

Resource

This article is Part 3 of 7 in Venture Financing Process. Already up-to-speed on this topic? Skip to [Part 4. Negotiating Terms and Transaction Documents](#).

Timing

Once a Term Sheet is signed, two processes generally commence more or less simultaneously: legal due diligence and the drafting of the investment documents. Apart from any gating items that arise during the closing process, it is these two processes that generally control how long the remainder of the entire investment process will take: each is a requirement for a VC fund to make an investment, and these two processes generally take the longest amount of time to complete (with the notable exception of the pitch process, that is).

While a VC firm may have started to conduct business due diligence when deciding whether or not to propose a term sheet to a your company, it usually will hold off on commencing full legal due diligence until a term sheet is signed. This is because:

1. The process involves requesting vast amounts of otherwise confidential information and materials from the your company, which you likely wouldn't be willing to share prior to executing a term sheet, and
2. Lawyers typically play a large role in reviewing diligence materials, and engaging lawyers costs time and money. That cost will usually be taken on only once the VC

firm has a signed term sheet, providing it with some assurance that the deal will move forward toward closing. Otherwise, they'd risk large sunk costs.

Due Diligence Request

Legal due diligence will typically start with the VC firm, or more specifically, its counsel, sending your company (and more specifically again, you and your outside counsel) a “due diligence request,” detailing all of the various information that the VC firm wants to review. This request will most likely be in the form of a comprehensive, if not exhaustive, list of documents and information related to your corporate records and business, covering things like capitalization records, corporate documents, investor agreements and all types of other business information and contracts.

You and your team will then get to work, often working with your outside counsel, to gather and provide the requested information and documents and respond in a timely manner to move the diligence process forward. There may also be specific phone calls or meetings to discuss certain information or follow up on key points, all with the goal of the VC firm mitigating risk by understanding the business and legal position of your company.

Responding

When diligence kicks off, it's generally the case that you and your team at the company will be the holders of the majority of the information and documents that will need to be provided to the investors and their counsel. However, your Gunderson team will be involved from the get-go to make sure this process is handled efficiently and in an appropriate manner for the financing: both so that we can collectively be thoughtful about what information to provide and how to provide it, but also to be as quick and responsive as possible.

The Process

One of the biggest ways you can help the financing process along is by preparing for the diligence process. Taking time in advance of getting a term sheet to prepare for this can save a ton of time for your company while making the team look impressive to the investors and their counsel. Getting the necessary preparation together like organizing your files, gathering necessary documents, considering what key team members may need to be brought into the process to answer discrete questions (like product leads when discussing the development of your products and services, for example) and anticipating any issues around sensitive materials or topics can be incredibly helpful in managing a diligence process. Your Gunderson team can then

work with you to manage and coordinate presenting all of this information and documentation to the investors. For example, while you may need to collect all of your material contracts, Gunderson will help you organize them and review any questions on which documents are responsive to certain diligence requests. Some files may not be necessary to include, while others, for example, may be responsive to more than one request.

In addition, many times you and your Gunderson team may want to consider whether certain information should be produced in a certain manner, whether any redactions are appropriate, and/or the timing of certain disclosures. Your Gunderson team will be able to advise you on all manner of the diligence process to make sure the company responds efficiently while protecting its own interests.

Potential Issues

Assuming the process is completed with no large show-stopper issues, or “red flags” as they’re commonly referred to, being raised that jeopardize the investment, the VC firm will either sign off completely on the diligence, or if there are any concerns, determine how best to clean them up. To address these items, the VC firm may request items be addressed either before or after the closing of the investment.

For example, a VC firm may determine in the diligence review process that the company’s insurance coverage is too low for your industry or stage. To handle this, the VC firm might decide to require evidence that the insurance coverage has been adjusted before moving forward toward closing, or, alternatively, rather than put the deal on hold, the parties may include a provision in the investment documents requiring that the insurance coverage be increased within a certain period of time. Working to respond to and address any items raised by the investors is a key part of completing the diligence process.

Once all of the issues are addressed, the investment can move forward. Depending on the status of the transaction documents in the negotiation stage, this might mean moving to closing or toward finalizing the documentation.

Your Gunderson attorneys are experienced in handling legal diligence, both on behalf of the company and investors, so we know what to expect and the best ways to handle any potential issues that arise. We’ll be available to assist you to timely respond to any diligence requests and help manage the process smoothly.

Next section: [Part 4. Negotiating Terms and Transaction Documents](#)

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Venture Financing Process

1. The Pitch
2. Term Sheet Stage
3. Due Diligence
4. Negotiating Terms and Transaction Documents
5. Closing
6. Post-Closing
7. Timeline

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