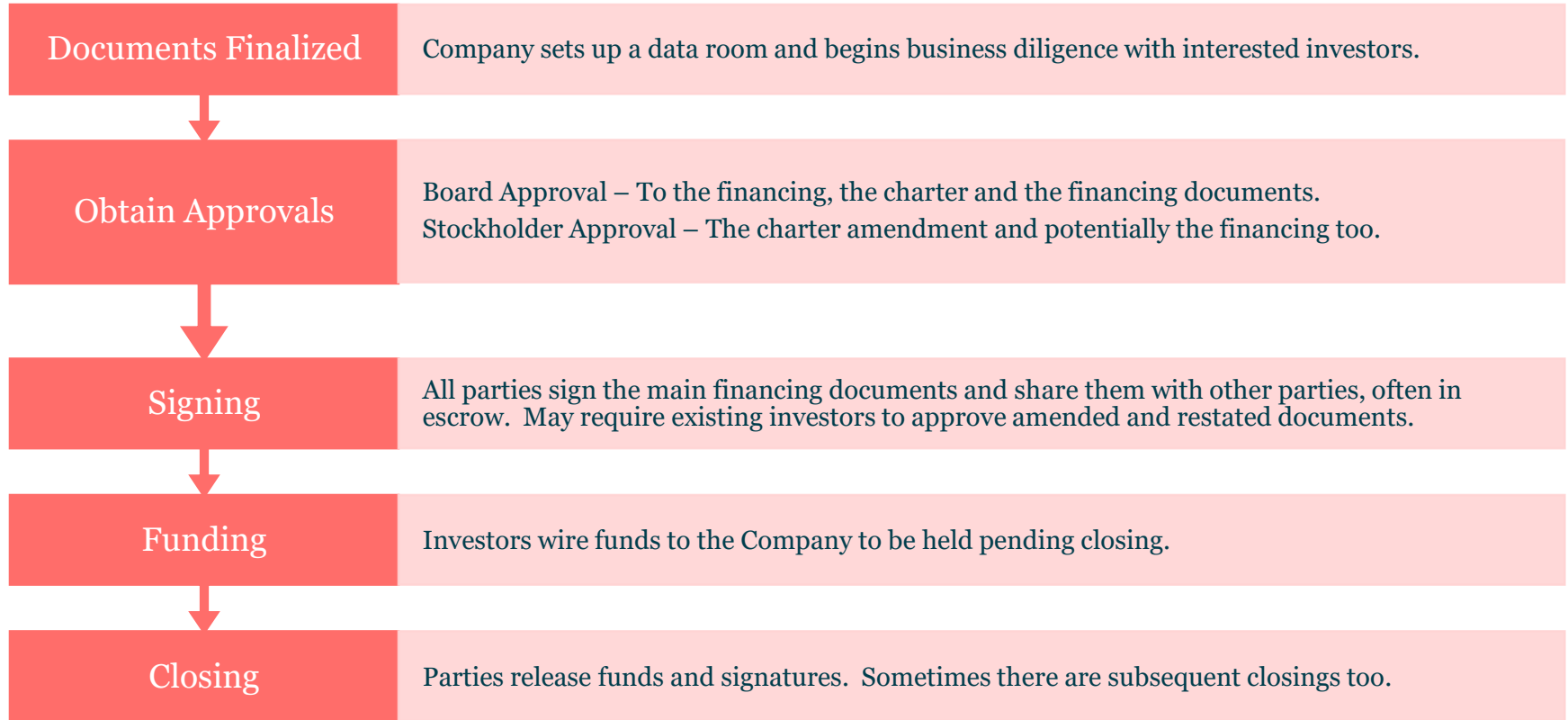
- At one time it was a simpler / stripped down version of a preferred stock with fewer rights and less complicated documents, but not so true today.

■ Preferred Stock Round

Process



Process continued . . .



What are the main financing documents?

Certificate of
Incorporation

Preferred Stock
Purchase
Agreement

Voting
Agreement

Investors'
Rights
Agreement

Right of First
Refusal and Co-
Sale Agreement

NVCA - <https://nvca.org/model-legal-documents/>

What is the Certificate of Incorporation?



Organization of the Charter

AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
ABC, INC.

[Pursuant to Sections 242 and 245 of the
General Corporation Law of the State of Delaware)

ABC, Inc., a corporation organized and existing under and by virtue of the provisions of the General Corporation Law of the State of Delaware (the "*General Corporation Law*"),

DOES HEREBY CERTIFY:

1. That the name of this corporation is ABC, Inc. and that this corporation was originally incorporated pursuant to the General Corporation Law on May 23, 2019.

2. That the Board of Directors of this corporation (the "*Board of Directors*") duly adopted resolutions proposing to amend and restate the Certificate of Incorporation of this corporation, declaring said amendment and restatement to be advisable and in the best interests of this corporation and its stockholders, and authorizing the appropriate officers of this corporation to solicit the consent of the stockholders therefor, which resolution setting forth the proposed amendment and restatement is as follows:

RESOLVED, that the Certificate of Incorporation of this corporation be amended and restated in its entirety to read as follows:

FIRST: The name of this corporation is ABC, Inc. (the "*Corporation*").

SECOND: The address of the registered office of the Corporation in the State of Delaware is 1209 Orange Street, in the City of Wilmington, County of New Castle, Delaware 19801. The name of its registered agent at such address is The Corporation Trust Company.

THIRD: The nature of the business or purposes to be conducted or promoted is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law.

FOURTH: The total number of shares of all classes of stock which the Corporation shall have authority to issue is (i) 30,000,000 shares of Common Stock, \$0.001 par value per share ("*Common Stock*") and (ii) 14,767,463 shares of Preferred Stock, \$0.001 par value per share ("*Preferred Stock*"). Of the authorized Preferred Stock, 5,500,000 shares are hereby designated "*Series Seed Preferred Stock*," 3,209,087 shares are hereby designated "*Series A Preferred Stock*," 1,324,815 shares are hereby designated "*Series A-1 Preferred Stock*" (the Series A Preferred Stock and Series A-1 Preferred Stock, collectively, the "*Combined Series A Preferred Stock*") and 4,733,561 shares are hereby designated "*Series B Preferred Stock*," each with the following rights, preferences, powers and restrictions, qualifications and limitations.

The following is a statement of the designations and the powers, preferences and special rights, and the qualifications, limitations or restrictions thereof in respect of each class of capital stock of the Corporation.

Article FOURTH

A. Common Stock

1. General & 2. Voting

B. Preferred Stock

1. Dividends

2. Liquidation, Dissolution or Winding Up

3. Voting

4. Option Conversion

4.4 Adjustment to Preferred Stock Conversion Price

5. Mandatory Conversion

Dividends

A distribution made on a share by share basis.

■ Section 1. – Dividends

- Cash or Shares
- Mandatory or Discretionary
- Cumulative / Accruing or Non-cumulative
- Participating or Non-participating

Liquidation Preference

The amount that is paid to the preferred stock before payment to the common stock.

- Section 2. – Liquidation, Dissolution or Winding Up; Certain Mergers, Consolidations and Asset Sales
 - 2.1 Preferential Payments to Holders of Preferred Stock
 - 2.2 Payments to Holders of Common Stock / Distribution of Remaining Assets
 - 2.3 Deemed Liquidation Events

- The liquidation preference is often expressed as a multiple of the original issue price of the shares (1x, 2x, etc.)

- Original issue price is a defined term and therefore a set amount for each series of stock. A main reason for “shadow series” of stock.

Liquidation Analysis

How do the available assets for distribution get allocated if there is not enough money to pay the full amount of the liquidation preference?

Pari Passu

All preferred stock participate together on a pari passu basis. If there is not enough money for all preferred to get its full preference, the series would get back the same relative percentage to their investment.

Senior/Junior

Some preferred stock is senior to other series of preferred. Sometimes just the last round is senior to all other rounds, and the other rounds participate on a pari passu basis with each other. Sometimes each subsequent series is senior to the prior ones.

Complex

Most often seen when the last series in wants more than 1x liquidation preference. They might end up getting 1x first, paying the rest of the preferences and then taking a second 1x after the rest of the preferred preference but before the common.

Liquidation Analysis

If there are assets remaining after all the liquidation preferences are paid, how do those assets get allocated?

Non-Participating

Preferred stockholders do not receive any of the remaining assets.

Participating up to a Cap

Preferred stockholders share the remaining assets with the common stockholders until they receive a specified amount per share, which is typically described as a multiple of the Liquidation Preference.

Fully Participating

Preferred stockholders share the remaining assets with the common stockholders on a pro rata based on the number of shares.

When is the preferred stock forced to convert into common stock? And why?

Section 4. – Optional Conversion

- At the election of the holder.
- Mechanism for anti-dilution adjustments.

Section 5. – Mandatory Conversion

- IPO
- Direct Listings
- SPACs
- Vote of the Preferred

Price Based Antidilution



Preferred stock often has some form of price-based anti-dilution protection

Section 4.4 – Adjustments to Conversion Price for Diluting Issues



Price-based anti-dilution provisions protect existing investors from the issuance of ANY securities at a per share price below what the existing investors paid for their shares

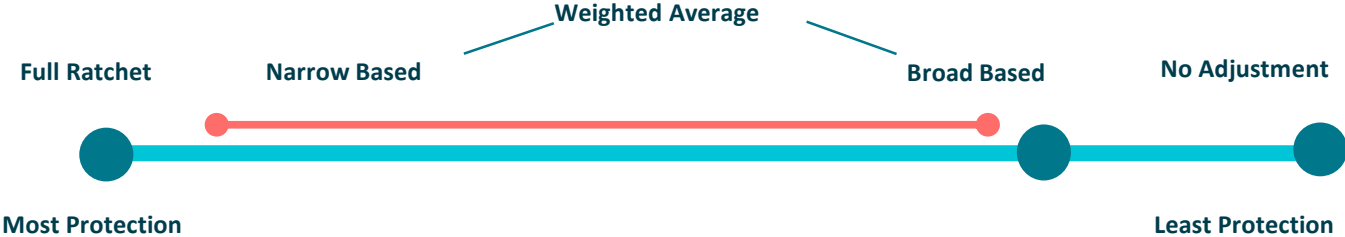
Section 4.4.1(a) - Additional Shares of Common Stock



There are typically “carve outs” to price-based anti-dilution for common non-financing events

Section 4.4.1(a)(i)-(viii) – Exempted Securities

Spectrum of Antidilution Protections



Weighted Average Adjustment

Weighted Average Adjustment

$$\text{New Conversion Price [NCP]} = \text{Existing Conversion Price [ECP]} \times \frac{\text{Outstanding Stock} + \left(\frac{\text{Invest.}}{\text{ECP}} \right)}{\text{Outstanding Stock} + \text{Add'l Shares}}$$

- *Narrow based Weighted Average Adjustment (fewer shares included in definition of outstanding stock results in a greater impact of the new dilutive shares)*
- *Broad based Weighted Average Adjustment (more equity included in the outstanding stock number means less of an impact on the existing conversion price)*

Board of Directors

What is the composition of the Board of Directors?

Control right

■ Section 3.2. – Election of Directors

- **At-Large Directors**
 - elected by a majority of all stockholders
- **Class Directors**
 - elected by a majority of the specified class, Common/Preferred
- **Series Directors**
 - elected by a specific series of stock, Series A Preferred

■ Directors have fiduciary duties all stockholders, regardless of which shares elect them.

■ This section also sets out the details regarding removal, filling vacancies, votes, etc.

Protective Provisions

Sets out a list of actions which the Company cannot do without first getting stockholder approval.

■ Section 3.4. – Preferred Stock Protective Provisions

- Class or Series Rights
- Timing of approvals

■ Examples:

- Liquidate or dissolve the company
- Amend the charter (impact on future financings)
- Purchase or redeem shares

Series [A] Preferred Stock Purchase Agreement

Section 1	Purchase and Sale of Preferred Stock
Section 2	Representations and Warranties of the Company
Section 3	Representations and Warranties of the Purchasers
Section 4	Conditions to the Purchasers' Obligations at Closing
Section 5	Conditions to the Company's Obligations at Closing
Section 6	Miscellaneous

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Series [A] Preferred Stock Purchase Agreement

■ Section 1. – Purchase and Sale of Preferred Stock

- 1.1 Sale and Issuance of Preferred Stock
 - Parties are agreeing to purchase the shares at a certain price
- 1.2 Closing; Delivery
 - Mechanics of Closing
- 1.3 Sale of Additional Shares of Preferred Stock
 - Will there be more than one closing?
 - If so, for how long?
 - Will any investors have the right to approve subsequent investors?
- 1.4 Use of Proceeds
- 1.5 Defined Terms Used in this Agreement

Series [A] Preferred Stock Purchase Agreement

Representations and Warranties

■ By the Company

- Two Types of Reps
 - Factual Statements
 - Listing Reps
- Disclosure Schedule / Schedule of Exceptions
- Negotiate the language of the rep vs making a disclosure
- May also implicate certain defined terms

■ By the Investor

- Authority to enter into the transaction
- Characteristics about the Investor, often related to securities law compliance
 - e.g.
 - Accredited Investor
 - No plans to distribute the shares
 - Residence

Series [A] Preferred Stock Purchase Agreement

Closing Conditions

- Company Obligations (Section 4)
- Investor Obligations (Section 5)

Despite separate sections, the obligations of the Company and the Investors are similar.

Confirm the reps and warranties you made are correct.

Sign and deliver the other ancillary agreements you agreed to.



Most Preferred Stock Financings are simultaneous sign and close. For that reason, the closing conditions are not as important as they are in an agreement where the date it is signed and agreed to, is different from the date it becomes effective.

Series [A] Preferred Stock Purchase Agreement

■ Section 6. – Miscellaneous

- Most of it is legalese and not really negotiated.
- Potential points of negotiation:
 - Amendment provisions
 - Governing law
 - Attorney's Fees

■ Exhibit A – Schedule of Purchasers

- Lists out the Investors, the number of shares and purchase price

Voting Agreement

Agreement among the Investors and certain large common holders to vote their shares as specified in the agreement.

■ Appointment of Directors

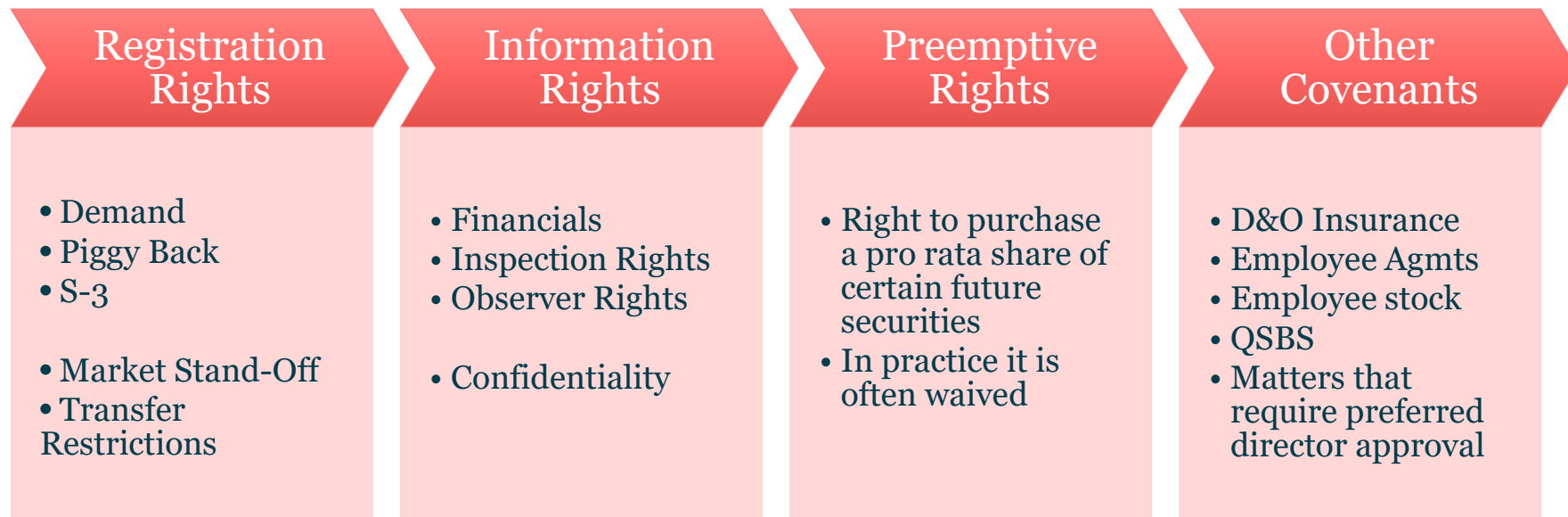
- Who has the right to appoint nominees?
 - All preferred
 - A specific series of stock
 - A specific venture fund
 - A founder
 - A specific role, ie CEO
- How can they lose that right?

■ Drag Along

- Agreement to vote for a transaction, ie a merger, if some composition of people approve it
- Usually includes:
 - the board,
 - a majority of Investors (preferred shares), and
 - sometimes a majority of “Key Holders” (common shares)
- Also includes certain guarantees about the deal

Investors' Rights Agreement

The Company is making certain promises to the Investors.



While registration rights usually flow to all Investors (and sometimes founders), the information rights and preemptive rights are often limited to “Major Investors” in other words, those holding a significant number of shares.

Rights of First Refusal & Co-Sale Agreement

The Key Holders are making certain promises to the Investors.

■ If a Key Holder is planning to sell shares

- Negotiate and number of shares and price with a third-party buyer.
- Give notice to the Company and other Investors.
- Company gets the first opportunity to purchase the shares at the price they negotiated with the third-party.
- If the Company does not buy the shares, the Investors can purchase the shares.
- If an Investor prefers to sell its shares, rather than buy the Key Holder's shares, it can sell a pro rata portion of its shares and the Key Holder is not able to sell all of the shares it was planning to.

■ Rights are rarely exercised in practice

- Often waived
- Certain exceptions

Ancillary Documents

Other documents that you may come across.

■ Side Letter

- Standard VC request.
- Vary from simple information rights to board observers and notice rights.
- Link rights to the IRA when you can.

■ Indemnification Agreement.

- Important for VC's who appoint partners to the board.

■ Legal Opinion

Entrepreneur's Report

EntrepreneursReport@wsgr.com



THE ENTREPRENEURS REPORT PRIVATE COMPANY FINANCING TRENDS

From the Wilson Sonsini Database:

FINANCING TRENDS FULL-YEAR 2023



Appendix – Private Company Financing Deal Terms (Wilson Sonsini Deals)

	2019 All Rounds ²	2020 All Rounds ²	2021 All Rounds ²	2022 All Rounds ²	2023 All Rounds ²	2019 Up Rounds ³	2020 Up Rounds ³	2021 Up Rounds ³	2022 Up Rounds ³	2023 Up Rounds ³	2019 Down Rounds ³	2020 Down Rounds ³	2021 Down Rounds ³	2022 Down Rounds ³	2023 Down Rounds ³
Liquidation Preferences - Series B and Later															
Senior	35%	35%	24%	30%	26%	30%	32%	23%	26%	20%	63%	56%	50%	64%	38%
Pari Passu with Other Preferred	63%	63%	75%	70%	74%	68%	67%	76%	74%	80%	37%	44%	50%	36%	62%
Junior	1%	0%	1%	0%	0%	1%	0%	1%	0%	0%	0%	0%	0%	0%	0%
Complex	2%	1%	0%	0%	0%	2%	1%	0%	0%	0%	0%	0%	0%	0%	0%
Participating vs. Non-Participating															
Participating - Cap	5%	4%	4%	3%	2%	5%	6%	4%	3%	4%	5%	0%	0%	0%	14%
Participating - No Cap	10%	8%	6%	6%	8%	12%	8%	7%	7%	10%	32%	24%	0%	36%	24%
Non-Participating	85%	88%	90%	91%	90%	83%	86%	89%	90%	85%	63%	76%	100%	64%	62%
Dividends															
Yes, Cumulative	5%	10% ⁴	5%	6%	3%	6%	10% ⁴	6%	8%	6%	11%	25% ⁴	0%	8%	0%
Yes, Non-Cumulative	56%	79% ⁴	56%	51%	46%	67%	83% ⁴	65%	57%	53%	79%	69% ⁴	57%	58%	65%
None	39%	10% ⁴	39%	43%	51%	28%	7% ⁴	29%	35%	40%	11%	6% ⁴	43%	33%	35%
Anti-Dilution Provisions															
Weighted Average - Broad	94%	95%	97%	98%	98%	99%	98%	98%	99%	100%	89%	76%	100%	100%	95%
Weighted Average - Narrow	0%	1%	1%	0%	1%	0%	2%	1%	0%	0%	5%	6%	0%	0%	5%
Ratchet	0%	1%	1%	1%	0%	0%	0%	1%	1%	0%	5%	6%	0%	0%	0%
Other (Including Blend)	1%	1%	0%	0%	0%	0%	1%	1%	0%	0%	0%	0%	0%	0%	0%
None	4%	2%	1%	1%	2%	1%	0%	0%	0%	0%	0%	12%	0%	0%	
Pay to Play - Series B and Later															
Yes, Pay to Play	3%	7%	3%	7%	8%	2%	3%	3%	4%	4%	16%	12%	17%	43%	10%
None	97%	93%	97%	93%	92%	98%	97%	97%	96%	96%	84%	88%	83%	57%	90%
Redemption															
Yes, Redemption	14%	13%	10%	8%	5%	17%	10%	15%	12%	4%	26%	25%	17%	7%	15%
None	86%	88%	90%	92%	95%	82%	90%	86%	89%	96%	74%	75%	83%	93%	86%

¹ We based this analysis on deals having an initial closing in the period to ensure that the data clearly reflects current trends. Please note the numbers do not always add up to 100% due to rounding.

² Includes flat rounds and, unless otherwise indicated, Series A rounds.

³ Note that the All Rounds metrics include flat rounds and, in certain cases, Seed and Series A financings as well. Consequently, metrics in the All Rounds column may be outside the ranges bounded by the Up Rounds and Down Rounds columns, which will not include such transactions.

⁴ The 2020 increase in the number of transactions reported as including dividends resulted in part from a change to our reporting methodology.

Questions?

Thank you



Melinda Douglass

Senior Counsel

Corporate

mdouglas@wsgr.com

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