

Resource

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“What can I do to get ready for this deal?”

“What will my lawyers spend their time on during this financing, and how will I work with them?”

These are questions we often hear from GCs and in-house attorneys as they prepare to take on corporate financing transactions, and this primer is aimed at providing an overview of steps you can take to position yourself for success and efficiency going

into a financing round. Given that these deals are not part of an in-house attorney's day-to-day workload, these tips may also be helpful for seasoned in-house attorneys getting ready for their second (or third, or fourth...) financing round as well.

As a General Counsel or other in-house attorney, you'll likely be responsible in one way or another for helping the company shepherd its corporate financing activities to a close. While it's impossible to foresee all the areas you might work on during a financing as an in-house attorney, being prepared—and helping your organization prepare—is always a good starting place.

Below is a list of a few early value-ads you can focus on to make the process go more smoothly and allow for time to be spent on the deal's important pieces rather than getting bogged down in road-blocks and process hiccups.

Check Your Pitch

As your team is putting together its pitch deck and other pitch materials, keep an eye on any legal disclosure obligations. The earlier you can craft and address any needed disclosures—and get your Gunderson team involved to help—the faster your team can confidently send the pitch to potential investors. If you can avoid a delay in the process by heading off needing to “stop the presses” at the last minute to add legal jargon, the happier your team will be.

You can also use this time to start understanding the type of deal you're hoping to land with your pitch. VCs will certainly want to know how much money you're looking to raise, and that will generally be discussed as part of your pitch. But you should also be prepared to counsel your team on the structures and types of financings that might be offered to you, and make sure your team is ready to potentially field a question or two from investors on the current capitalization structure and potential investment structures. For example, are you looking to avoid structured return terms in a priced equity round? Do you know what impacts might result from agreeing to certain valuations? Is the team comfortable to raise money in tranches or upon achieving certain metrics?

You can use this opportunity to start planning for how to assess and respond to offers for investments with your Gunderson team. Together, you can walk through your priorities with the fundraise, your goals and any “red-flags” that might cause you pause in accepting a new investment. And, of course, once a term sheet is offered, make sure to get it to your Gunderson team to work with you on your review!

Get Your Corporate Documents In Order

Chances are your company houses contracts and other key documents in various places—the cloud, a document management system/CMS, or employees' own files and email inboxes. The diligence process often forces companies to collect and organize their files into a central location for the first time, which can add days to the timeline. The better prepared you are for providing all relevant diligence materials, the faster the parties can move through that phase of the transaction.

You'll likely have to produce all key contracts and any key governance, equity, policy or other material documents, so get out ahead of collecting and organizing them into one place. This will likely entail working with various people across your organization, so you may want to give them as much time as you can to gather documents and create a process to make sure any new or additional documents are identified as well. If you don't currently have a CMS or other secure central file storage for this purpose, your Gunderson team can help provide this and help organize documents to prepare for their eventual production in the diligence process. Gunderson can also provide a standard due diligence request list to help you gather and organize these documents in advance.

An additional area to focus on here is to make sure your cap table is up to date with any recent issuances, terminations, transfers or other changes. Whether you use a cap table management system or keep the cap table internally, it will be used in the financing process as the basis to create a "pro forma" cap table to price out the new securities. The cap table numbers are also referenced in the financing documents as part of the "representations and warranties" in the purchase agreement, so accuracy is key. Work with your Gunderson team to confirm if there are any updates needed to the cap table, and pass along any relevant information so we can make sure you're as up to date as possible before going into the financing process.

Identify Diligence Issues

Since you're collecting all of your documents anyway, this is a good time to do an assessment of whether there may be any key diligence items that might be identified or noted by counsel to the investors that you could get a jump on handling. For example, do you have employee offer letters and IP agreements with all of your employees? Do you have copies of all equity issuances, including stock option agreements? Does your cap table line up with all of the equity that's been issued? Are any important insurance policies approaching expiration? Are there any pending or threatened litigations matters against the company or its representatives, or that the company is pursuing against a third party?

To the extent you're able to identify and get started on addressing any of these diligence-level questions, you'll be in a better position to either have the issues

corrected by the time diligence rolls around, or to tell the investors' counsel the plan for handling them. Having a good grip on and plan for your own diligence issues is a strong signal to the investors' counsel that the company knows how to address and manage internal issues appropriately and efficiently.

If there are any discreet issues the company has faced in the past, or if there are detailed intellectual property or technical questions that are likely to come up in the diligence process it's also worth thinking about assembling the relevant experts to assist with the diligence process. For example, are the company's products used in a novel way, and it would be helpful to have the product lead available to answer questions? Was there any past litigation, and would it be useful for the company's outside litigation counsel to be ready to answer questions? If so, consider when and how to let these folks know they may be needed to assist in the process.

Create a Plan to Review Term Sheets

We always recommend that you send any term sheets you receive to your Gunderson team to help you analyze and review them in an efficient manner. However, you won't always be the recipient of the term sheet proposal—it may get sent to a board member or your CEO without your knowledge. In these situations, excitement can get the better of people and term sheets can be signed hastily, with the idea that “we can fix any issues later,” or in other cases, with a board member or executive thinking they can negotiate the document on their own.

To avoid any premature decision-making that doesn't incorporate input from you and Gunderson, make sure your executive team is on board with a plan to have you and your Gunderson team be part of the term sheet negotiation process.

This can head off any term sheet level issues, avoid any re-trading down the line and prevent unforeseen consequences from agreeing to non-standard provisions that tie up the company unnecessarily.

Identify Your Stockholder Consent Base

An inevitable part of the financing process will be soliciting and receiving the approval for the financing from those stockholders with a right to vote on whether they approve the transactions. Based on your current governing documents, the universe of stockholders you'll need to approve the transaction may include several different sets of stockholders. For example, do you need just a majority of all stockholders? A majority of preferred and common holders? 60% of the Series A holders? Are there “key holders” that need to be contacted to sign relevant documents?

Identifying the stockholders you'll need to approve your transaction, and creating a plan for which holders to solicit and how to do such solicitation, shouldn't be put off until closing. For example, there may be holders who are unavailable and alternate methods may need to be used to reach them, or an alternate set of people need to be asked for approvals. Crafting a plan early can prevent last-minute delays.

Since the required approvals are generally set forth in the current financing and governance documents, rather than any new to-be-executed financing agreements, your Gunderson team can help you analyze your stockholder base to create the best plan for seeking such approval. Additionally, together you and your Gunderson team can craft communications to be sent to each such holder. Reach out to your Gunderson team early to get a head start on this and avoid coming up with this list at the last minute.

Get Ahead of Stock Options Issues

Once your company receives a term sheet, it should cease issuing any further stock options or other equity until a new 409A valuation report can be completed following the financing. This is due to the fact that 409A valuations may be relied upon for a 12-month period, or until the occurrence of a "material event" that could affect the company's stock price. Equity financings are one of the most common types of material event that triggers a need for a refreshed 409A valuation report for startup companies, and entering into a term sheet is generally considered to be the start of that event. Therefore, the receipt of a term sheet during the fundraising process is commonly cited as the time at which your company should stop relying on any previous valuation for the purposes of option grants.

You should be sure to communicate this concept directly with anyone responsible for the company's options process and make sure they're all well informed of the plan to pause equity issuances. This might include the HR team (so they can communicate timing and pricing expectations to new hires) and key executives (so they can speak accurately with the board and others). You'll want to avoid overpromising on options timing and pricing to any new hires or others awaiting stock option grants, and certainly want to avoid going to the board for approval, just to have to redo the process in the future.

Another potential step to consider is preparing talking points with the executive team regarding employee equity. When word gets out around a financing being on the horizon or in process, it's inevitable that people will have questions about the value of their equity and the financing's impact on dilution, pricing, etc. Preparing a list of talking points (including what information should and should not be shared with employees) can help team members handle these questions with confidence. It is

critical to consider confidentiality and potential deal leakage in any of these conversations. For example, will you disclose how much money you're raising in advance? Will you tell people what the new 409A valuation is and if so, when? Your Gunderson team can help you craft a plan for any and all of these potential questions and help get your executive team on the same page to be ready for these inevitable questions.

Identify Any Third Party Consent Requirements

Similar to identifying your stockholder base, you can start determining whether any specific third parties have consent rights over the transaction. While consent rights for financings are uncommon, a bank lender is one party that could have such rights. Some lending agreements provide that the lender either needs notice of, or in some cases has a consent right over, certain transactions like financings. You'll want to understand whether any of these arrangements exist in order to plan appropriately.

There are also rights that certain investors or other parties may have to potentially participate in your financing that you will need to address. For example, do any current investors hold "pro rata" or "pre-emptive" rights, through prior investment documents or even side letters, to get notice of, and potentially participate in, the financing? If so, proper steps must be taken in advance to provide all such notices, determine if any such participation will occur, and receive any approvals or waivers needed in order to close the financing. Do any banking partners, like venture debt lenders, hold investment rights they received as part of their lending agreement? Here again, if such rights exist, the company will need to take the appropriate steps to provide information to these parties and receive any needed approvals or waivers.

Even if Gunderson doesn't represent the company in bank lending transactions, we are happy to assist with reviewing any bank agreements—or any other third-party agreements—just for the purpose of determining if consent or notice is needed, and to assist in obtaining that consent.

Start Work on Known-Post Closing Items

When the financing begins, it may be clear from the term sheet or from discussions with your investors what some of the particular closing or post-closing requirements of the company might look like. Things like increasing the company's D&O Insurance policy limits, getting onto a cap table management platform, getting audited financials, or even more bespoke requests like obtaining a cyber-security audit, may all be included in what the investors expect either as closing conditions or as post-closing obligations of the company.

To the extent any of these are known, the company can get a head start on things like pricing out quotes for services and policies and preparing documentation. The goal is not to unnecessarily take on any additional costs (especially if the deal were to fall through) but to be as prepared as possible to make sure finalizing any agreements or coverage can occur on an appropriate timeline.

Other items may not be required by investors but might be an immediate want or need on the company's side, like a new 409A valuation of the company's common stock. It may make sense to reach out to the company's current valuation firm, if it has one, or to price out competitors, early in the process so they can start to gather information and be ready to deliver a valuation report soon after closing. Once a transaction closes and the funds hit the company's account, there is usually a strong desire to refocus on running the business, so whatever the company can do during the financing process to get ahead of these required post-closing items can help save time and hassle later on.

Gunderson has an extensive list of vendors and providers of services like D&O and other insurance and 409A valuations, so to the extent the company wants to start working on these items and needs a point in the right direction, we're happy to help find you the right partner.

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Types of investors providing capital to startups, basic terminology regarding the structure and focus of venture capital investors and an overview of basic types of venture capital financings.

Venture Financing Process

Seven-part series on the venture financing process from pitch to post-closing.

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