

Legal Deal Term



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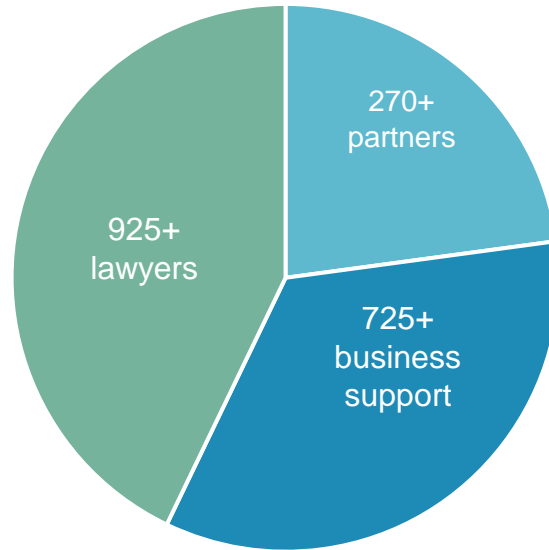
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About Osborne Clarke

2,220

employees and
counting



26

international
locations*

Europe

Belgium: Brussels

France: Paris

Germany: Berlin, Cologne, Hamburg, Munich

Italy: Busto Arsizio, Milan, Rome

The Netherlands: Amsterdam

Poland: Warsaw

Spain: Barcelona, Madrid, Zaragoza

Sweden: Stockholm

UK: Bristol, London, Reading

Asia

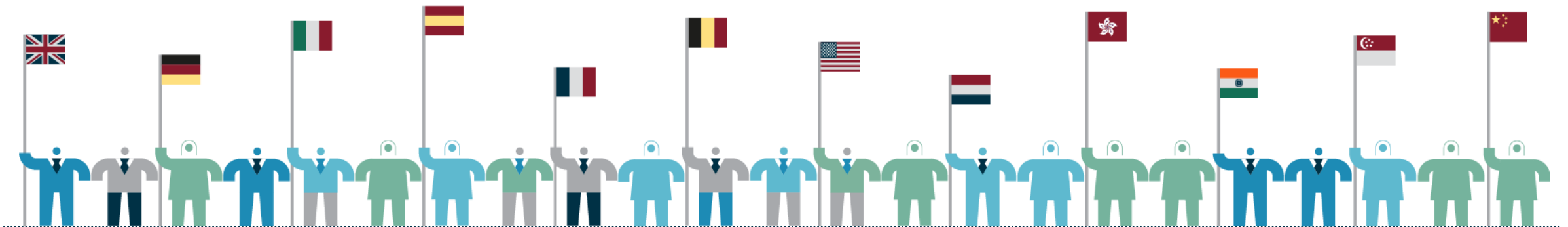
China: Shanghai

India*: Bangalore, Mumbai, New Delhi

Singapore

USA

New York, San Francisco, Silicon Valley



About Osborne Clarke and Venture Capital

NOMINIERT

JUVE Awards 2022

Kanzlei des Jahres für
Private Equity und Venture Capital



Venture Capital – Tier 1



Juve Handbuch 2021

Venture Capital ★★★★★

- ✓ Recognised as leading Venture Capital Law Firm
- ✓ 100 – 120 Venture Capital financing rounds per year
- ✓ Specialised teams in Cologne and Berlin as well as in Munich and Hamburg

About Osborne Clarke and Venture Capital

neoteq
ventures

SEQUOIA 

Capnamic

 **R Ventures**

 **RAC**

WARBURG PINCUS

 **CREATHOR**
VENTURES

 **CRÉDIT AGRICOLE**
PRIVATE EQUITY

 **MTech**
CAPITAL

red alpine

KEEN

ATLANTIC
LABS

 **CATHAY**
INNOVATION

 **HOLTZBRINCK**
VENTURES

8^{oo} EIGHT ROADS™

 **High-Tech Gründerfonds**

About Osborne Clarke and Venture Capital



Pre-Funding Considerations

The best funding is revenue

Pre-Funding Considerations

Debt or Equity?

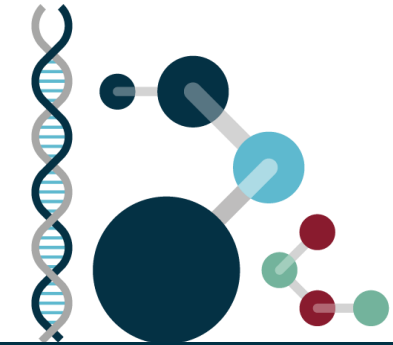
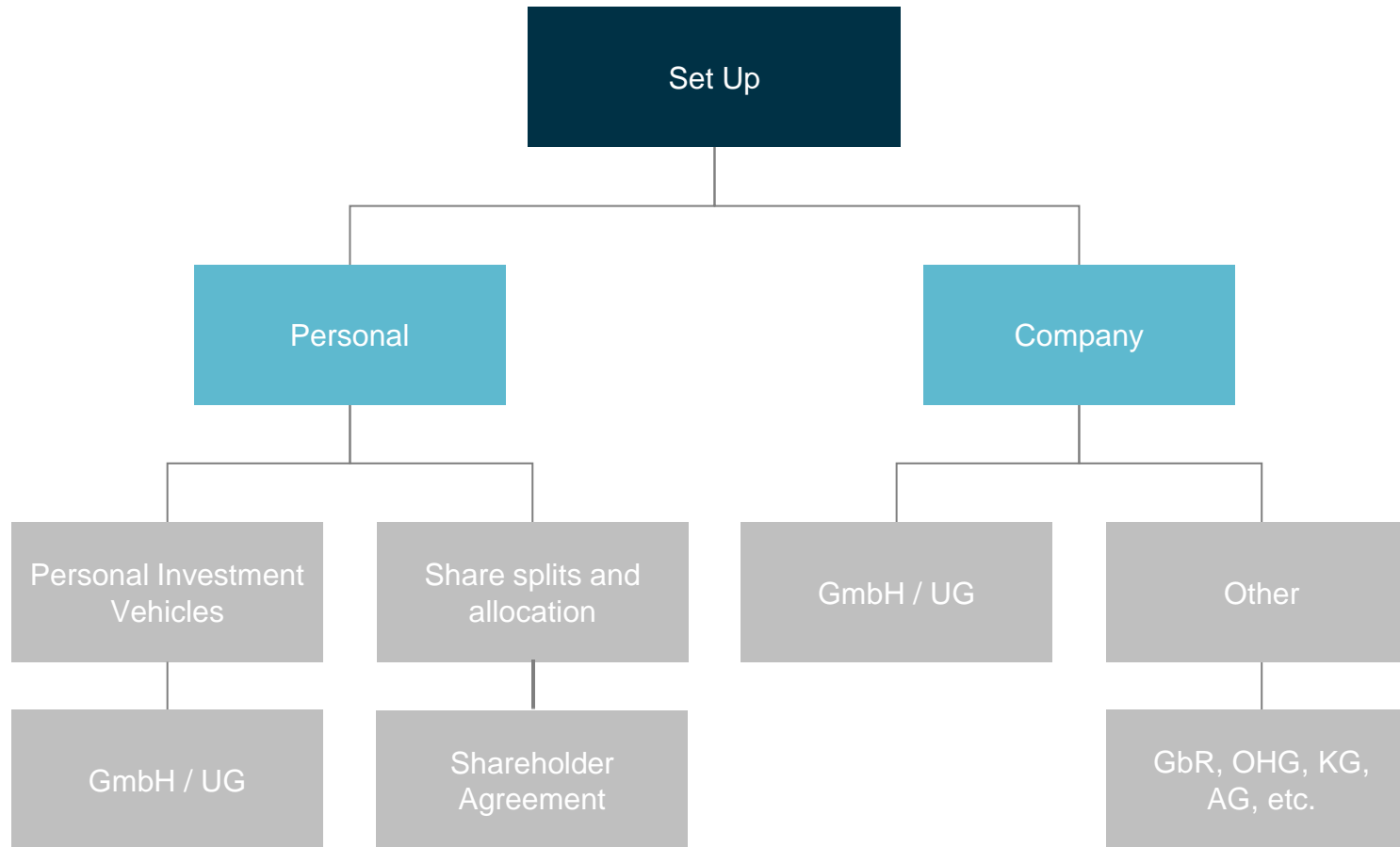
Debt

- Typically granted as a loan (e.g. bank financing).
- There is usually a fixed term and a fixed deposit claim (repayment claim + interest)
- Usually only granted against collateral (guarantee, etc.)

Equity

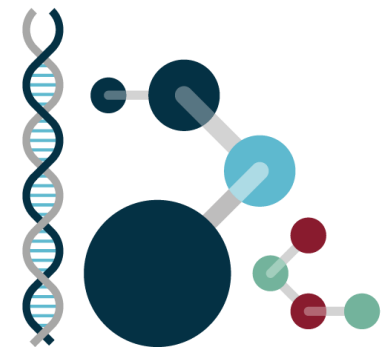
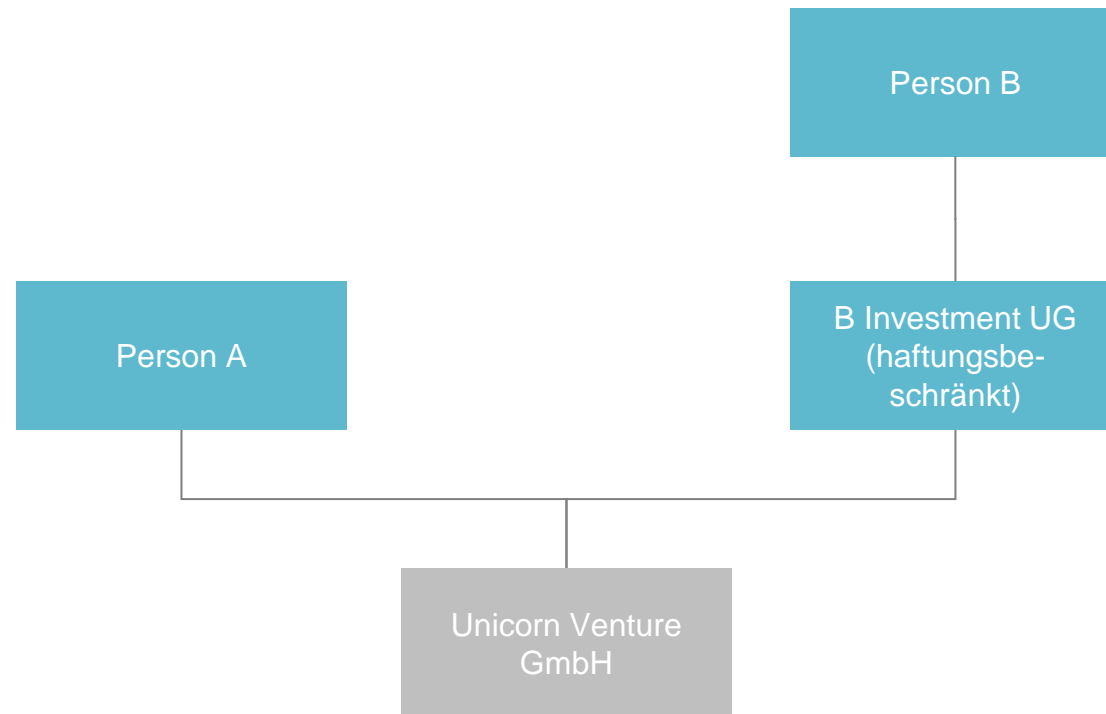
- Liable assets of the company that are exposed to the risk of total loss and serve to protect the company's existence and creditors.
- Consists of: Share capital, capital reserves, hidden reserves, etc.
- Equity = financing foundation without which it is not possible to raise outside capital.

The Set Up



Anticipate your
set up

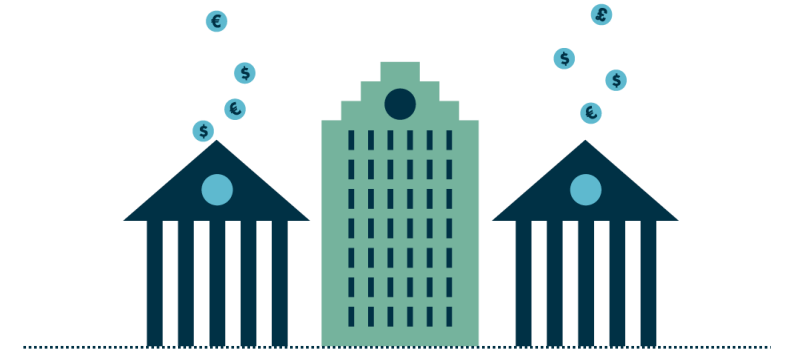
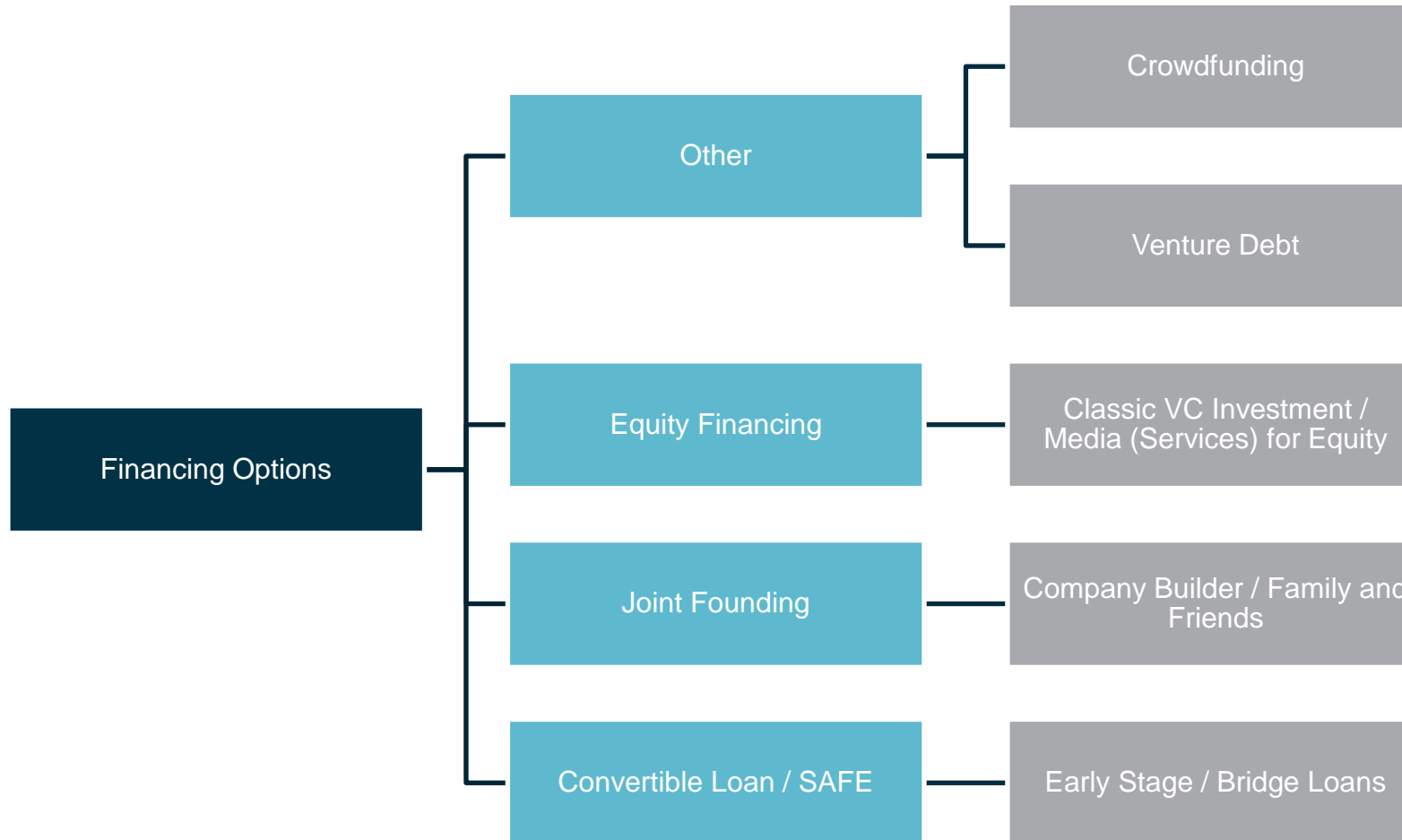
Personal Investment Vehicles



#3 VC Financing Instrument Overview

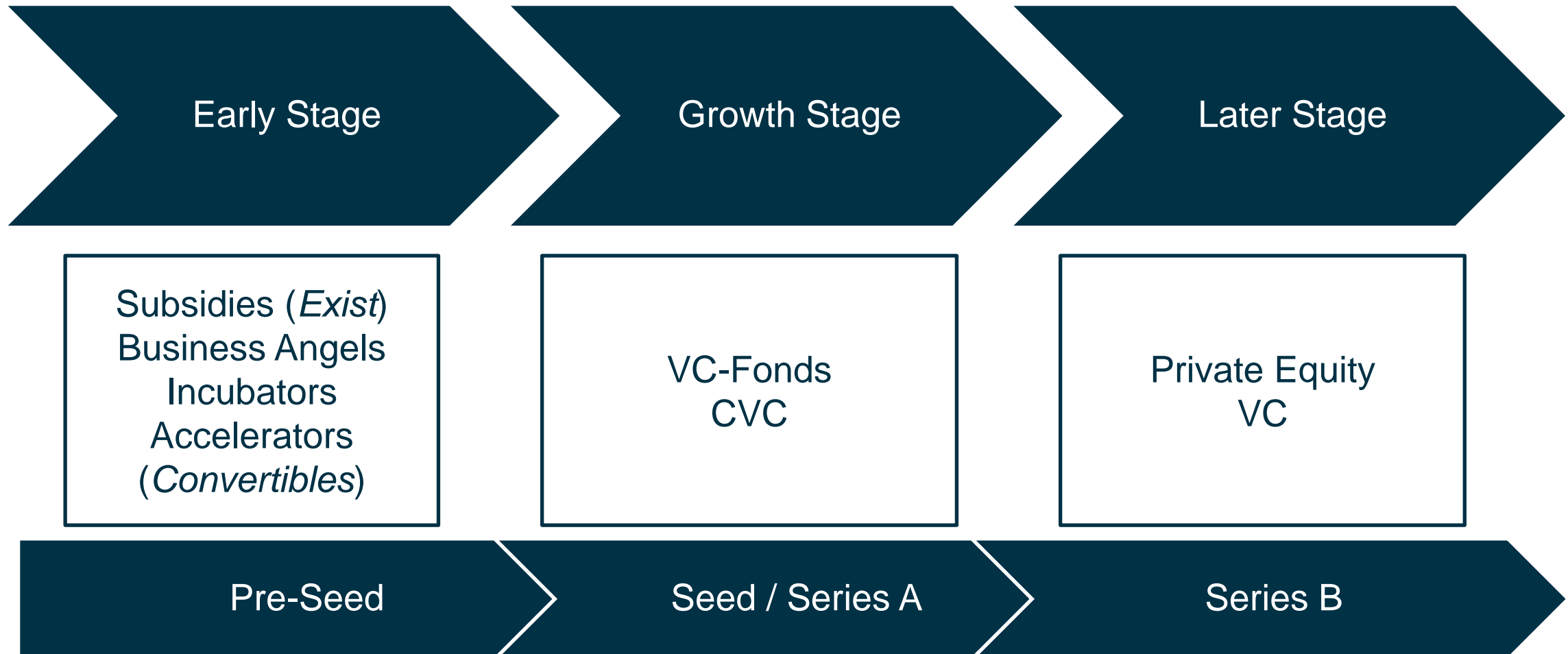


VC - Financing Instrument Overview



„The best funding
is revenue“

VC - Financing Instruments



Convertible Loan

- Different Types of Investors
 - Financial vs. strategic
 - Public vs. private
 - Crowdfunding
- Different Preferences of VC Investors
 - Growth vs. profits
- Stage of Start-up / Financing Purpose
 - Early stage
 - Growth stage
 - Later stage
 - Bridge financing
- Market situation
 - Liquidity
 - Exits – buyer vs. seller market
 - Trending industry sectors



#4

Convertible Loan //

SAFE




Convertible Loan // SAFE

- Loan amount // *Purchase amount*
- Interest bearing 1,5 - 8% (SAFE: Bonus amount)
- CLA: (potential) repayment // SAFE: no repayment
- Conversion provisions:
 - Trigger Events
 - Financing round (qualified)
 - Exit
 - Maturity
 - *Right to convert vs. Obligation to convert*
- Discounts
- Floors / Caps
- Repayment provisions
- CLA: Subordinated



Convertible Loan // SAFE

Convertible Loan (SAFE) vs. Equity (Founder Perspective)

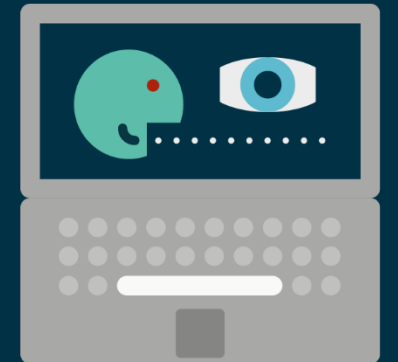
- 
- ✓ **No valuation necessary**
 - ✓ No immediate dilution
 - ✓ No equity participation
 - ✓ Time limitation
 - ✓ Low costs
 - ✓ Quick implementation
 - ✓ Variability

- 
- ✓ High interest rates

Typical Investment Process



Non-Disclosure Agreement



Non-Disclosure Agreement (NDA)

Purpose

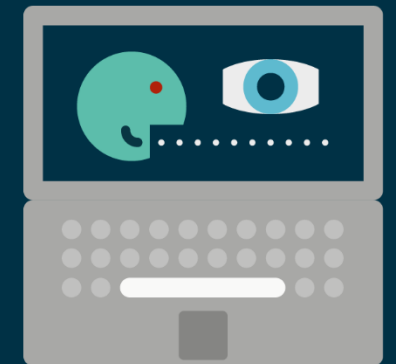
- Protect confidential information

Essential contents

- Definition: What is „confidential information“?
- Exceptions?
- Contractual penalty?
- No liability for correctness and completeness of information?
- **Trade Secrets Act and current Patent applications**

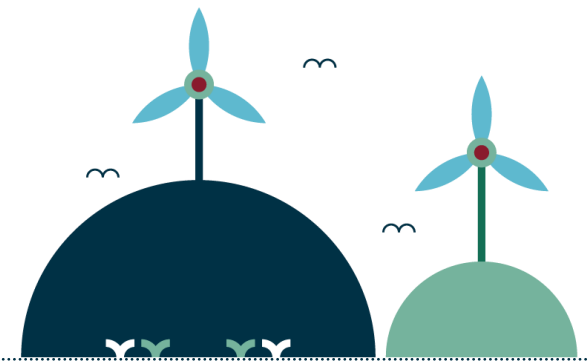


Term Sheet



Term Sheet

- *Non-binding* declaration of interest
- **Scope:** short (= quick negotiation, quick entering into main contract negotiations) vs. long (= recognising incompatibilities, determine key terms)?
 - Key aspects of main documents should be determined to avoid conflicts and detrimental negotiation situation
 - **Focus:** Valuation, share participation, main provisions
- **Negotiate confidently - don't be afraid of the investor**
- **Also serves to check the “fit” with the investor**
- „**Power of the pen**“: Creating the first draft of the documentation has a psychological effect and changes would then have to be negotiated in principle
- Think about future financing rounds



Valuation



Valuation

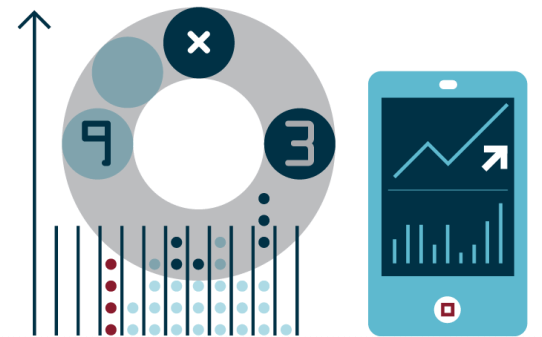
- *Pre-money valuation / Post-money valuation*
- What share capital is the valuation referencing:
 - “Fully Diluted” Share Capital, what’s included?
 - CLAs // SAFEs?
 - VESOP

Cap Table should be finalized, ideally on term sheet stage



Example: VESOP (1)

- Scenario:
 - 2 Founders, each 50% shareholding,
 - Share capital 25.000,00 Euro
 - Investment: 1m Euro, Valuation (pre-money) 5m Euro
 - VESOP: 3.000 virtual shares
- Tbd: Who carries burden of VESOP (Everyone pro rata vs. Founders only)
- Share capital: Non-diluted 25.000 € vs. Fully-Diluted 28.000 €
- Share price 200€ vs. 178,57 €



Example: VESOP (2)

	VESOP wird nur durch Gründer getragen				VESOP wird von allen getragen			
	Anteile (Equity)	Anteile (inkl. VESOP)	Beteiligung (Equity)	Beteiligung voll verwässert	Anteile (Equity)	Anteile (inkl. VESOP)	Beteiligung (Equity)	Beteiligung voll verwässert
Gründer 1	12.500	12.500	40,85%	37,20%	12.500	12.500	41,67%	37,88%
Gründer 2	12.500	12.500	40,85%	37,20%	12.500	12.500	41,67%	37,88%
Investor	5.600	5.600	18,30%	16,67%	5.000	5.000	16,67%	15,15%
VESOP	0	3.000	0,00%	8,93%	0	3.000	0,00%	9,09%
Gesamt	30.600	33.600	100,00%	100,00%	30.000	33.000	100,00%	100,00%

Example: CLA (1)

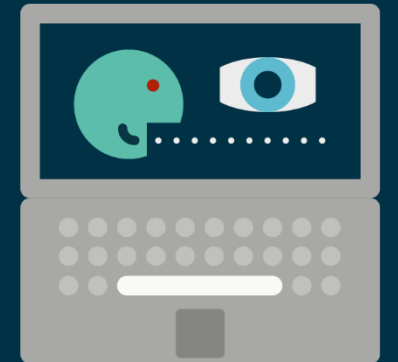
- Same as before (without VESOP)
- CLA 100.000 €, Discount 20%
- Investor should receive 16.67% post round (1m€ Investment at 5m Euro pre money valuation)
- According to CLA, 20% discount applies to final round price
- Conversion *pre* or *post* round?



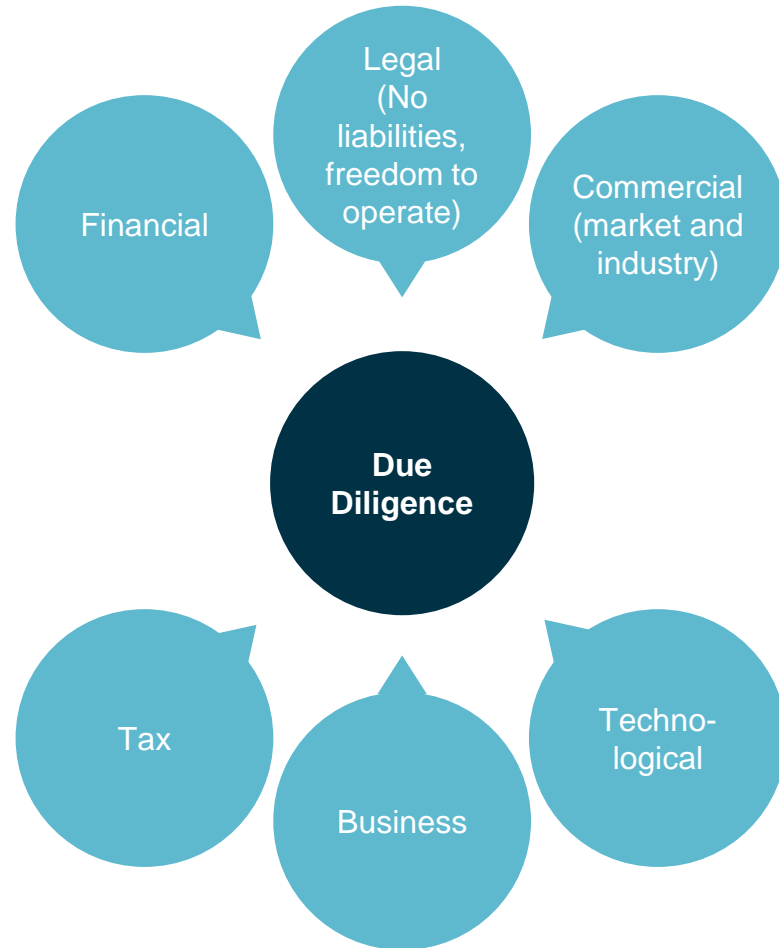
Example: CLA (2)

	CLA nicht in fully diluted share capital		CLA Teil des fully diluted share capitals		CLA in fully diluted share capital drin und CLA-Wandlungspreis angepasst	
	Anteile (Equity)	Beteiligung (Equity)	Anteile (Equity)	Beteiligung (Equity)	Anteile (Equity)	Beteiligung (Equity)
Gründer 1	12.500	40,79%	12.500	40,64%	12.500	40,62%
Gründer 2	12.500	40,79%	12.500	40,64%	12.500	40,62%
Darlehensgeber	645	2,10%	629	2,04%	645	2,10%
Investor	5.000	16,32%	5.129	16,68%	5.129	16,67%
Gesamt	30.645	100,00%	30.758	100,00%	30.774	100,00%
Problem	Investor bekommt nicht seine 16,67%		Discount liegt nicht mehr bei 20% sondern bei 18,5%		Lösung entspricht Verträgen, aber verwässert Gründer am stärksten	

Due Diligence



Due Diligence



#6 Contract Overview



Contract Overview

Articles of Association

Investment Agreement

Shareholders Agreement

Rules of Procedure / Mgmt

Rules of Procedure / Adv Brd

VESOP

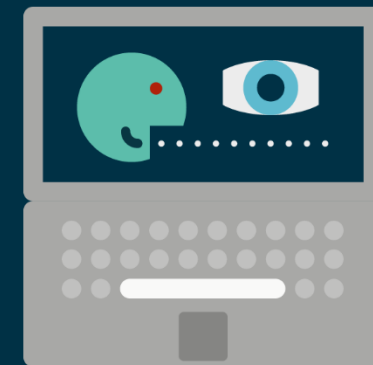
MD Service Agreement(s)

Disclosures

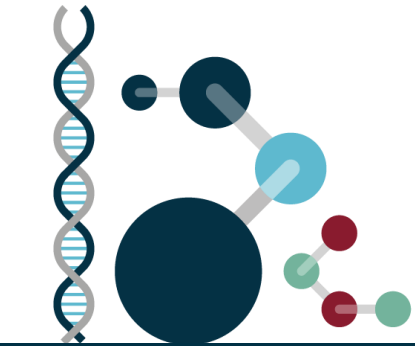
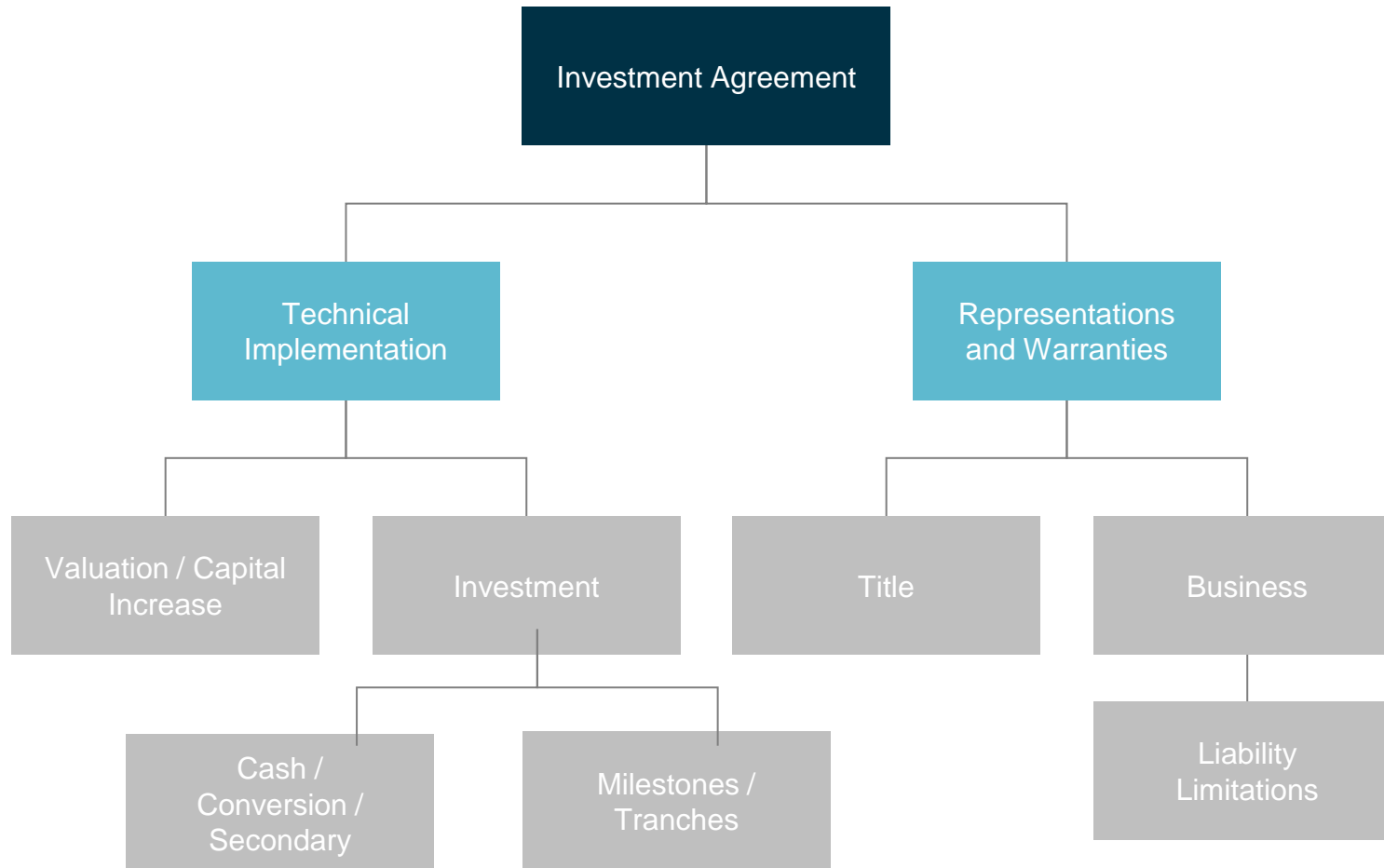
Annexes/Exhibits



Investment Agreement

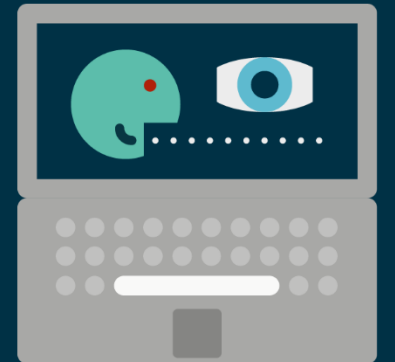


Investment Agreement



Investment Agreement

Shareholder Agreement



Balancing Interests



Founder

- Business-idea
- Majority shareholder
- Management
- Limited funds
- (Build-to-Last / Build-to-Sell)

Investor

- High financial risk
- Minority shareholding
- Limited influence on management
(Build-to-Sell)


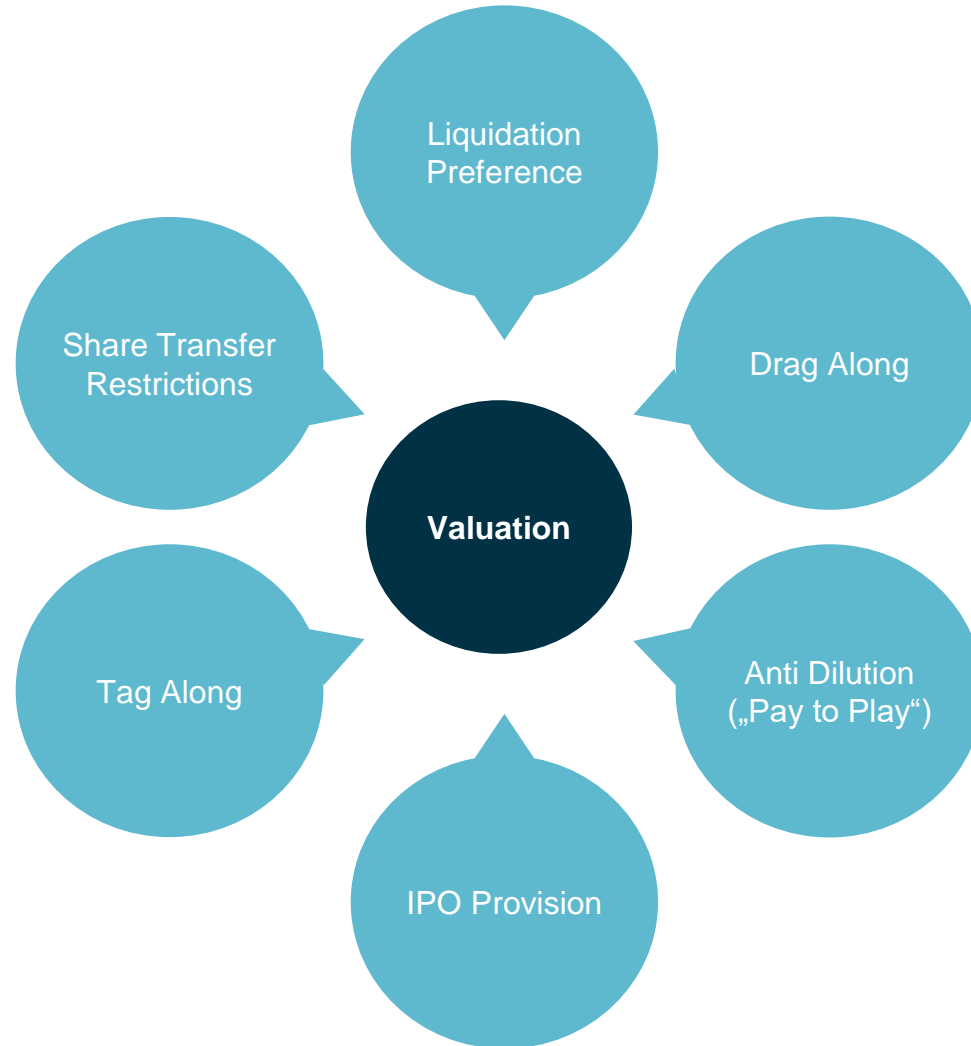


Balancing Interests

	Economic Terms	Control Terms
Ongoing Business	<ul style="list-style-type: none">• Vesting• Lock-up• Employee Stock Option• Non-compete (contractual)	<ul style="list-style-type: none">• Control of the governing bodies• Protective provisions• Information rights
Later Financing Rounds / Exit	<ul style="list-style-type: none">• Pricing / Valuation• Liquidation preference• Anti-dilution• Reps & Warranties• Non-compete (post-contractual)	<ul style="list-style-type: none">• Drag-along• Tag-along• Exit terms



Valuation



A high valuation may
come with a price

Liquidation preference

- **LIFO (Last in first out) – Investor receives its investment firsts**
- **Purpose: Investment protection**
- Berlin Triad
- Return Multiples / Interst
- Priorities / Seniors
- Participating / Non-participating
- Caps
- Dividend preference



Anti-Dilution / Dilution Protection

- **Protects investors against dilution in case of „Down-Round“**
- „Good“ vs. „Bad“ dilution
- Full Ratchet vs. Weighted Average
- Broad based vs. Narrow based
- Pay to Play
- Upheld in next round?

Shareholding

- Share transfer restrictions („*Vinkulierung*“)
- Lock-Up
- Right of first refusal („RoFr“) / Right of first offer („Rofo“)
- **Tag Along**
- **Drag Along**
- Put Option

Tag Along / Drag Along

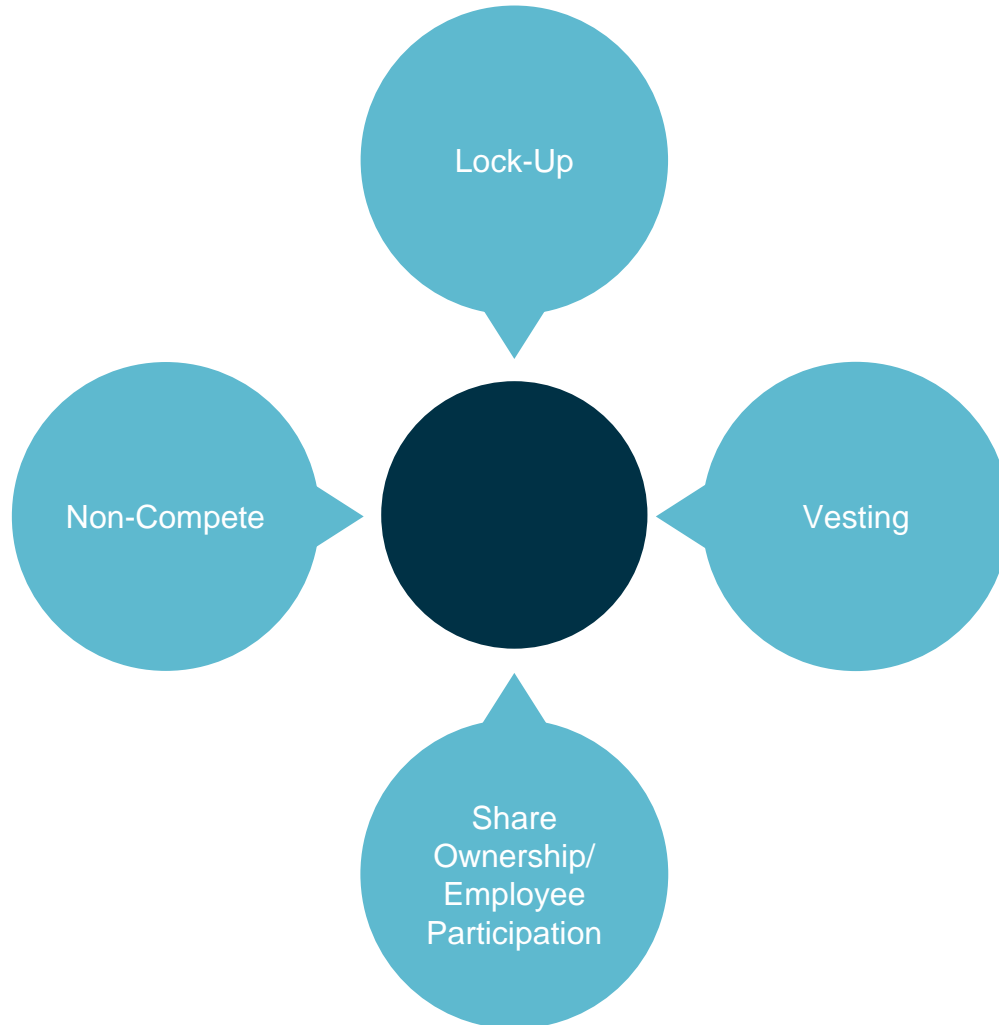
Tag Along

- Right of shareholders to participate in share sale
- Shareholder may only sell if buyer is willing to buy all shares on offer
- Who benefits from the tag along?
- What about the Lock-Up?

Drag Along

- Obligation of shareholders to sell shares
- Special right of investors vs. Minority drag as protection
- **Negotiate specific execution periods and valuations**

Founder Incentive – Founder Retention



Vesting

- **Founders lose shares when they prematurely leave the Company**
- **Purpose: Founder retention**
- Investors invest in founders more than in company

Investment as Goodwill for future value

- If founders do not stay to realise future value, leaving founder's shares need to be „re-evaluated“
- Redistribution to founder replacement



Vesting

- Term
- Cliff
- Vesting Event: **Good Leaver** or **Bad Leaver**?

Usually, obligation to transfer „**un-vested** shares“

Usually, obligation to transfer **all** shares

Grey Leaver cases – termination without cause or reason

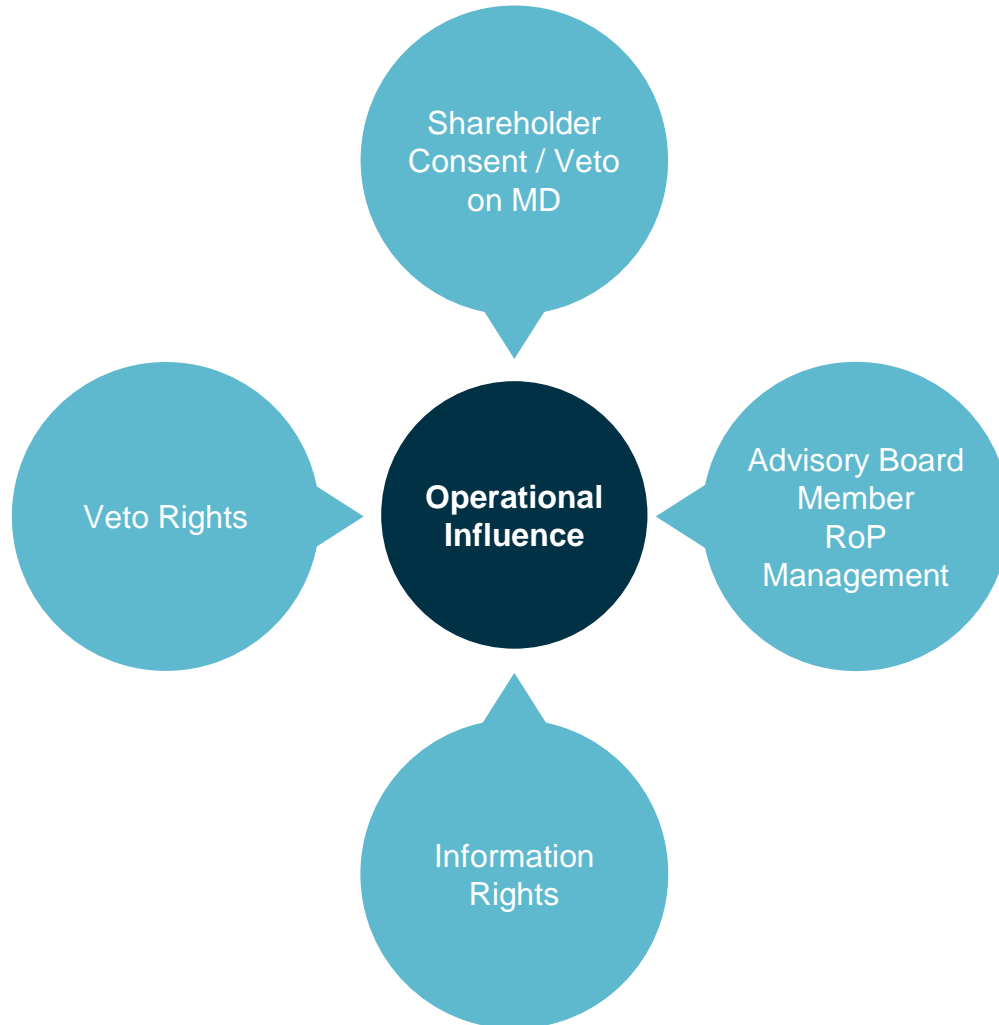
Vesting consideration EUR 1



Lock-Up

- **Founders are prohibited to sell shares during vesting period**
- Usually combined with vesting clause
- **Exception: Tag-Along (?)**

Operational Influence



Shareholder Meeting

- Typical control rights:
 - Appointment and dismissal of managing directors
 - Amendments to the articles of association
 - Transformation measures
 - Annual financial statements
 - Disposals of shares
 - Business plan
- Catalogue of transactions requiring approval
- Investor veto



Advisory Board

Legal position:

- Optional advisory board can be established to advise the management
- No supervisory board in the sense of stock corporation law
- Shall establish flexible regulations

Composition

- Founder representatives
- Investor representatives
- Independent industry experts

Duties

- The advisory board has control and veto rights on management measures (Catalogue of measures)
- Consultation of the management

Management

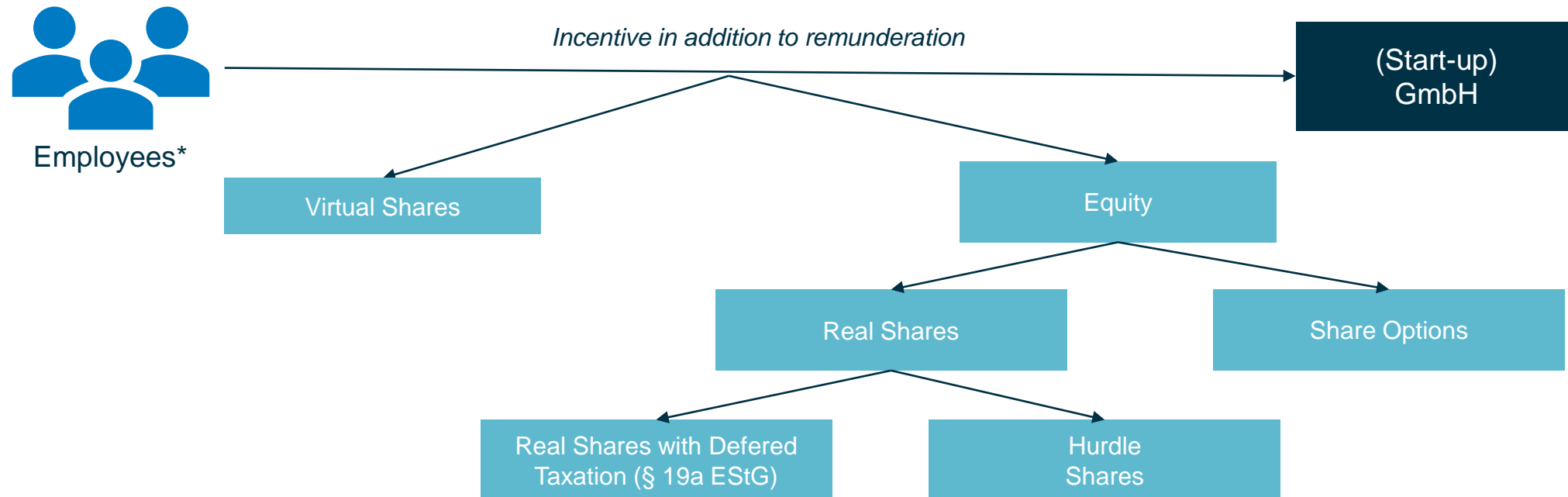
- As a rule, the founders are managing directors; the management should also remain with them
- Joint vs. individual power of representation
- If necessary, remove the exemption from the ban on self-contracting (at least the exemption from the ban on entering into legal transactions in one's own name and as a representative of the company)
- Conclusion of new managing director contracts if necessary



Employee Participation Overview

- **Dry income?**
- Holding company possible?
- Taxation as income or capital gains?

- Individual or multiple employees?
- Notary necessary?
- Will employees become shareholders?
- Complexity and (recurring) costs



* and other beneficiaries

Employee Participation Overview

Real participation

Granting of shares (personally / to holding company)

- Monetary benefit (= difference between market value and purchase price) is taxable salary (up to 47.5%)

⚠ Valuation uncertainty

- Taxation when shares are granted

⚠ Dry income!

- Compliance issues for the company; possible liability of the company for income tax
- Dividends and sales proceeds are subject to the “more favorable” taxation regimes (personal: 26.4% (capital gains tax) or 28.5% (TEV) / holding company: approx. 1.6% or approx. 32% (dividends for shareholding <10%))

ESOP (Share Option)

Option to acquire shares at a certain exercise price at a fixed exercise date (often: exit)

Monetary benefit (= difference between market value on exercise of option and exercise price) is taxable salary (up to 47.5%)

Taxation upon exercise of the option (generally applicable) or upon earlier “option realization” (e.g. granting to / transfer to holding company)

Exercise before Exit:

- Valuation uncertainty & dry income
- Lower valuation grants capital gains

Exercise at Exit:

- No valuation uncertainty & no dry income
- Taxation as salary

VSOP

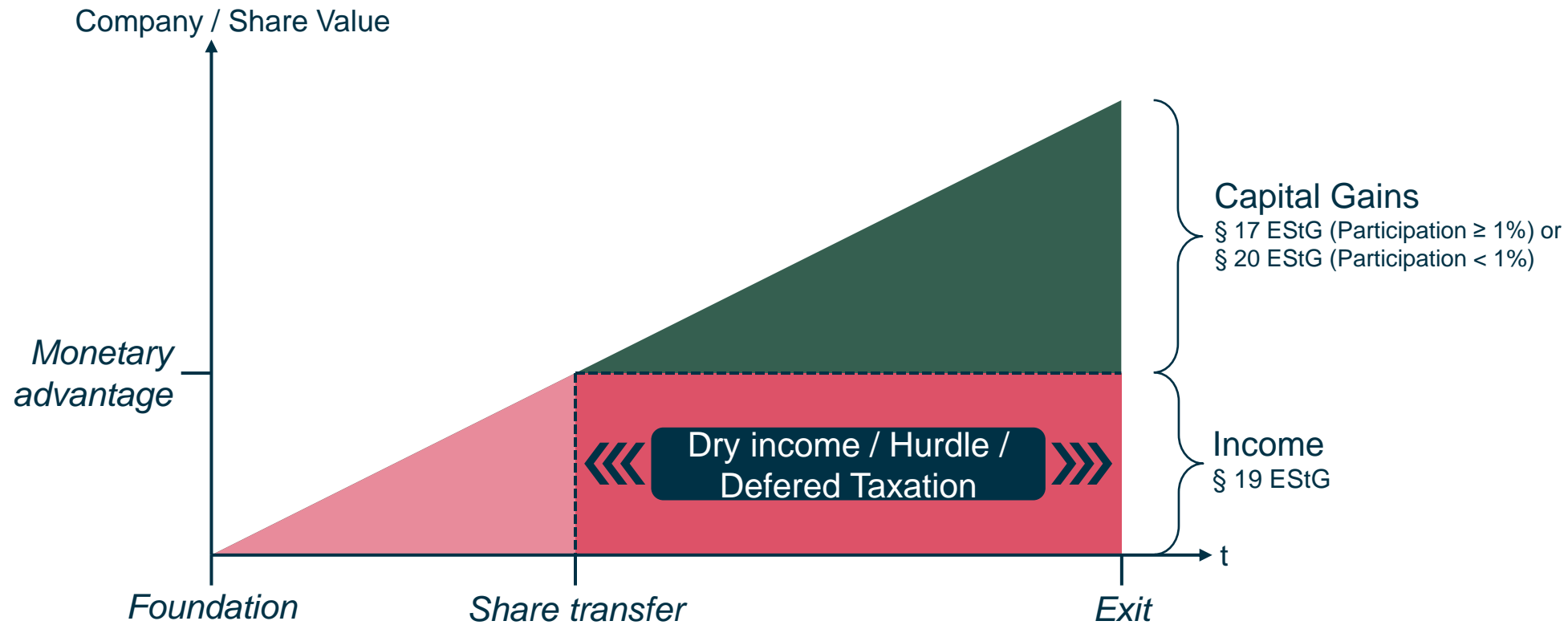
Unreal „virtual“ shares.

- Contractual obligation to treat employee as shareholder economically in case of Exit
- Claim for (Cash-)payment in event of Exit (= Delta between „Strike Price“ and Exit Price)
- Qualifies as (Exit-)Bonus
- Taxation at payment (= Exit) as salary (up to 47,5%)

+ No dry income

- Taxation at „high“ tax rate as salary

Dry Income / Hurdle Shares / § 19a EStG



About



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Thank you

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