

Term Sheet Battle ®



An Improvised Mock Negotiation of a Seed Stage Financing

The Cast & Crew

*Naren Shaam
Dr. Christian Nagel
Dr. Mattias Birkholz*

*Brad Furber
Alex Farcet
Emily-Jane Shurey*

The Characters

*Naren - Co-Founder & Manager, Fruit Platter GmbH
Christian, General Partners of Mixed Grill Ventures IV, L.P.
Matthias - Partner, Turlip LLP*

*Brad - Referee
Lars - Master of Ceremonies
Emily - Organizer*

Setting the Stage/Background

Fruit Platter GmbH ("**Fruit Platter**") was co-founded by two entrepreneurs, Naren (a US citizen) and Suzy (a Dutch citizen) in June 2012. Naren and Suzy had met in Berlin, where they both live. Fruit Platter sells customized fruit platters online. It aims at nothing less than providing customers with the perfect fruit platter - a custom-prepared healthy and organic snack based on over 100 different types of fruit under the brand name „fruitzz“. Fruit Platter is using breakthrough conservation technology developed by Naren during his Master studies at the Boston Fruit Institute. Fruit Platter went online in November 2012 and has been a huge success with customers. It has been honoured with several awards and was voted Germany's startup of the year in 2012.

There are already two other relatively early stage competitors who have basically tried to imitate Fruit Platter's business model, one of them is backed by the reknown Berlin accelerator firm Stratosphere Ventures. To date, Fruit Platter has been able to bootstrap and angel finance (EUR 150K) its way to 2,500 fruit platter orders a month.

Fruit Platter has been incorporated as a GmbH, a limited liability company under German law. The share capital amounts to EUR 25,000.00, consisting of 25,000 shares. Fruit Platter was accepted and enrolled into the spring program of Startupbootcamp ("**SBC**"). Naren currently through Naren UG (haftungsbeschränkt) holds 14,250 shares (57%) and Suzy holds 6,250 shares (25%) in Fruit Platter. Herbert, a German angel investor and entrepreneur, purchased 2,500 shares (10%) for EUR 150K in August 2012. SBC owns 2.000 shares (8%). Naren and Suzy have told three key employees that they would each get 3% of Fruit Platter in light of the fact that they worked for virtually nothing during the initial phase. They never got around to formalizing anything in this regard.

Fruit Platter participated in the SBC Investor Day in November 2012. Christian, a General Partner of Mixed Grill Ventures IV, L.P. ("**Mixed Grill**"), the European arm of a venture capital firm headquartered in Silicon Valley with over US\$1.5B in assets under management, attended the SBC Investor Day and was impressed enough by the pitch that he invited the Fruit Platter team to make a presentation to his firm in late-March 2013. Naren and Suzy have also been approached by various other VC firms, as well as by the international fruit conglomerate United Fruit Lovers Inc., all expressing strong interest in investing in Fruit Platter.

Fruit Platter management let it be known that Fruit Platter would be very pleased to sell a 20% equity stake in exchange for EUR 750K, and management was also confident that with that amount of equity at its disposal Fruit Platter could achieve the following milestones within six months or less: (i) 5,000.00 fruit platter

orders/month, (ii) revenue over EUR 150K/month, and (iii) gross profit over EUR 10K/month. After several follow-up meetings with Fruit Platter and considerable market due diligence, Mixed Grill delivered to Fruit Platter on Wednesday, May 15, 2013, a proposed Term Sheet to lead a Series A financing, a copy of which is incorporated into this Playbill.

Mixed Grill has engaged Roger, a partner in Berlin office of Birch Clarke LLP, a global law firm that represents dozens of venture capital firms doing business in the USA and Europe, to draft the Series A Term Sheet and definitive documents contemplated thereby, perform legal due diligence, and provide such other legal services as may be necessary and appropriate to negotiate and close the proposed transaction.

Fruit Platter has engaged Matthias, a well known corporate lawyer who has advised numerous startups in financing rounds with VCs. He is based in the Berlin office of Turlip LLP, a mid-size law firm with offices in major financial and tech centers in the USA and Europe.

Christian, the General Partner of Mixed Grill, has requested a meeting with Naren on 7 June 2013, to discuss the proposed Term Sheet. Currently being on a trip to Silicon Valley by invitation of the German American Chamber of Commerce, Suzy is unable to attend the meeting, but Naren has asked Matthias to participate in the meeting as counsel to Fruit Platter. Christian normally prefers that the first meeting between them and the CEO of a prospective portfolio company be among principals only (no lawyers), with a view towards enabling them to explain the purposes and intent of the various proposed terms and conditions, with ample time for questions and answers without concern for the meter/billable hours. Never having raised VC financing before, Naren does not understand a lot of language and "legalese" contained in Mixed Grill's proposed term sheet, and he believes that he will be more comfortable and effective at the meeting if Matthias is by his side. Christian has many years of experience negotiating term sheets and the various legal agreements contemplated thereby, and to avoid racking up more legal fees at this point in the deal process, they opt to attend the meeting without Roger's participation.

Talking Points

Naren has a number of questions regarding the proposed Term Sheet. Christian suggests that in his experience, meetings of this sort are most efficient and productive if the parties can first identify the main questions and potential points of contention.

General Term Sheet Issues

1. Why do we need a term sheet at all?
 - A. Can we not negotiate the contract right away?
 - B. Generally not Binding: what parts of the term sheet are legally binding?
 - C. Factually binding nature of term sheets
2. No Shop
 - A. What is the rationale for shutting down the dating process?
 - B. Would a simple non-solicitation be good enough instead?
 - C. How long is "long enough" and should obligations terminate immediately if the VC terminates the process?
 - D. Should acquisitions be carved out?
3. Confidentiality
 - A. Is there a risk that they steal my idea?
 - B. NDAs for VC?
4. Penalty Clauses and Expenses
 - A. Rationale of penalty clauses
 - B. Is there a standard for such clauses?
 - C. Who bears the costs?
 - D. Break-fees

Economic Issues

1. Price
 - A. Pre- and Post-Money Valuation. Fruit Platter focused on pre-money valuation. Mixed Grill proposes a tranching financing.
 - B. Payment formula matters: Mixed Grill possibly does not pay EUR 750.000 in exchange for 20 % at First Tranche.
 - C. Option Pool to affect Founder dilution.
 - D. Is the Second Tranche a "call" (i.e., "mandatory" at the option of Fruit Platter) or an "option" ("discretionary" at the option of Mixed Grill?)
 - E. Who decides if milestones have been achieved?
2. Liquidation Preference
 - A. Why is there a 2X liquidation preference? How does that work in operation?

- B. What is the rationale behind a term that gives Mixed Grill both a liquidation preference, first, and full participation rights, second? Isn't that getting two bites at the apple? Is that fair?
 - C. What is "market"? Are "market" terms different in Germany vs Rest of Europe vs USA?
3. Vesting/Reverse Vesting on Founders Stock and Options
- A. If the founders' stock has already been issued, then why would VC, angel and/or co-founders want "reverse vesting" (i.e., buyback rights)? Is it "fair"?
 - B. What is "market" in terms of reverse vesting on founders stock? What are the tax consequences?
 - C. What is "market" for vesting on forward-looking option grants?
 - D. Is there a big difference in what is "market" between Germany vs Rest of Europe vs USA?
 - E. What about acceleration provisions in the event of M&A? What is the difference between a "single trigger" and "double trigger" acceleration provision?
4. Option Pool
- A. How much is "enough"? For how long a period is it intended to last?
 - B. How does size of unallocated option pool affect pre- and post-money valuation?
 - C. What is "market" as regards to employee incentives: direct employee participation, phantom stocks etc.?
5. Anti-dilution Formula
- A. What is the difference between "full ratchet" and "weighted average" antidilution formulas? What is difference between "broad-based" and "narrow-based" weighted average antidilution formulas?
 - B. Is this solely an "economic" issue, or is this also a "control/voting" issue?
 - C. What is "market"?
 - D. Are there differences between Germany vs Rest of Europe vs USA?
6. Representations and warranties
- A. What is the rationale for representations and warranties?
 - B. Why should the Founders be also personally responsible for potential breaches of the representations and warranties?
 - C. What is "market"?

Control Issues

1. Protective Provisions
 - A. Why should investors get the right to veto certain actions?
 - B. "Belt and suspenders" approach
 - C. Are protective provisions/veto rights generally meant to restrict or intrude into operations or ordinary course of business matters?
 - D. What about using "materiality" qualifiers?
 - E. When should these protection provisions terminate?
 - F. What is "market"?

2. Means to exercise control
 - A. Right to appoint Managing Directors?
 - B. Advisory Board plus rights to appoint members
 - C. Shareholder Assembly

3. Drag-Along Rights
 - A. Why and when should the preferred stock holders (in this case a minority of the voting stock) be able to force a sale of the company?
 - B. How might founders and management be adversely impacted, and what alternatives exist as protection?
 - C. What is "market"?
 - D. Are there differences between Germany vs Rest of Europe vs USA in terms frequency and structure of drag-along rights?

4. Right of First Refusal/Right of Co-Sale
 - A. How has the emergence of private secondary markets changed these terms and conditions?
 - B. Should the common holders have these rights too?
 - C. What is market?

To Follow-Up with Cast & Crew

The Cast & Crew

Email

*Naren Shaam
Dr. Christian Nagel
Dr. Mattias*

*naren.shaam@goeuro.com
nagel@earlybird.com
birkholz@lindenpartners.eu*

*Brad Furber
Alex Farcet
Emily-Jane Shurey*

*brad.furber@aeryadvisors.com
af@startupbootcamp.org
m@playfulmarketing.com*