

## SimpsonWigle LAW Annotated Sample Preferred Term Sheet

Corporation: [\_\_\_\_\_]

### TERM SHEET<sup>1</sup>

Date: [\_\_\_\_\_]

This Term Sheet represents the current understanding of the parties with respect to certain of the major issues relating to the proposed private offering and does not constitute a legally binding agreement. Except for the sections entitled “Expenses and Fees” and “Confidentiality / No Shop” this summary does not constitute a legally binding obligation.<sup>2</sup> Any other legally binding obligation will only be made pursuant to definitive agreements to be negotiated and executed by the parties. This Term Sheet does not constitute an offer to sell or a solicitation of an offer to buy securities in any jurisdiction where the offer or sale is not permitted.

### THE OFFERING

**Issuer:** [\_\_\_\_\_], a corporation incorporated under the laws of [insert Canada or Ontario] (the “**Corporation**”)

**Founders:** The founder(s) of the Corporation [are/is] \_\_\_\_\_ [and \_\_\_\_\_] (the “**Founder(s)**”)

**Securities:** [Series A] Preferred Shares (the “**Preferred**”)<sup>3</sup>

**Amount of the offering:** Minimum of \$[\_\_\_\_\_] and maximum of \$[\_\_\_\_\_] in aggregate.<sup>4</sup>

**Total Securities Offered:** Maximum [insert] Preferred.

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<sup>1</sup> This sample Term Sheet is developed for financing early stage corporations with investments from Angel One investors. The Term Sheet sets out the common terms to be inserted and alternative wordings and terms are included in brackets. The Term Sheet will need to be appropriately customized for each investor’s application and depending on the negotiations between the investors and the target corporation. For example, references to “Common Shares” may have to be replaced if appropriate. SimpsonWigle LAW LLP acknowledges that many of the specific terms and comments in this Term Sheet were obtained and modified from various term sheet sources, including without limitation: the Network of Angel Organization-Ontario’s “Summary Terms for Series A Preferred Stock”; MaRs Discovery District’s “Sample Preferred Term Sheet”; Gust’s American “Gust Series Seed Term Sheet”; and NVCA’s venture capital “Term Sheet for a Series A Preferred Stock Financing”. If you have any questions regarding this Term Sheet, please contact Hussein Hamdani at [hussein@simpsonwigle.com](mailto:hussein@simpsonwigle.com) or Aaron Stone at [StoneA@simpsonwigle.com](mailto:StoneA@simpsonwigle.com) from SimpsonWigle LAW LLP.

<sup>2</sup> For the most part, this Term Sheet is “non-binding” and is used only to document the general meeting of the minds between the investors and the target corporation, and not to serve as the legal basis for the investment. However, this paragraph states that the two specific sections referenced, “Expenses and Fees” and “Confidentiality / No Shop” are legally binding. Once this Term Sheet is signed by both the corporation and the investors, the foregoing two terms are immediately in force.

<sup>3</sup> The investors are acquiring preferred shares in the corporation, instead of common shares. Although the preferred shares (also known as preferred stock) in this Term Sheet are called “Series A Preferred Shares”, preferred shares in a first offering may also be called “Series Seed Preferred Shares” or Series B, Series C, Series D, etc. Preferred Shares for each subsequent round after a Series A round. Generally, the difference between preferred and common shares is that in the event of a sale, liquidation or winding up of the Corporation, the preferred shares are paid back first, before any common shares. The founders and employees of the corporation typically hold common shares. However, preferred shares typically get back only the amount invested (subject to negotiation), meaning that all of the upside, if any, goes to the common shareholders. For that reason, a section of the Term Sheet provides investors with the option to convert the preferred to common shares, if and when the conversion would be in the investors’ interest.

<sup>4</sup> This term states the total aggregate proceeds that the corporation is aiming to raise in this offering round. Typically, investors will not want to fund their commitments until they are confident that the Corporation will receive enough money to be able to achieve its use of proceeds objectives for the round. Thus, most investors typically will not deliver investment funds to the Corporation (or in trust to the Corporation’s legal counsel) until at least the minimum amount has been committed by the investors. The Corporation and investors may also agree on a maximum amount to be raised.

## Sample Preferred Term Sheet

|                             |   |
|-----------------------------|---|
| <i>Price per share:</i>     | [\$_____] per share (the “ <b>Initial Price</b> ”), based on a pre-money valuation, fully diluted, of \$[_____] and the attached capitalization table (Appendix A) [inclusive of an unallocated, post-closing, employee pool of at least [___%] of the total]. <sup>5</sup> |
| <i>Currency:</i>            | Canadian Dollars  |
| <i>Investor(s):</i>         | [_____] and other accredited investors, acceptable to the Corporation (collectively, the “ <b>Investors</b> ” or individually referred to as the “ <b>Investor</b> ”)   |
| <i>Closing date:</i>        | Initial closing on or before [_____]  |
| <i>Subscription Limits:</i> | Each Investor is required to purchase a minimum of [\$_____] of the Preferred.  |
| <i>Use of Proceeds:</i>     | The Corporation will use the proceeds from the financing for the following purposes: [insert brief description here, include a more detailed table in an Appendix if required].   |

### **TERMS OF THE PREFERRED<sup>6</sup>**

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|-------------------|--|
| <i>Dividends:</i> | <p>[<i>Alternative 1:</i> The Preferred will be entitled to an annual per share dividend equal to [___%] of the Initial Price, payable when, as and if declared by the board of directors of the Corporation. Non-cumulative dividends as declared. Preferred to participate in all dividends declared on an “as converted” basis. No dividends payable on Common Shares or any other class of preferred shares without payment of similar and all accrued dividends to the Preferred.]</p> <p>[<i>Alternative 2:</i> The Preferred will be entitled to an annual per share accruing cumulative dividend equal to [___%] of the Initial Price, payable when, as and if declared by the board of directors of the Corporation, and upon (a) a redemption or (b) a liquidation (including a Deemed Liquidation Event) of the Corporation [which the holder of the Preferred receives less than [5] times the Initial Price per share (the “<b>Cap</b>”).] For any other dividends or distributions, participation with Common Shares on an as-converted basis.<sup>7</sup></p> <p>[<i>Alternative 3:</i> The Preferred will be entitled to dividends on an as-converted basis if, as and when declared by the board of directors.]</p> |
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<sup>5</sup> In the second part of the sentence, an “unallocated, post-closing, option pool” is in brackets as an optional term, whereby the investors and Corporation agree that before the investment occurs, the Corporation will set aside extra Common Shares that will be used to attract and compensate future employees. It is important to remember that percentage of the allocated percentage of the option pool will exist after the investment, but the calculation is done before the investment is made. This means that all of the shares of the option pool come out of the founder(s)’ shares, not the investors.

<sup>6</sup> The terms of the Preferred often require a corporate filing of articles of amendment. The terms of the Preferred must match the language in the articles of incorporation or articles of amendment.

<sup>7</sup> Some sophisticated target corporations may request a “cap” on an Investor’s entitlement to cumulative dividends in the event of redemption or liquidation. Obviously, Angel Investors do not want this cap. In some cases, accrued and unpaid dividends are payable on conversion as well as upon a liquidation or redemption event. Most typically, however, dividends are not paid if the Preferred is converted. Another alternative is to give the Corporation the option to pay accrued and unpaid dividends in cash or in common shares valued at fair market value. The latter are referred to as “PIK” (payment-in-kind) dividends.

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### *Liquidation preference:*

In the event of any liquidation, dissolution or winding up of the Corporation, the proceeds shall be paid as follows:

[*Alternative 1 (non-participating Preferred):* First pay [one] times the Initial Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Preferred (or, if greater, the amount that the Preferred would receive on an as-converted basis). The balance of any proceeds shall be distributed pro rata to holders of Common Shares.]<sup>8</sup>

[*Alternative 2 (full participating Preferred):* First pay [one] times the Initial Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Preferred. Thereafter, the Preferred participates with the Common Shares pro rata on an as-converted basis.]<sup>9</sup>

[*Alternative 3 (cap on Preferred participation rights):* First pay [one] times the Initial Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Preferred. Thereafter, Preferred participates with Common Shares pro rata on an as-converted basis until the holders of Preferred receive an aggregate of [\_\_\_\_\_] times the Initial Price (including the amount paid pursuant to the preceding sentence).]

A merger or consolidation (other than one in which shareholders of the Corporation own a majority by voting power of the outstanding shares of the surviving or acquiring corporation) and a sale, lease, transfer, exclusive license or other disposition of all or substantially all of the assets of the Corporation will be treated as a liquidation event (a “**Deemed Liquidation Event**”), thereby triggering payment of the liquidation preferences described above [unless the holders of [\_\_\_\_\_] % of the Preferred elect otherwise]. [The Investors' entitlement to their liquidation preference shall not be abrogated or diminished in the event part of the consideration is subject to escrow in connection with a Deemed Liquidation Event.]

### *Conversion:*

The Preferred may be converted at any time, at the option of the holder, into Common Shares. The conversion rate will initially be 1:1, subject to customary adjustments for stock splits, stock dividends and similar events and is subject to “Anti-dilution Provisions” described below.<sup>10</sup>

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<sup>8</sup> This is typically the most common term out of the three alternatives as it is fair for both the investors and the Corporation. It strikes a balance between the respective parties' interests. Note that the wording in the brackets can be completed, inserted or deleted depending on the outcome of negotiations.

<sup>9</sup> In an ideal situation, Angel investors would negotiate for this term.

<sup>10</sup> This is where investors obtain their return. While the Preferred are paid off first, it does not participate in any upside benefits. On the other hand, Common Shares get a proportional share of any incoming money (such as from proceeds of an acquisition), but have to stand in line behind the Preferred. Thus, this term states that investors who hold Preferred can choose at any time to convert into Common Shares. The result is that in a bad scenario (the Corporation is going out of business) the investors stay with Preferred, and receive the first money out. In a good scenario (an acquisition at a high price), they will choose instead to convert to Common, and share in the upside.

## Sample Preferred Term Sheet

### ***Anti-dilution Provisions:***

In the event that the Corporation issues additional securities at a purchase price less than the current Preferred conversion price, such conversion price shall be adjusted in accordance with the following formula:

[*Alternative 1: “Typical” weighted average:*

$$CP_2 = CP_1 * (A+B) / (A+C)$$

CP<sub>2</sub> = Series A Conversion Price in effect immediately after new issue

CP<sub>1</sub> = Series A Conversion Price in effect immediately prior to new issue

A = Number of shares of Common Shares deemed to be outstanding immediately prior to new issue (includes all shares of outstanding common shares, all shares of outstanding preferred shares on an as-converted basis, and all outstanding options on an as-exercised basis; and does not include any convertible securities converting into this round of financing)<sup>11</sup>

B = Aggregate consideration received by the Corporation with respect to the new issue divided by CP<sub>1</sub>

C = Number of shares of stock issued in the subject transaction]<sup>12</sup>

[*Alternative 2(a): Full-ratchet – the conversion price will be reduced to the price at which the new shares are issued.*]<sup>13</sup>

[*Alternative 3: No price-based anti-dilution protection.*]

### ***Automatic conversion:***

Each share of Preferred will automatically convert into Common Shares, at the then applicable conversion rate, upon (i) the closing of a firmly underwritten initial public offering of common shares (“IPO”), or (ii) the consent the holders of at least a majority of the then outstanding shares of Preferred.<sup>14</sup>

### ***General voting rights:***

Each share of Preferred votes together with the Common Shares on all matters on an as converted basis, except as specifically noted herein or required by law.

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<sup>11</sup> The “broadest” base would include shares reserved in the option pool.

<sup>12</sup> The “Typical” weighted average, also known as the Broad-based Weighted Average, means that if the Corporation at some point in the future raises money at a lower valuation than that being used for the current round, the current Investors will be partially protected. This provision is a middle-of-the-road industry standard, half-way between the founder-biased “no anti-dilution” approach and the Investor biased “full ratchet anti-dilution” version.

<sup>13</sup> In the alternative, some investor may negotiate a full ratchet provision whereby new shares are immediately issued to the Investors to prevent dilution, instead of a ratchet to the conversion price. See “Ratcheting Down Protection” [Alternative 2(b)] in the “Other Matters” section of the Term Sheet below for an example of an alternative ratchet mechanism whereby shares are immediately issued to the Investors to prevent dilution.

<sup>14</sup> The parties may want to set a minimum IPO value and might insert the following alternative wording: “Mandatory conversion of Preferred on closing of firmly underwritten initial public offering (“IPO”) at an initial price to the public at a valuation of at least \$\_\_ million and gross proceeds to the Corporation of at least \$\_\_\_\_\_ million.”

## Sample Preferred Term Sheet

### SHAREHOLDERS AGREEMENT

#### *Information rights:*

The Corporation will deliver to shareholders:

- (1) Audited financial statements or reviewed (as determined by Investors) for each fiscal year within 90 days after the end of the fiscal year and management-prepared quarterly financial statements for the first three quarters of the year within 30 days after the end of each quarter.
- (2) Annual budgets at least 30 days prior to the beginning of each fiscal year.
- (3) Quarterly updates on progress and accomplishments and anticipated progress against target in next period.
- (4) Notification of any material defaults or litigation; and any other information reasonably requested.
- (5) Customary inspection rights shall take place.

The foregoing rights will expire at the date the Corporation completes its qualified IPO and the Corporation has no outstanding obligations to Investors.<sup>15</sup>

#### *Protective provisions:*

So long as any of the Preferred are outstanding, consent of two-thirds (2/3) majority of the then-outstanding Preferred will be required for any action that: (i) amends the Articles or by-laws of the Corporation if it would adversely alter the rights, preferences, privileges or powers of Preferred; (ii) changes the number of directors from current number; or (iii) approves any Sale Transaction (merger, asset sale, liquidation, etc.) or other corporate reorganization or acquisition [(iv) increase the total number of authorized Preferred by more than twenty percent (20%); or (v) declares dividends on Common Shares].

#### *Redemption:*

The Preferred shall be redeemable from funds legally available for distribution at the option of the holders of a majority of the outstanding Preferred commencing any time after the [fifth] anniversary of the closing at a price equal to the Initial Price plus all accrued but unpaid dividends and any other declared and unpaid dividends thereon. Redemption shall occur in [three] equal annual portions.<sup>16</sup>

#### *Pre-emptive rights (to maintain*

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<sup>15</sup> In Ontario, all shareholders will receive a copy of annual financial statements and additional information rights are provided to major shareholders, typically defined to be owners of 5% or more of the Corporation. If investors want to know more about the Corporation's performance, or want further information rights, they must negotiate them here.

<sup>16</sup> If, after several years, the Corporation becomes a 'lifestyle' business, where it is profitable but not likely to ever have an exit, this term gives the Investors the right to require the Corporation to buy back their shares for what the Investors paid for them (plus dividends). The repurchase (known as "redemption") would take place over three years, or as negotiated, starting at the investor's option any time after the fifth year. In practice, redemption rights are not often used; however, they do provide some form of exit and some possible leverage over the Corporation.

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### *proportionate ownership):*

Each of the Investors will have a right to purchase its *pro rata* share of any offering of new securities by the Corporation, subject to customary exceptions. This right will terminate immediately prior to the Corporation's IPO, a Sale Transaction or [\_\_\_\_\_] <sup>17</sup> years after the date of Shareholders' Agreement executed upon closing. In addition, should any Investor choose not to purchase its full pro rata share, the remaining Investors shall have the right to purchase the remaining pro rata shares. <sup>18</sup>

### *Co-Sale Rights:*

In the event that any shareholder ("Selling Party") proposes to sell their shares to a third party ("Third Party"), the Selling Party agrees not to make the sale unless Third Party includes an offer to purchase the shares of the Investors on the same terms. If Third Party has specified a maximum number of shares that they are willing to buy, then the Selling Party and interested Investors may sell their pro-rata share of the amount to be purchased by Third Party.

### *Right of First Refusal:*

In the event that any shareholder(s) of the Corporation (including the Founder(s) and management) proposes to sell their shares to a Third Party before an IPO, the other shareholders shall have a thirty (30) day right of first refusal to purchase their pro-rata proportion of the shares proposing to be sold by the Founder(s) and management.

### *Election of directors:*

[*Alternative 1:* Provision agreeing to elect the following individuals to the board of directors (the "**Board**"): (i) one representative designated by the holders of Preferred [\_\_\_\_\_] <sup>19</sup> (the "**Investor Nominee**"); (ii) one representative designated by the Founders; and (iii) one representative designated by Common shareholders acceptable to the Investor Nominee and Founders.

[*Alternative 2:* The board of directors (the "**Board**") shall initially consist of 5 directors:

- (i) The CEO and another nominee by existing Corporation's shareholders;
- (ii) Two (2) individuals designated by the holders of the Preferred (the "**Preferred Directors**"); and
- (iii) One (1) individual who is not otherwise affiliated with the Corporation who is approved by (designate which) Directors above.] <sup>20</sup>

### *Sale Transaction:*

A "**Sale Transaction**" shall mean (i) any merger, amalgamation, reorganization, consolidation or other transaction involving the Corporation and any other corporation or other entity or person in

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<sup>17</sup> Management and Investors may agree to have Investors' rights to participate in additional financing rounds of the Corporation end after a certain term. The term is dependent on Corporation's financing needs and plans and typically ranges from two to four years, if a term is being set.

<sup>18</sup> This provision allows each individual investor to maintain its pro rata share and also allows the group of Investors to maintain its overall percentage, even if some of the individual Investors choose not to purchase their full *pro rata* share.

<sup>19</sup> This right may be assigned to a specific Preferred investor during term sheet phase, in which case the blank will be filled in with name of that investor (fund or corporation name if they are not investing for individual account) or the blank can be removed, indicating that the majority of the Preferred will elect director to represent the Preferred.

<sup>20</sup> While the practice isn't uniform, Angels often require some formal representation on a startup's board of directors. It is important for investors to remember that there is legal exposure for a director (although the parties will request Directors & Officer's liability insurance).

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which the persons who were the shareholders of the Corporation immediately prior to such merger, amalgamation, reorganization, consolidation or other transaction own less than fifty percent (50%) of the outstanding voting shares of the surviving or continuing entity after such merger, amalgamation, reorganization, consolidation or other transaction; (ii) the sale, exchange or transfer by the Corporation's shareholders, in a single transaction or series of related transactions, of all of the voting shares of the Corporation; or (iii) the sale of all or substantially all of the assets of the Corporation.

### ***Tag Along Rights:***

In the event the Founder(s), management of the Corporation or significant common shareholders propose to sell shares of the Corporation [or for a sale of [\_\_\_%] of the shares,] each Investor shall be entitled to participate in such sale by selling the same percentage of their shares as such Founder(s), management of the Corporation or significant common shareholders are selling of their shares.

### ***Drag Along Rights:***

[*Alternative 1:* Subject to the above First Right of Refusal provision, all Founder(s), management of the Corporation or significant common shareholders will agree to sell a proportionate part of their ownership in the Corporation if the holders of a majority of the Preferred sell a portion or all of their interest, provided that the result of such a transaction results in a Change in Control. For the purposes of these Drag Along Rights, the term "Change in Control" shall mean any sale, exchange, conveyance or other disposition of securities of the Corporation in which more than 50% of the voting power of the Corporation is transferred.]

[*Alternative 2:* Subject to the above First Right of Refusal provision, all Founder(s), management of the Corporation or significant common shareholders will agree to sell all of their ownership in the Corporation if the holders of at least a two-thirds (2/3) majority of the Preferred agree to sell all of the Preferred.]<sup>21</sup>

**The parties will also agree to other clauses normally and typically in a shareholders' agreement.**

## **OTHER MATTERS**

### ***Ratcheting Down Protection:***

[*Alternative 2(b) to Alternative 2(a) conversion ratchet*] The Corporation acknowledges that the Investors will have, at closing, purchased a percentage of the issued and outstanding shares in the Corporation for the Initial Price, which was calculated based on a pre-money valuation, fully diluted, of the Corporation of \$[\_\_\_\_\_] (the "**Current Valuation**") If, during the next [two (2) years] the Board should decide to issue new shares based on a pre-money valuation, fully diluted, of the Corporation that is less than \$[\_\_\_\_\_] (the "**Lower Valuation**"), then the Corporation shall issue additional shares to each Investor to increase

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<sup>21</sup> If the Preferred hold only 20% (or a small minority) of the outstanding shares of the Corporation, the Founders and major common shareholders will likely be reluctant to allow a majority of the Preferred to be able to 'drag-along' the shares of the Founders and major common shareholders. Thus, Alternative 2 will not often be used.

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the percentage interest to equal the number of shares each Investor would have received based on the Lower Valuation.<sup>22</sup>

### ***Option pool:***

The number of Common Shares reserved for issuance under the Corporation's stock option plan will be increased to equal [\_\_\_\_\_%]<sup>23</sup> shares outstanding after issuance of the Preferred to Investors.

### ***Subscription agreement:***

The Corporation and each Investor will enter into a subscription agreement containing standard representations and warranties by the Corporation and the subscribing Investor [and the Founder(s)] [with a survival period of \_\_\_\_\_ years].<sup>24</sup>

### ***Founder matters:***

Each Founder shall have transferred all relevant intellectual property to the Corporation, entered into an employment agreement with the Corporation and signed agreements with respect to voting and vesting their Founders shares over an agreed term of [\_\_\_\_\_] years, the terms of such agreements satisfactory to Investors prior to Closing Date. The vesting agreement will provide for full acceleration of vesting for all shares held by the Founders on the completion of an IPO or Sale Transaction.

### ***Key Person Insurance:***

The Corporation will purchase key person insurance in the amounts of \$\_\_\_\_\_ for individual A and \$\_\_\_\_\_ for individual B. Proceeds shall be payable to the Corporation. 50% of proceeds available shall be payable to the Investors upon their option. The individuals shall complete full medicals, satisfactory to the Investors prior to closing.

### ***D&O and E&O Insurance:***

Prior to closing, the Corporation shall obtain each of a Directors & Officers and an Errors & Omissions insurance policy in an amount suitable for the Corporation's size and type and given consideration for its line of business. Such insurance is to be put firmly in place and made effective by the Board within 30 days of closing.

### ***Confidentiality / No Shop:***

The Corporation and the Founder(s) agree that they will not, for a period of 60 days from the date these terms are accepted, take any action to solicit, initiate, encourage or assist the submission of any proposal, negotiation or offer from any person or entity other than the Investors relating to the sale or insurance, of any of the capital

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<sup>22</sup> As previously indicated, this is an alternative to "Alternative 2(a)" under "Anti-dilution Provisions" described above.

<sup>23</sup> Total number of shares reserved under the option pool is typically 10-20% of the fully-diluted capitalization of the Corporation post-money. As stated previously in footnote 5, not all transactions have employee option pools.

<sup>24</sup> The typical range is from two to four years and may vary dependent on a specific representation or warranty. Investors and Founders may also want to consider indicating a minimum threshold for losses or claims associated with breach of representations and warranties as well as a maximum cap. Founders' representations are controversial and may elicit significant resistance as they are not found in all Angel deals. They are more likely to appear if Founders are receiving liquidity from the transaction, or if there is heightened concern over intellectual property (e.g. the Founder was formerly with another company whose business could be deemed competitive with the Corporation), or in international deals. Founders' representations are even less common in subsequent rounds, where risk is viewed as significantly diminished and fairly shared by the investors, rather than being disproportionately borne by the Founders. A full sample set of representations and warranties is attached as a schedule to this Term Sheet. We encourage investors to negotiate these representations and warranties, as applicable, into the Subscription Agreement.

<sup>25</sup> The typical range is three to four years for new start-ups but may be less or not required for businesses that are more mature.

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stock of the Corporation and shall notify the Investors promptly of any inquiries by any third parties in regards to the foregoing. The Corporation and the Founder(s) will not disclose the terms of this Term Sheet to any person other than officers, members of the Board and the Corporation's accountants and lawyers and other potential Investors acceptable to the Investors, without the written consent of the Investors.<sup>26</sup>

### *Exit Notice [OPTIONAL]:*

Notwithstanding any other term of this Term Sheet, at any time [48] months after the Closing Date (as amended), Investors may by delivery of a written notice (an "**Exit Notice**") to the Corporation and to the other shareholders state a price per share (the "**Exit Price**") at which at least 75% of the Investors are prepared to sell their shares. The Corporation shall have the right to either: (i) purchase the Investors at the Exit Price, in which case Investors will be paid out in equal monthly instalments over a period of [\_\_\_] years with interest accruing on the outstanding amount at a rate of [10%] per annum; or (ii) in co-operation with the Investors, seek *bona fide* offers from third parties to purchase all the shares of the Corporation at the Exit Price. Within [15] days of receiving the Exit Notice, the Corporation shall provide the Investors with written notice of whether it will exercise option (i) or (ii). If the Corporation does not provide written notice within 15 days of receiving the Exit Notice, the Corporation shall be deemed to have agreed to purchase the Investors at the Exit Price pursuant option (i). If the Corporation properly elects to exercise option (ii) and if within 180 days from delivery of the Exit Notice, a third party offer is not made at the Exit Price or higher, the obligations of the Corporation shall expire.

If a third party offer is made at the Exit Price or higher (the "**Initial Offer**") then, (i) if a share sale, all of the shareholders of the company will sell all the shares owned by said shareholders on the terms and conditions contained in the Initial Offer; and/or (ii) if an asset sale or other transaction, all the shareholders will take all action reasonably necessary to effect the asset sale or other transaction pursuant to the Initial Offer, including voting in favour of the proposed asset sale or other transaction on any resolution of shareholders necessary or desirable in connection with such asset sale or other transaction. Where an Initial Offer provides for consideration to the shareholders that is other than cash payable upon closing, the value shall be determined by a nationally recognized investment dealer independent of each of the shareholders and appointed by the Board. The fees of the valuation shall be borne by the Corporation. The determination of the nationally recognized investment dealer shall be final and binding on the shareholders.<sup>27</sup>

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<sup>26</sup> 'No Shop' provisions are sometimes inserted so that the Corporation does not use the Investors as a 'straw man' for the purpose of helping the Corporation obtain a better deal from someone else. With a 'No Shop' clause, as soon as the Corporation signs the term sheet, they are agreeing that for 60 days they will not talk to anyone else about investing, without the Investors' approval.

<sup>27</sup> Recently, some Angel One investors have been interested in negotiating exit mechanisms beyond the redemption provision. This provision is an example of a possible exit mechanism that was recently used in an Angel One term sheet.

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**Expenses and fees:**

[*Alternative 1:* The Corporation will reimburse counsel to Investors for legal fees and reasonable disbursements.]

[*Alternative 2:* The Corporation will reimburse counsel to Investors for legal fees in the amount of up to \$1,500 per Investor, all exclusive of HST and disbursements which the Corporation will also reimburse. The Corporation shall pay all of its own legal and professional fees and other expenses.]<sup>28</sup>

**Governing Law:**

The transaction and related agreements shall be governed by the laws of the Province of Ontario applicable therein.

**Expiration date:**

These terms are valid until, and will expire on, [\_\_\_\_\_].<sup>29</sup>

**Condition Precedents:**<sup>30</sup>

The following are conditions precedent to closing or any funding:

1. Completion of due diligence satisfactory to Investor: financial, technical, commercial, operational, intellectual property and legal (including evidence of IP assignment to the Corporation by all Founder(s)/employees, the review or entering into of updated proprietary rights agreements by all Founder(s)/employees satisfactory to the Investors, etc.);
2. The absence of any material change in the business of the Corporation;
3. In addition to standard confidentiality/development agreements, key employees will execute agreements not to compete with the Corporation or solicit employees of the Corporation or its subsidiaries, directly or indirectly, for [two (2)] years after termination of employment;
4. All shareholder loans have been repaid or converted prior to closing;
5. An opening balance sheet as of the closing date is to be delivered [three (3)] weeks after closing;
6. Execution of a subscription agreement including representations and warranties by the Company [and Founder(s)] satisfactory to the Investor, and including standard disclosure schedules;
7. Execution of a unanimous shareholders' agreement based on the terms above and satisfactory to the shareholders of the Corporation;

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<sup>28</sup> The agreement SimpsonWigle LAW LLP has with Angel One is that for Tranche 1 investments, the legal fees will be capped at \$1,500 per investor, plus disbursements and HST.

<sup>29</sup> Typically 30 days after the date first set forth above.

<sup>30</sup> For each financing transaction, the parties will want to negotiate specific condition precedents depending on the context. This provision is an example of some condition precedents, but it is not a complete list.

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- 8. Subject to the approval of the Investors, amendment of Corporation's articles or by-laws [*if necessary*];
- 9. Evidence of the suitable insurance coverage previously described above;
- 10. Delivery of financial statements for the period ending immediately before closing, delivered [three (3) weeks] after closing;
- 11. Delivery of a fully-diluted capitalization table of the Corporation.

This Term Sheet may be executed in counterparts, which together will constitute one document. Electronic signatures shall have the same legal effect as original signatures.

**[Insert CORPORATION NAME]**

**[Insert NAME OF INVESTOR(s)] (On behalf of the Investors)**

\_\_\_\_\_  
*Signature*

\_\_\_\_\_  
*Signature*

\_\_\_\_\_  
*Print name*

\_\_\_\_\_  
*Print name*

\_\_\_\_\_  
*Print title*

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*Print title*

\_\_\_\_\_  
*Date*

\_\_\_\_\_  
*Date*

## SimpsonWigle LAW Annotated Sample Preferred Term Sheet

### Appendix A – Capitalization Table

| Shareholder Name                   | Common Shares <sup>31</sup> | Options          | Preferred Shares | Fully Diluted Shares | Pro-forma Fully Diluted Ownership % |
|------------------------------------|-----------------------------|------------------|------------------|----------------------|-------------------------------------|
| Name Founder1                      | 5,000,000                   | -                | -                | 5,000,000            | 34.6%                               |
| Name Founder2                      | 5,000,000                   | -                | -                | 5,000,000            | 34.6%                               |
| <b>Subtotal – Current Holdings</b> | <b>10,000,000</b>           | <b>-</b>         | <b>-</b>         | <b>10,000,000</b>    | <b>n/a</b>                          |
| Investors <sup>32</sup>            | -                           | -                | 3,000,000        | 3,000,000            | 20.8%                               |
| Option pool <sup>33</sup>          | -                           | 1,444,444        | -                | 1,444,444            | 10.0%                               |
| <b>Total – Proforma Holdings</b>   | <b>10,000,000</b>           | <b>1,444,444</b> | <b>3,000,000</b> | <b>14,444,444</b>    | <b>100%</b>                         |

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<sup>31</sup> Enter names and number of common shares already issued to Founder(s) and any other shareholders

<sup>32</sup> Equal to the estimated amount of investment for all Preferred Investors divided by the agreed price per share.

<sup>33</sup> See footnote 5 above