

*Presenting a live 90-minute webinar with interactive Q&A*

## **Drafting and Negotiating Convertible Preferred Stock Provisions: Protecting Interests of Businesses and Investors**

Structuring Liquidation and Distribution Preferences, Conversion Rights,  
Negative Control Rights, Anti-Dilution Protection, and Tax Provisions

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THURSDAY, MAY 8, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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**TERM SHEET FOR THE OFFERING AND SALE OF  
SERIES B PREFERRED STOCK OF XYZ, INC.**

**THIS TERM SHEET SUMMARIZES THE PRINCIPAL TERMS OF THE PROPOSED FINANCING OF XYZ, INC., A DELAWARE CORPORATION (THE “COMPANY”). THIS TERM SHEET IS FOR DISCUSSION PURPOSES ONLY; THERE IS NO OBLIGATION ON THE PART OF ANY NEGOTIATING PARTY UNTIL A DEFINITIVE STOCK PURCHASE AGREEMENT IS SIGNED BY ALL PARTIES. THIS TERM SHEET DOES NOT CONSTITUTE EITHER AN OFFER TO SELL OR AN OFFER TO PURCHASE SECURITIES.**

*Amount to be Raised:* \$\_\_\_\_\_.

*Type of Security:* Series B Preferred Stock (“Series B Preferred”).

*Number of Shares:* \_\_\_\_\_ shares.

*Purchase Price:* \$\_\_\_\_\_ per share (the “Purchase Price”).

*Closing Date:* The [initial] closing of the sale of the Series B Preferred (the “[Initial] Closing”) will be on or before \_\_\_\_\_, \_\_\_\_\_, [subject to a minimum sale of \_\_\_\_\_ shares]. [Subsequent sales may occur within \_\_\_\_\_ days of the Initial Closing until a maximum of \_\_\_\_\_ shares have been sold.]

*Rights, Preferences and Restrictions of Preferred Stock:*

**Dividends:** The holders of Series B Preferred will be entitled to receive noncumulative dividends [in preference to][on a parity with] the holders of Series A Preferred Stock (the “Series A Preferred”) and in preference to the holders of Common Stock at an annual rate of \_\_\_% of the Purchase Price per share [with respect to the Series B Preferred and \_\_\_% with respect to the Series A Preferred)] from legally available funds and when, as and if declared by the Board of Directors.

**Liquidation Preference:** In the event of any liquidation, dissolution or winding up of the Company, the holders of Series B Preferred will be entitled to receive [in preference to][on a parity with] the holders of Series A Preferred and in preference to the holders of Common Stock the amount of \$\_\_\_\_\_ per share plus declared and unpaid dividends, if any, and [thereafter] the holders of Series A Preferred will be entitled to receive in preference to the holders of

Common Stock the amount of \$ \_\_\_\_ per share], plus declared and unpaid dividends, if any [(the “**Initial Payment**”). **After the Initial Payment has been made, the holders of Series A Preferred and Series B Preferred and the holders of Common Stock shall participate ratably until holders of Series A Preferred have received an aggregate of \$ \_\_\_\_ per share and the holders of Series B Preferred have received an aggregate of \$ \_\_\_\_ per share.**] Thereafter, the remaining assets of the Company will be distributed ratably to the holders of Common Stock.

A Liquidation Transaction shall be treated as though it were a liquidation, for purposes of triggering an immediate obligation to pay an amount equal to the aggregate liquidation preference of the Preferred Stock. A “Liquidation Transaction” means an Acquisition of the Company, as defined immediately below, provided that if the holders of at least \_\_\_\_% of the Preferred Stock elect not to treat the transaction as a Liquidation Transaction, an Acquisition of the Company shall be deemed not to constitute a Liquidation Transaction.

An “Acquisition of the Company” means (i) a sale, conveyance or other disposition of all or substantially all of the property or business of the Company, (ii) a merger or consolidation with or into any other entity, unless the stockholders of the Company immediately before the transaction own 50% or more of the voting stock of the acquiring or surviving corporation following the transaction (taking into account, in the numerator, only stock of the Company held by such stockholders before the transaction and stock issued in respect of such prior-held Company stock), or (iii) any other transaction which results in (assuming an immediate and maximum exercise/conversion of all derivative securities issued in the transaction) the holders of the Company’s capital stock as of immediately before the transaction owning less than 50% of the voting power of the Company’s capital stock as of immediately after the transaction, provided, however, that an equity financing transaction in which the Company is the surviving corporation and does not (directly or through a subsidiary) receive any assets other than cash and rights to receive cash shall be deemed not to constitute an Acquisition of the Company. A series of related transactions shall be

deemed to constitute a single transaction, and where such transactions involve securities issuances, they shall be deemed “related” if under applicable securities laws they would be treated as integrated.

The liquidation preference of the Preferred Stock, if not specified in a merger agreement, will be paid 100% in the form of cash unless the Board of Directors elects to pay it in another form; if the Board does so elect, all stockholder of the same class must be treated equally.

**Redemption:** The Series B Preferred will not be redeemable, except to the extent the liquidation provisions specified above are deemed by any applicable law to constitute redemption.

**Voluntary Conversion:** Each holder of Series B Preferred will have the right, at the option of the holder at any time, to convert shares of Series B Preferred into shares of Common Stock at an initial conversion ratio of one-to-one.

**Automatic Conversion:** The Series B Preferred will be automatically converted into Common Stock, at the then applicable conversion rate, either (i) with the consent of the holders of a majority of the shares of Preferred Stock then outstanding, voting together as a class or, if earlier, (ii) immediately before the closing of a firm commitment underwritten initial public offering pursuant to a registration statement under the Securities Act of 1933, as amended, with aggregate gross proceeds of at least \$\_\_ million at a public offering price (adjusted for intervening common stock splits, reverse stock splits and stock dividends) of at least \$\_\_\_\_\_ per share (a “Qualified IPO”).

**Antidilution Provisions:** The conversion price of the Series B Preferred will be subject to proportional adjustment for stock splits, stock dividends and the like (“Stock Split Changes”), [and to adjustments on a [broad-based weighted average] [narrow-based weighted average] [ratchet]] basis for issuances at a purchase price less than the then-effective conversion price, subject to the following carve-outs:

(i) common stock issued pursuant to stock splits and

common-stock-on-common-stock dividends,

(ii) [up to \_\_\_\_\_ shares of ] common stock issued or issuable [for compensatory purposes] to employees, officers, consultants or directors of the Company, or other persons performing services for the Company, directly or pursuant to a stock option plan or restricted stock plan or agreement approved by the Board of Directors[, **including the Series A director representative and the Series B director representative then in office, if any (the “Preferred Directors”)**];

(iii) capital stock, or options or warrants to purchase capital stock, issued to financial institutions with federal or state charters or to lessors in connection with commercial credit arrangements, equipment financings, commercial property lease transactions or similar transactions;

(iv) capital stock issued or issuable to an entity as a component of any business relationship with such entity for the purpose of (A) joint venture, technology licensing or development activities, (B) distribution, supply or manufacture of the Company’s products or services or (C) any other arrangements involving corporate partners that are primarily for purposes other than raising capital, the terms of which business relationship with such entity are approved by the Board of Directors [, **including the Preferred Directors**];

(v) capital stock, or warrants or options to purchase capital stock, issued in connection with bona fide acquisitions, mergers or similar transactions, the terms of which are approved by the Board of Directors [, **including the Preferred Directors**];

(vi) common stock or other underlying security actually issued upon conversion, exchange or exercise of any derivative security;

(vii) common stock issued or issuable in or under a Qualified IPO;

(viii) common stock issued or issuable as a result of the antidilution provisions of any derivative securities; and

(ix) common stock issued or issuable in or under a

transaction for which the holders of at least **[a majority of]** the then outstanding shares of Preferred Stock, voting together as a class, adopt a resolution that expressly states that such Common Stock is not to be considered Additional Shares.

**Voting Rights:** The holder of a share of Series B Preferred will be entitled to that number of votes on all matters presented to stockholders equal to the number of shares of Common Stock then issuable upon conversion of such share of Series B Preferred. Notwithstanding the foregoing, the Series B Preferred shall not be entitled to vote on any matter for which voting is expressly reserved, by law or the express provisions of the Company's Certificate of Incorporation, solely for a class or classes of stock other than the Preferred Stock, or for one or more series of Preferred Stock other than the Series B Preferred.

**Protective Provisions:** So long as at least \_\_\_\_\_ shares of Preferred Stock remain outstanding, the Company will not (by amendment, merger, consolidation or otherwise, and either directly or indirectly by a subsidiary), without the approval of a majority of the Preferred Stock, voting together as a class:

(i) effect (A) a liquidation, dissolution or winding up of the Company **[or]** (B) an Acquisition of the Company**[,or (C) any other merger or consolidation of the Company, or a Company subsidiary, with or into any other entity];**

(ii) alter or change the rights, preferences or privileges of the Preferred Stock so as to materially and adversely affect such shares;

(iii) increase or decrease the number of authorized shares of the Preferred Stock, the Series A Preferred or the Series B Preferred;

(iv) authorize the issuance of securities having a preference over or on a parity with the Series A Preferred or Series B Preferred as to dividends or liquidation **[or that involves the issuance of any Company security, other than securities that fall within an express carveout to the antidilution**

**provisions and that are not restricted by another protective provision];**

(v) redeem, repurchase or otherwise acquire shares of Preferred Stock or Common Stock other than in accordance with **[the redemption provisions of the Preferred Stock or]** the repurchase of shares from employees, officers, directors, consultants or other persons providing services to the Company at no greater than cost pursuant to the original terms of such agreements, or such modified terms as have been agreed to by the Board of Directors **[including the Series A director representative and the Series B director representative then in office, if any].**

***Registration Rights:***

**Registrable Securities:** All shares of Common Stock issuable upon conversion of the Preferred Stock shall be deemed "Registrable Securities."

**Demand Registration:** Beginning \_\_\_\_\_, or six months after a Qualified IPO, whichever is earlier, \_\_\_\_\_ demand registrations of at least \$ \_\_\_\_\_ each, upon initiation by holders of \_\_\_% of the outstanding Registrable Securities.

**Piggyback Registration Rights:** Unlimited piggyback registration rights, subject to pro rata cutback to a minimum of \_\_\_% of the offering (complete cutbacks on the IPO) at the underwriter's discretion.

**Registration on Form S-3:** The holders of at least \_\_\_% of the Registrable Securities will have the right to require the Company to register on Form S-3, if available for use by the Company, shares of Registrable Securities for an aggregate offering price of at least **[\$500,000]**. The Company will not be obligated to effect more than two S-3 registration statement in any twelve month period. **[There shall be a limit of a total of \_\_\_\_\_ such S-3 registrations.]**

**Registration Expenses:** Registration expenses (exclusive of underwriting discounts and commissions, stock transfer taxes and fees of counsel to the selling stockholders) will be borne by the Company for all demand, piggyback and S-3 registrations. The Company will also pay the reasonable fees and expenses of one special counsel to the selling

stockholders[, not to exceed \$ \_\_\_\_\_].

**Assignment of Registration Rights:** The registration rights may be transferred to a transferee who acquires at least \_\_\_\_\_ shares of the original purchaser's Registrable Securities (or all of the transferring holder's shares, if less), provided that the Company is given prompt notice of the transfer and the transferee agrees to be bound by the terms and conditions of the Investors' Rights Agreement. Transfer of registration rights to a partner or affiliate of the transferee will be without restrictions as to minimum shareholdings.

**Lock-up Agreement:** In connection with a Qualified IPO, each holder of registration rights will be required not to sell or otherwise dispose of any securities of the Company (except for those securities being registered) for a period of 180 days following the effective date of the registration statement for such offering if so requested by the underwriters of such offering subject to such extensions of time as may be required by the underwriters under NASD Rule 2711 or a successor rule. **[In addition, each holder of registration rights will agree to be bound by similar restrictions, and be bound by similar agreements, with respect to one additional registration statement filed within 12 months after the IPO, provided that the duration of the lock-up with respect to such additional registration shall not exceed 90 days.]**

**Termination of Registration Rights:** The registration obligations of the Company will terminate on the earliest of (i) \_\_ years after a Qualified IPO, (ii) with respect to any holder of registration rights, at such time as all Registrable Securities of such holder may be sold within a three month period pursuant to Rule 144 or (iii) upon an Acquisition of the Company.

***Information Rights:***

So long as a holder of Series B Preferred continues to hold **[at least \_\_\_\_\_]** shares of Series B Preferred or Common Stock issued upon conversion of Series B Preferred, the Company will deliver to such holder annual, quarterly and monthly financial statements as well as an annual budget. The obligation of the Company to furnish such information will terminate at the earlier of (i) such time as the Company becomes subject to the reporting provisions of the Securities

Exchange Act of 1934, as amended, or (ii) an Acquisition of the Company.

***Right of First Offer:***

Each holder of at least \_\_\_ shares of the Series B Preferred will have the right in the event the Company proposes to offer equity securities to any person other than:

(i) common stock issued pursuant to stock splits and common-stock-on-common-stock dividends,

(ii) **[up to \_\_\_\_\_ shares of ]** common stock issued or issuable **[for compensatory purposes]** to employees, officers, consultants or directors of the Company, or other persons performing services for the Company, directly or pursuant to a stock option plan or restricted stock plan or agreement approved by the Board of Directors**[, including the Preferred Directors];**

(iii) capital stock, or options or warrants to purchase capital stock, issued to financial institutions with federal or state charters or to lessors in connection with commercial credit arrangements, equipment financings, commercial property lease transactions or similar transactions;

(iv) capital stock issued or issuable to an entity as a component of any business relationship with such entity for the purpose of (A) joint venture, technology licensing or development activities, (B) distribution, supply or manufacture of the Company's products or services or (C) any other arrangements involving corporate partners that are primarily for purposes other than raising capital, the terms of which business relationship with such entity are approved by the Board of Directors **[, including the Preferred Directors];**

(v) capital stock, or warrants or options to purchase capital stock, issued in connection with bona fide acquisitions, mergers or similar transactions, the terms of which are approved by the Board of Directors **[, including the Preferred Directors];**

(vi) common stock or other underlying security actually issued upon conversion, exchange or exercise of any derivative security;

(vii) common stock issued or issuable in or under a

Qualified IPO;

(viii) common stock issued or issuable as a result of the antidilution provisions of any derivative securities;

(ix) securities issued with the affirmative vote of at least **[a majority of]** the then outstanding shares of Preferred Stock, voting together as a class; or

(x) securities that, with the approval of every then-sitting member of the Board of Directors, are not offered to any existing stockholder of the Company.

Such right of first offer shall consist of a right to purchase that portion of such equity securities equal to (i) the number of shares of Common Stock issued or issuable upon conversion of the Series B Preferred held by such holder of Series B Preferred divided by (ii) all of the Company's Common Stock then outstanding or issuable upon exercise of options or warrants or conversion of Preferred Stock.

Such right of first offer will terminate upon a Qualified IPO or upon an Acquisition of the Company. The right of first offer shall not be applicable with respect to any covered investor and any subsequent securities issuance, if (i) at the time of such subsequent securities issuance, such investor is not an accredited investor, and (ii) such subsequent securities issuance is otherwise being offered only to accredited investors.

***Co-Sale Right [and Right of First Refusal]:***

Holders of Preferred Stock shall have the right to participate on a pro-rata basis in transfers of stock for value by \_\_\_\_\_ and \_\_\_\_\_ (the "Founders") (with customary exceptions for transfers in connection with estate planning and similar matters and an exception for up to \_\_\_% of each Founder's common stock). This right will terminate immediately before a Qualified IPO or an Acquisition of the Company.

The existing right of first refusal and vesting provisions with respect to the Founders' stock will remain in effect. **[The right of first refusal will be assigned to the holders of the Preferred Stock on a pro-rata basis in the event it is not exercised by the Company.]**

***[Board of Directors:***

So long as \_\_\_\_\_ shares of **[Series A and Series B]** Preferred Stock, respectively, remain outstanding, the **[Series A and Series B]** Preferred Stock, voting **[together as a class][separately as a series]**, shall be entitled to elect \_\_\_\_\_ member(s) of the Company's Board of Directors, and the remaining members will be elected by the Preferred Stock and Common Stock voting together as a class. Upon closing of the Financing, the Board of Directors of the Company shall consist of \_\_\_\_\_ directors, with \_\_\_ directors designated as the **[Series B]** Preferred Stock directors.]

***[Exclusivity:***

In consideration of \_\_\_ investing substantial time, effort and expense in connection with the evaluation and execution of the transactions contemplated by this term sheet, the Company agrees that it will immediately cease any and all discussions or interactions with third parties concerning alternative financing transactions and, for a period of time expiring on the earlier of \_\_\_\_\_ or the date that \_\_\_\_\_ shall have notified the Company in writing that it does not intend to proceed with the transactions contemplated hereby, (a) the Company and \_\_\_\_\_ will work in good faith toward the consummation of the transactions contemplated by this term sheet and (b) the Company will not negotiate with, provide information to, or otherwise interact with any third party concerning any alternative transaction.]

***Purchase Agreement:***

The sale of the Series B Preferred will be made pursuant to a stock purchase agreement reasonably acceptable to the Company and the Investors, which agreement will contain, among other things, appropriate representations and warranties of the Company and the Investors, covenants of the Company reflecting the provisions set forth in this term sheet and appropriate conditions to closing which will include, among other things, qualification or exemption of the shares to be sold under applicable Blue Sky laws, and the filing of Amended and Restated Certificate of Incorporation.