

Resource

January 2, 2024

*This article is Part 4 of 7 in Venture Financing Process. Already up-to-speed on this topic? Skip to [Part 5. Closing](#) or check out the full [New GC & In-House Counsel Resources](#) collection.*

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After a term sheet is signed and simultaneously with kicking off the legal Due Diligence process, the parties will start to prepare and negotiate the various investment agreements for the financing, or as they're commonly known, the "transaction documents." Following the execution of term sheet, this is where all of the remaining terms of the investment will be negotiated and all of the details not specifically covered in the term sheet will be raised. Because of the complexity of the transaction documents and the length of time that the negotiating and drafting process can take, it's common practice to start this process while the legal due diligence is ongoing. Waiting to complete diligence might unnecessarily extend the timeline to finalizing the investment.

## Primary Transaction Documents

A typical VC financing for preferred stock will include the drafting and negotiation of five primary transaction documents:

- *Certificate of Incorporation (or Charter)*: This outlines the respective rights and privileges of the target company's capital stock, including the stock to be issued in the financing.
- *Purchase Agreement (or Stock Purchase Agreement, or simply SPA)*: This covers the actual sale and issuance of the shares of preferred stock and various representations and warranties made by the company to the investors (including any disclosure to be made in regards thereto via a "disclosure schedule" or "schedule of exceptions").
- *Investors' Rights Agreement (or IRA)*: This outlines rights given to investors (or a subset of certain larger investors) covering things like the ability to receive financial and other information, rights to participate in future securities issuances and rights to approve certain corporate acts.
- *Right of First Refusal and Co-Sale Agreement (or ROFR)*: This gives investors rights to purchase certain shares of the company's stock that a founder or other key holders may offer to sell, or to participate in such a sale by including some of the investors' own shares to realize some liquidity.
- *Voting Agreement*: This provides for a set of agreements among stockholders regarding how to vote in respect of certain stockholder actions, including the negotiated composition of the company's board of directors and in some cases how to vote in respect of a sale of the company.

For most transactions, these documents will be based on the forms of such agreements as published by the National Venture Capital Association (or NVCA). Some law firms use other forms of the document or heavily modified versions of these forms, but investors typically prefer the NVCA versions. You can see and download the form versions from the NVCA's website (<https://nvca.org/model-legal-documents/>).

There will also be other related documents to be negotiated, either as a matter of custom or by request of the investors, such as side letters (like a Management Rights Letter), indemnification agreements, various management certificates, etc., as well as any board and stockholder actions that are required to approve the financing transaction. These are generally referred to as “Ancillary Documents.”

Working directly with you and your executive team, your Gunderson attorneys will take the lead in liaising directly with the investors' counsel in the preparation of both the primary documents and ancillary documents during the transaction. Customarily, the target company's counsel is responsible for the initial drafting of these documents (with the caveat that like most things, this isn't a hard and fast rule), so your Gunderson attorneys will discuss all of these key documents with you as part of kicking off the negotiation stage of your transaction.

## Pro-Forma Cap Table

Another component of a financing that is usually put together during this stage is the “pro forma cap table” for the transaction. A pro forma cap table is essentially a financing model that is used to determine the price per share of the equity securities to be sold. This allows all parties (including the company, the current stockholders and the new investors) to see the impacts of the financing and confirm that the terms of the financing are implemented correctly.

The term “pro forma” means “for the sake of form” or “as a matter of form” and as such relates to the fact that the pro forma cap table sets forth a model of what the company's cap table will look like, based on certain facts and assumptions, if the round were to be completed. The model starts with all of the company's currently outstanding equity securities and convertible securities, and then adds in the details of the new financing, including the valuation, conversion of securities and any increase in the company's stock option pool.

Using those details, the parties are able to show the predicted final, post-financing cap table. The parties will be able to calculate, among other things, and based on the agreed upon valuation in the term sheet: the price per share of new securities to be

sold in the financing; the impact of the conversion of outstanding convertible securities; and how many new shares (if any) should be added to the option pool.

The pro forma is usually created via excel spreadsheet, and often will be generated initially by the company or its counsel. It may undergo a few rounds of tweaks and changes as the parties confirm all relevant details, however, this is less of a negotiation and more of a confirmation of the correct implementation of all of the agreed upon deal terms. It's in all parties' interests to have a complete and accurate pro-forma, so that there's no surprises or issues with the company's actual capitalization following the financing round. For example, an inaccurate pro-forma resulting in a price per share that is too high, if discovered later, might cause the investors to believe they didn't receive their agreed upon ownership percentage of the company, and seek measures to address that deficit. Those measures can be costly and administratively burdensome to the company, including having to deal with such an issue while trying to move on to running their business.

## Disclosure Schedules

The Stock Purchase Agreement for a venture financing will contain, among other things, certain representations and warranties about the business that are made by the company to the investors. These representations and warranties are intended to provide the investors with a certain degree of comfort –via contractual provision – around the statements and information the company has delivered to the investors in the course of the pitch and diligence processes. The “reps and warranties,” as they're known, can be broad, especially in later stage financings, and cover a wide range of areas regarding the company's business and activities, including among other things compliance with laws, material contracts, ownership structure, employees, regulatory matters and insurance policies.

For example, the representations might cover that the company is duly qualified and in good standing in the state in which it is incorporated; or it may call for the number of outstanding equity securities and the amounts of and holders of the company's debt. Those representations and warranties are intended to be read in connection with a schedule of disclosures (the “disclosure schedule” or “schedule of exceptions”), prepared by the company, that relate to each such representation or warranty. A representation in the SPA may state that the disclosure schedule shall set forth all material agreements of the company; the disclosure schedule will in turn include an analogous section that lists or “discloses” all of those relevant material contracts.

The disclosure schedule is virtually always prepared primarily by the company, with the assistance of its counsel (especially in relation to schedules pertaining to the

company's activities with which counsel advises the company). The scheduling process requires a close reading of the SPA in order to determine what, if any, disclosures might be needed in relation to any particular section.

The negotiation of the SPA by the respective counsels of the company and investors will determine the extensiveness of the disclosures required to be made, with the company often seeking to limit disclosures to avoid needing to devote too much time or energy toward their preparation.

Your Gunderson attorneys will walk you and your team through the preparation of the disclosure schedules during your deal and take the lead on its preparation; however, it's important to note that the company is in the best position to accurately provide all relevant information for each disclosure.

## Ancillary Documents

While the five main transaction documents will be the focus of most drafting and negotiation, there are a number of additional ancillary documents that are commonly required in connection with the financing.

### Supplemental Documents

One bucket of ancillary documents are those that supplement the main transaction documents and become part of the transaction deliverables themselves: specifically, those that are called for as conditions to the closing of the transaction in the Purchase Agreement.

- *Secretary's Certificate*: This is a document signed by the company's secretary (as appointed by the company in accordance with its bylaws and other governing documents) and delivered to the investors that certifies then-current copies of the company's charter, bylaws, and the resolutions approving the venture financing as adopted by both the board of directors and the company's stockholders.
- *Compliance Certificate*: Also known as an "officer's certificate" or "closing certificate," this is a short certificate delivered to the investors by the most senior executive of the company (usually the President or CEO) that certifies that the company's reps and warranties made in the SPA are true and accurate as of the closing of the financing, and the company is in compliance with all agreements or obligations required by the SPA.
- *Legal Opinion*: In some financings, the SPA will require that the company's legal counsel prepare and deliver an "opinion" covering topics like the company's authority to issue securities and its compliance with certain laws and regulations.



Your Gunderson team will prepare any legal opinion as required, and will generally rely on a “Back-Up Certificate” in order to do so.

- *Back-Up Certificate to Opinion:* Any law firm delivering a legal opinion (including Gunderson) will typically require the company to review and sign a “back-up” certificate, which certifies certain information in the form of reps and warranties. This is to make sure the company and Gunderson have discussed any issues that may impact the legal opinion.
- *Rule 506 “Bad Actor” Certificates:* Rule 506 is one of the most widely used exemptions under Regulation D of the SEC Act in order for private companies to issue their securities (See more on security laws basics here). Rule 506(d) limits the use of such exemption if certain participants in the offering are felons or other “bad actors.” In order to document that an offering can take advantage of Rule 506, often the company will ask (or the investors may require) that certain persons or entities sign certificates attesting to the absence of the existence of any “bad actors.” Your Gunderson team will discuss these with you in the context of your financing.
- *Form D:* In connection with a private financing conducted pursuant to Rule 506, the SEC requires that the issuer of securities make a public filing with the SEC on “Form D.” This filing notifies the SEC of the sale of securities in the private offering, and includes information regarding the company (including certain executives and board members) and the size of the offering. The SEC requires this filing be made within 15 days of the first sale of securities in an offering. Your Gunderson team will work with you in preparing any Form D required to be filed in connection with your financing.

## Party-Specific Agreements

Another type of ancillary documents are agreements that are only applicable to or required by certain parties for closing—for example, certain investors or board members. Examples include:

- *Management Rights Letters (or MRL):* Most VC funds will require an MRL from any company in which they invest. These MRLs grant the VC fund certain “management rights” that allow it to participate in and/or influence the conduct of management.
- This might seem puzzling at first: why would the company now enter an additional agreement granting even more rights, when it’s just negotiated the

investors' rights through the financing documents? The short answer is: because VC Funds won't do deals without them.

- These agreements are necessary for the VC Fund to confirm that it qualifies as a "VCOC": a venture capital operating company. Qualifying as a VCOC allows the VC Fund to fall under an exemption to avoid its assets being subject to ERISA requirements. Since many of a VC Fund's LPs may be subject to ERISA themselves, like pension funds, the VC Fund could, as a result of having such LPs in its structure, find itself subject to ERISA and its onerous requirements. Therefore the MRL is an important part of the investment strategy for the VC Fund in order to avoid this circumstance.
- While the MRL may seem like its granting the VC Fund with some additional rights (and technically it may be doing just that) these are standard agreements within the venture financing community and commonplace in nearly all deals in which a VC fund invests. Further, in practice, these agreements don't impose any material operational burdens on the company. Your Gunderson team will prepare and negotiate an appropriate MRL with any investors who require them as part of their investment process.
- *Indemnification Agreements:* In many financings, a VC fund will negotiate for the right to designate and/or appoint a member of the company's board of directors. When these individuals join the board, they are acting in their individual capacity and therefore, not as employees of (and outside the employment contracts they may have with) the VC fund.
- Serving as a board member for a company comes with the inherent risk of becoming party to or otherwise involved with a law suit or other legal action, which in turn may result in expenses and costs. In order to entice these board members to serve and to protect them from having to shoulder such costs on their own, companies will generally provide indemnification to step in and cover such costs or expenses (subject to standard limits, including that this generally won't extend to costs or expenses arising as a result of their own bad acts). This indemnification can be covered via a provision in the company's charter, however, in order to ensure that the details of the indemnification are appropriately negotiated and as an additional level of comfort for the individual, an Indemnification Agreement is generally executed directly between the company and the director.
- Gunderson will take the lead on preparing any necessary indemnification agreements for new directors joining your board in the context of a financing. These agreements can also be offered to other board members joining the

board, whether it be in the context of a financing or otherwise. For example, if an “independent” director is to be appointed, the board may want to extend such indemnification protection to that individual as well, and a similar agreement can be prepared.

- *Side Letters:* Side letters are often used in the context of a venture financing, generally between the company and a single or certain subset of investors. A side letter can cover any number of additional agreements between the parties, with some typical uses including board observer rights, confidentiality arrangements, specific voting rights or notice obligations, and additional investment rights. In some cases, the “management rights” of an MRL may be combined alongside other provisions, like a board observer right, into a single side letter agreement.
- While side letters are commonplace in the context of venture capital financings, and most are mainly benign and immaterial to anyone other than the parties thereto, they should be used judiciously. Depending on the subject matter of the agreements in a side letter, the company may need to disclose its existence, either to other investors in the financing at the time it’s executed, or to new investors in future rounds of diligence.
- For example, if an agreement in a side letter impacts the rights of other parties—say, a specific economic right not available to the other investors in the financing—the provisions can become quite problematic. If they are not properly disclosed and managed with the other investors, issues may arise in the future that can be messy to fix.
- We recommend that you reach out to strategize with your Gunderson team if you receive any requests for, or want to offer up, any arrangements in a side letter. Your Gunderson team can take the lead in drafting any such arrangements to work with you to prevent any unwanted impacts and best document the arrangements between the parties.

## Consents and Approvals

A final set of documents that will need to be prepared in connection with the closing of a venture financing are the various approvals needed, as required by the company’s current governing documents and any material contracts giving a third party rise to a consent right over the financing transaction.

- *Board Approval:* In virtually all instances, board approval will be required in order for the company to sell its equity securities. For purposes of receiving such approval, resolutions to be adopted by the board will be prepared by your



Gunderson team and distributed with the Board for their review. Once final documentation is available, the company will then seek the actual adoption of those resolutions in order to formally approve the financing.

- Your board can approve the transaction either at a board meeting, or via written consent. The resolutions in each case will generally follow the same structure, and content with some minor tweaks to reference the reality of which alternative is used. Reach out to your Gunderson team to discuss which form of approval will be most appropriate –for example, if a director is suddenly unavailable, a written consent (which must be unanimous) may not be efficient and a board meeting might need to be called. Preparing an approval plan in advance can help avoid last minute delays.
- *Stockholder Approval:* Stockholder approval of a transaction is generally a requirement for closing a financing. First, Delaware law requires stockholder consent to, among other things, amend a company's certificate of incorporation, and the creation of a new security, as is typically the case in a preferred stock financing, requires such an amendment. Second, a company's charter often lays out its own additional stockholder approval provisions, which may match or even be more stringent than those set forth in the DGCL. Further, the company's investor agreements may include their own approval provisions, all which need to be achieved in order for the financing to be closed.
- Obtaining this stockholder approval is virtually always accomplished through the execution of a written consent document. This approach is generally preferred given its relative ease, rather than the alternative approach of holding a stockholder meeting, which has more burdensome requirements to be completed appropriately. Gunderson can and usually will take the lead on putting together a written consent document for this purpose to be distributed to the relevant stockholders to seek their approval.
- This distribution usually also includes notifying certain stockholders in advance that the financing is occurring and their consent will be required. Since the Charter and other primary transaction documents are often included in the distribution, some stockholders might ask for additional time to review all the materials. Therefore, a plan to reach out to such investors with plenty of advance notice can be helpful to ward off last minute issues or delays. Your Gunderson team can advise you on and manage any such stockholder communication plan.
- *Third Party Consents:* While uncommon, some contracts that companies sign with third parties can include consent rights over consummating certain transactions,

like issuing securities. For example, a lender may ask for such a consent right over fund raising in the context of a loan so that it is aware of the capital position of the company. If your company has any contracts that contain such provisions, it's likely they will need to be disclosed as part of the diligence and/or reps and warranties disclosure process, and that the investors may require seeing evidence of such consent prior to closing.

- While the actual documentation regarding such approval may be minimal, its encouraged to seek assistance from your Gunderson team to obtain these consents. For example, it may make sense to appropriately time the request so as to limit any chance of a public disclosure of a pending deal, or even to ask for a confidentiality provision as part of the consent prior to providing any information on the transaction. Your Gunderson team can advise on the best approach for reach out to the relevant third party.

Next section: [Part 5. Closing](#)

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