

# Term Sheet Battle ®



## An Improvised Mock Negotiation of a Series A Financing

### The Cast & Crew

*Micke Paqvalen  
Daniel Blomquist and  
Jimmy Fussing Nielsen  
Kimmo Reina*

*Brad Furber  
Lars Buch  
Dimitri Sarle*

### The Characters

*Micke - Co-Founder & CEO, Gaming Solutions IQ Ltd*

*Daniel & Jimmy, General Partners of Ravenous Ventures IV, L.P.  
Kimmo - Partner, Schwartz & Shields LLP*

*Brad - Referee  
Lars - Master of Ceremonies  
Dimitri - Host*

## Setting the Stage/Background

Gaming Solutions IQ Ltd (“GSIQ”) was co-founded by three European entrepreneurs, Micke (a Finnish citizen), Simon (a Dutch citizen) and Lone (a Danish citizen) in March, 2012. GSIQ is creating a collection of localized cross-platform portals that form the core of an online and mobile game community, and provides solutions to advertisers and publishers to target, connect with and acquire users and customers among such gaming audiences. There are at least three other relatively early stage competitors with similar business models, two of which are already backed by sophisticated venture investors. To date, GSIQ has been able to bootstrap and angel finance (EUR 150K) its way to building a community currently approaching 250,000 members.

GSIQ has been incorporated as a limited liability company under Finnish law (in Finnish: *Osaakehtiö*). It was accepted and enrolled into the Fall 2012 program of a Tech All Stars accelerator (“TASA”). The three co-founders of GSIQ each own 700,000 shares of common stock. Martti, a Finnish angel investor and entrepreneur, purchased 360,000 shares of common stock of GSIQ for EUR 150K in August 2012. TASA owns 240,000 shares of common stock. Options to purchase an additional 300,000 shares of common stock have been granted to individuals who have joined the GSIQ team as employees, contractors, consultants and advisors since its incorporation.

GSIQ participated in the TASA Investor Day program in mid November 2013. Daniel, a General Partner of Ravenous Ventures IV, L.P. (“Rave”), the European arm of a venture capital firm headquartered in Silicon Valley with over US\$1.5B in assets under management, attended the TASA Investor Day and was impressed enough by the GSIQ pitch that he invited the GSIQ team to make a presentation to his firm in late-March 2013. GSIQ management let it be known that GSIQ 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 GSIQ could achieve the following milestones within twelve months or less: (i) community over 1,000,000 members, (ii) revenue over EUR 150K/month, and (iii) gross profit over EUR 10K/month. After several follow-up meetings with GSIQ management and considerable market due diligence, Rave delivered to GSIQ on Wednesday, May 15, 2013, a proposed Term Sheet to lead a Series A financing, a copy of which is incorporated into this Playbill.

Rave has engaged Roger, a partner in Dewey Cheatem & Howe 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 Series A financing.

GSIQ has engaged Kimmo, a well known startup and emerging growth company lawyer based in the Helsinki office of Schwartz & Shields LLP, a mid-size law firm with offices in major financial and tech centers in the USA and Europe. Kimmo has reviewed the proposed Series A Term Sheet, and provided his initial written comments and feedback thereon to GSIQ’s Board of Directors.

Micke, the CEO of GSIQ, has requested a meeting with Daniel and his colleague Jimmy on May 28, 2013, to discuss the proposed Series A Term Sheet. Micke has asked Kimmo to

attend the meeting as counsel to GSIQ. Daniel and Jimmy normally prefer 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, Micke does not understand a lot of language and "legalese" contained in Rave's proposed term sheet, and he believes that he will be more comfortable and effective at the meeting if Kimmo is by his side as counsel to GSIQ. Daniel and Jimmy have 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

Micke and Kimmo have a number of questions regarding the proposed Term Sheet. Kimmo and Micke suggest that in their experience, meetings of this sort are most efficient and productive if the parties can first identify the main questions and potential points of contention.

### Economic Issues

1. Price
  - A. Pre- and Post-Money Valuation. GSIQ was asking for EUR 3M in pre-money valuation, and Rave is meeting that request. GSIQ is asking for EUR 3.75M post-money valuation, and Rave is offering EUR 3.75M (1<sup>st</sup> Closing) and EUR 4.5M (2<sup>nd</sup> Closing).
  - B. Equity Dilution: GSIQ is asking for 20%. Rave is offering 20% (1<sup>st</sup> Closing) and 33% (2<sup>nd</sup> Closing).
  - C. Questions/Issues: What is the purpose of Rave's proposal to create a tranching financing? Is the 2<sup>nd</sup> Closing a "call" (i.e., "mandatory" at the option of GSIQ) or an "option" ("discretionary" at the option of Rave)? 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 Rave both a liquidation preference, first, and full participation rights on an as-converted basis, second? Isn't that getting two bites at the apple? Is that fair?
  - C. What is "market"? Are "market" terms different in Finland 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 Finland 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?
  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. What is "market"?
    - C. Are there differences between Finland vs Rest of Europe vs USA?
    - D. Is this solely an "economic" issue, or is this also a "control/voting" issue?
  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. Composition and Election of Board of Directors
  - A. What is the "right" number of directors for an early stage company – 3, 4 or 5?
  - B. If common holders have right to elect one (or two) directors, and Series A holders have right to elect one (or two) directors, then how is the third (or fifth) director selected (i.e., by mutual consent of other directors, or by vote of all shareholders as a single class, or what)?
  - C. Should one board seat automatically go to the CEO?
  - D. Are there differences between Finland vs Rest of Europe vs USA in terms of standard board composition and corporate governance?
  - E. What about board observers – is that a good idea or common practice?
  - F. How are inside and outside directors generally compensated?
2. Protective Provisions
  - A. Why should investors get the right to veto certain actions?
  - B. Are protective provisions/veto rights generally meant to restrict or intrude into operations or ordinary course of business matters?
  - C. What is "market"?
  - D. What about using "materiality" qualifiers?
  - E. What about use of "belt and suspenders" protective provisions – at both the board level (Series A board designee), and shareholder level?
  - F. When should these protection provisions terminate?

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 Finland vs Rest of Europe vs USA in terms frequency and structure of drag-along rights?
4. Redemption Rights
  - A. What is the rationale for redemption rights?
  - B. Are there any traps for the unwary?
  - C. What is market?
5. 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?
6. No Shop/Confidentiality
  - 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?

## To Follow-Up with Cast & Crew

### The Cast & Crew

### Email

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