Lead Investor Negotiating Instructions
Standard Series Seed Term Sheet
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This and other tools are available from the Loon Creek Capital Group web site at: https://www.looncreekcapital.com/resources.

Below are instructions I wrote to guide deal leads for the Boise Angel Alliance in negotiating the terms of a seed stage priced round based upon the standard series seed term sheet as presented at https://www.seriesseed.com/

Note that we added three terms not included in the standard term sheet:

1. Drag along right: In the event a sale of the Company is approved by the Board of Directors and by the holders of a majority of the shares of Common Stock and a majority of the shares of Series Seed, then all shareholders (including the Founder) agree to vote their shares for the sale.

2. Qualified Small Business Stock. In the definitive documents, or by separate written notification to all investors within 30 days of the final close, the Company will confirm that, to its knowledge, the Company is a qualified small business within the meaning of IRS Code Section 1244, 1202, and 1045, and shares of the Series [Seed/A] Stock qualify as "qualified small business stock" as defined in Section 1202(c) of the Code as of the date hereof.

3. CFIUS: In connection with the Private Placement, all Investors will be required make factual reps & warranties supporting the Private Placement's compliance with CFIUS/FIRRMA"

Our term sheet is used when we are the lead investor and negotiating the terms of the deal with the company. If we are not the lead investors, then we should compare the term sheet proposed by the company to our standard term sheet. Term sheets are not binding, but are a statement of intent.

The Due Diligence team negotiates the terms with the entrepreneur (see "Variables to be Negotiated" below). Teams should be reluctant to agree to any material change to the standard term sheet, and may wish to seek advice from officers before agreeing to material changes. Any changes from the standard term sheet should be called out in the due diligence report.

Key Standard Provisions

1. Liquidation Preference: Upon a "liquidity" event we have the right to receive the amount of our investment, OR to convert to common stock and take our pro rata share of the liquidation proceeds. This is called "non-participating" preferred and is a typical term for Series Seed. "Participating" preferred receives the preference AND converts. Participating preferred is typical of later series of preferred stock.

2. Voting Rights: Votes with the common on most matters. However, approval of a majority of preferred stock ("veto rights") is required to:

> **a. Adversely change preferred rights.**
>
> **b. Change number of shares.**
>
> **c. Authorize new series of preferred stock**
>
> **d. Redeem or repurchase shares.**
>
> **e. Declare of pay dividends.**
>
> **f. Change number of directors.**
>
> **g. Liquidate or dissolve, or change control.**

3. Documentation: Documents will be **identical** to those at seriesseed.com, other than the changes agreed to in the term sheet. This prevents the company's attorney from tinkering with the documents, thereby incurring additional legal fees on the part of both parties.

4. Information and Inspection Rights: All preferred shareholders receive these rights, which include financial statements, a capitalization table and a narrative.

5. Participation Right: We have the right to participate on a pro rata basis on any subsequent financing.

6. Board: Common shareholders have a right to elect a director, we have the right to elect a director, and a third director is selected by "mutual consent."

7. Drag-Along Right. If board and majority of holders of common and preferred agree to sell, then all shareholders including the founder must sell.

8. Expenses: Company to engage attorney to draft documents at company's expense. Our experience is the fee to do this should not exceed $5,000. We will have our attorney review and company will reimburse us for up to $1,000 for this review. So long as the company's attorney has not changed anything, then the cost for our review is typically $500. This is part of the hammer we use when we say the documents shall be "identical to."

9. Future rights: We get same rights as the next series of preferred stock. So, for example, if the next series has a participating preference, then we receive that same participation right. This saves both company and investor from having to negotiate and document all those rights at this time (think complexity and attorney's fees), especially when we know many of these companies will fail and the additional rights will have been of no value.

10. Qualified Small Business Stock. We need a representation from the company that their stock qualifies for purposes of IRS Sections 1202 (no taxes on gain) and 1244 (ordinary rather than capital losses). Companies often don't know what this is and our having this in the term sheet gives us a chance to explain the importance and to be sure they discuss this with their counsel.

11. Committee on Foreign Investment in the United States (CIFUS). This committee, administered by the US Treasury Department, publishes regulations to ensure foreign nationals cannot transfer information in the national security interest to their countries. In particular, companies must isolate the information rights provided foreign investors from certain countries. The penalties for failing to do so can be quite onerous. Having this in the term sheet alerts the company that they need know who their investors are and to be sure they will not find themselves subject to CFIUS penalties.

11. Repurchase of Founders' Stock. See explanation below.

12: Signatures: We ask that the Founder sign the sheet before we vote on it. These then are the terms the company has agreed to, and our members vote on. Once approved, the Fund Chair signs and the Founder takes the signed document to his or her attorney who will draft final documents from the term sheet.

Variables to be Negotiated

1. State of Incorporation. Either Idaho or Delaware, we don't have a preference.

2. Round and Investors:

> **a. Aggregate proceeds:** The total size of the round we are investing in, including the conversion of any convertible debt.
>
> **b. Amount we will invest**
>
> **c. Amount needed for first close.**

E.g. The Company is raising a round of $500,000 (the "aggregate proceeds) which includes the conversion of $75,000 of convertible debt and $425,000 of cash. The Fund will invest $100,000 at first close of not less than $250,000, excluding the conversion of the convertible notes.

3. Valuation:

a. Pre-money valuation: The value of the company before this round of investment. This is a negotiated amount between the entrepreneurs and the due diligence team.

b. Option pool: The percentage of common stock set aside for the stock option pool before we make our investment. **Note:** we like to see 15-20% of the post-investment stock (common plus this round of preferred stock).

c. Price per share: The price at which we will purchase stock. Arithmetically, it is the pre-money value divided by the sum of outstanding common stock plus the stock option pool before the investment is made. **Note:** This number is very easy to get wrong. It comes from the capitalization (cap) table, and we prefer to construct the cap table ourselves so we know it is correct. If the company provides the cap table, we should always do our own to verify.

4. Board of Directors: At a minimum, this class of stock will have the right to elect one director. The common shareholders will have the right to elect one, typically the CEO. A third is selected by "mutual consent." We prefer the mutual consent director not be a founder or relative. We should always know who the directors will be before they are elected and make sure they are acceptable to us. We should specify the directors by name in the term sheet. Often founders (and sometimes due diligence teams) skip this step to get to the close. But we prefer to clearly identify before we write our check.

5. Repurchase right: This is the right to repurchase Founders' stock. Founders stock is stock issued by the company to the Founders in exchange for their sweat equity to form the company, and usually does not include stock the Founders purchased for cash. We specify a percentage of the Founders' stock, which we have the right to acquire for nominal payment in the event the Founder leaves the company early. This should never be below 50%, and may be 100% depending upon the due diligence team's view of what is warranted. The purpose of this term is to make sure that the Founders do not leave when they get discouraged, or to prevent a weak founder taking his/her stock when the founding group falls apart.

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