EDUCATIONAL NOTES TO THE COMMON TERM SHEET
April 2017

This paper will walk the reader through a section-by-section description of each part of the standard common term sheet. It will give the rationale and appropriate use of each section, company and investor perspectives, some examples and in some cases a short case study that seeks to clarify the use and importance of certain sections in a term sheet. The reader or investor should be able to determine what sections to use in addition to the recommended template common term sheet.

A - MINIMUM REQUIRED TERMS

1. Issuer

Name (the "Corporation")

Every term sheet starts with listing the full legal name of the entity that is selling or issuing the shares as outlined in the term sheet. This is a defined term and the name of the company will therefore not return later in the term sheet, we will see references to "Corporation" or "Issuer" only. The use of the term "Corporation" is recommended.

2. Business

The Corporation is a Toronto-based manufacturer of medical devices with offices in Toronto and Calgary.

The second clause in a term sheet makes it clear what the business the Corporation is active in, in this case we have the example of a medical device company. The key purpose here is to let the reader know instantly what the business is about and help the reader frame his or her point of reference when assessing the term sheet. In other words, an investor will typically read through the remainder of the term sheet with a certain perspective if he or she knows that the business is a software, medical device, cleantech or biotech company. It is also the opportunity to insert a geographical location that will further help in the full evaluation of the term sheet. The description however can and should be very short.

EXAMPLES

“ The Company is a Vancouver-based developer of mobile applications “

or

“ The Company is a Toronto-based manufacturer of medical devices with offices in Toronto and Calgary “

3. Financing

The Corporation is offering to issue 500,000 Common Shares of the Corporation at $1.00 per share (the “Purchase Price”), for a minimum of no less than $500,000 (the “Financing”) to a group of Investor(s) at a pre-money valuation of $2,200,000 and a post-money valuation of $2,700,000, representing a 18.52% ownership in the Corporation post-money.

The Corporation’s share capital consists of Common Shares and Common Share Purchase Options. As of the date of this Term Sheet, the Corporation has 2,000,000 Common Shares issued and outstanding, 200,000 Common Share Purchase Options are reserved under the Corporation’s Stock Option Plan (of which 150,000 have been granted).

There are no other securities of the Corporation outstanding.

This is the central clause of the term sheet that describes the size of the investment, the price and the class of shares that are offered. It will also explain in detail how many shares there are outstanding and of what class they are as well as other equity instruments that are outstanding such as stock options, warrants and convertible loans. Upon reading this section the Investor will know exactly what an investment in the Offering of Financing will mean in terms of ownership in the company. The clause includes the pre-money and post-money valuation of the company as well as the percentage ownership once the investment is completed.

This information will allow the investor to determine the company’s valuation before and after the investment. it is important to note that the data will allow anyone reading the term sheet to calculate the valuation. Sometimes this may include language like this:

The Corporation has issued promissory loans to existing investors in the amount of $75,000 that will convert at $1.00 per share concurrently with the closing of *the Financing at the same.*

In this case the $75,000 in value will be added to the total post money valuation and would reduce the ownership of the investors in this round to 18.02%.

The reader at this point will now know exactly what the Company or Issuer needs in dollar terms, where they are located and what business they are in.

Minimum Amount: The size of the Financing is based on what the business plan has informed the Corporation what they need to achieve certain milestones, they can be both commercial and/or technical. What is important for the investor to know is that with this statement the company signals that it has a certain level of confidence that with the amount of funds raised as indicated it can get to the next stage and will have sufficient cash to get there, at which time a subsequent financing round may be planned or the Company will be cashflow positive and has no need to further raise equity financing.

It is therefore very important to note that term sheets that say 'up to an amount of $1,000,000' should be viewed with some concern as it is not clear if that amount is $250,000, $300,000 or $1,000,000 and can be anything. The Company then signals that it does not know how much it needs and may end up raising an amount that will fall short of the business requirements. An investor should always ask the question what the amount required is and this number should be captured in the term sheet.

> *CASE STUDY*
>
> *A Vancouver-based company tried to raise $2,000,000 a number of years ago and set out to raise that amount from a few local angel investors. Within short order a total of $800,000 was raised after which it got harder to raise the balance of $1,200,000 while at the same time Christmas holidays loomed. The Company and its board decided in agreement with the angel investors to cash the $800,000 that was raised and continue the investment round after the holidays. What it had done at this point in time was to raise and cash an amount that was short of what the business plan required as a minimum, which was $2 million. On the face of it the Company's argument was reasonable but what it did not foresee was that business circumstances after the holidays would deteriorate (some orders did not proceed as expected) which put (a) more pressure on the business in terms of cash required and (b) made it harder to raise the remaining $1,200,000.*
>
> *As a result the Company got itself into a serious cash crunch and the bank that was financing its accounts payable pulled its lines forcing the*

Company into bankruptcy protection and a restructuring where the equity investors, most notably the group that had just invested $800,000, lost more than 90% of the value of their investment.

<u>*Learning Point:*</u> *The investors should never have agreed to close on the $800,000 before the minimum amount of $2,000,000 had been raised and closed. If that amount had been raised and closed the Company would likely have had enough cash to work through a period of low sales, been able to give comfort to its bank and been able to achieve the milestones it had originally presented to the investors.*

The most conventional and also most conservative way for investors to calculate the valuation of the company is to multiply all outstanding shares, options, warrants and share issued upon conversion by the price at which the Company offers its shares in the Term Sheet. Add to this the value for the Offering and you have both the pre-money and post-money valuation for the company.

The Company should also make a capitalization ('cap') table available as part of its package for investors, which will provide the exact detail of what is described in this section.

Good Practice: the right approach to this is to have a designated lawyer to collect investor cheques and only allow the company to cash them once the minimum amount and all other conditions as specified in the term sheet have been met by the Company on the date specified in the term sheet (see next). This can be covered in the Conditions Precedent to closing.

Milestones: in some cases, and this may depend on the industry the company is in, the Financing may tranched out and be released to the company when it achieves certain milestones.

Capitalization Table: a cap table or a summary thereof should be attached to the Term Sheet. The company can put one together using Excel of Numbers, another recommended option would be to use Captable.io which is a free online tool (this is a US tool, so note the use of the word "stock", where in Canada we use "shares", but is still an excellent way to do scenario building).

Note for Founders: It will be in the Founder's interest to get funding as soon as possible and the minimum closing requirement may not always be one that can be accomplished easily. This is an area where Founders and Investors will have to understand each other objectives fully and may require some flexibility in order to get to closing.

4. Close Date

The Corporation will not close the Financing unless subscriptions for the minimum amount of $500,000 is received, but no later than May 31, 2017, unless otherwise agreed by the parties.

Closely tied to the minimum sizing of the Financing is the Closing Date. Most companies will indicate the date they prefer to have the funds in the bank, giving a sufficient amount of time between the date the term sheet is presented to investors and the closing date so that the minimum amount can raised, investors can do due diligence and lawyers can paper the transaction. Generally, closing dates as set by companies are optimistic and it will be prudent to allow for a date that gives all parties sufficient time to complete the necessary tasks.

Given the mismatch between companies' expectations and the realities of closing an investment round, many companies will resort to a 'rolling close' which essentially means they will cash investor cheques as they come in. This is a potentially lethal approach as business circumstances can change (see the example under Section 4 above) and a company may not be able to reach the minimum required amount if it opts for a 'rolling close'.

Good Practice: The best way to do this and address the pitfalls highlighted under both Sections 3 and 4 is to insist on a minimum amount that can only be cashed on a fixed date. The easiest way to do this is to submit cheques 'in trust' to the company's lawyers (or other designated professional) with the instruction that they can only be released and cashed once the minimum amount has been collected. Alternatively funds can be wire to a lawyers' trust account.

Note for Founders: It will be in the Founder's interest to get funding as soon as possible and the minimum closing requirement may not always be one that can be accomplished easily. This is an area where Founders and Investors will have to understand each other objectives fully and may require some flexibility on both sides in order to get to closing.

5. Use of Proceeds

The Corporation will use the net proceeds of this Offering to complete the first release of its product, fund marketing activities and general corporate purposes.

In light of the above it is recommended to include what the funds are to be used for, note that this is only a general description but if gives the Investor some clarity as to where the funds raised will be deployed. Note that a detailed description is outside the scope of a term sheet and the Investor should refer back to the business plan and financial projections that the company provides in order to test their validity and appropriateness.

> *EXAMPLE*
>
> *" The Corporation will use the net proceeds of this Financing to complete the first release of it mobile platform, fund commercial activities and general corporate purposes "*

Good Practice: Investors should always ensure that the numbers presented in the term sheet tie back to the business plan and that there are sufficient funds to allow the company to achieve its milestones. It is also useful to ensure what relatively vague description like 'general corporate purposes' means. Some companies are inclined to have relatively high corporate overhead costs like rent and salaries and they tend to come under 'general corporate purposes'. The Investor(s) should ensure that they are comfortable with company's approach to fiscal management.

It is also important to note that Investors should ensure that their funds are not used to repay shareholder loans or expenses, unless the Investors and Corporation's founder come to an agreement on this prior to the closing date of the investment.

Note for Founders: Investors will expect a detailed budget to ensure that their funds will be spent appropriately. Although not a term sheet item this section is a brief reference that will need to be substantiated in the due diligence materials.

6. Share Option Pool

The Corporation agrees to maintain a Share Option Pool for the purchase of Common Shares that represents no more than [data field] % of the fully diluted ownership of the Corporation prior to the completion of the Offering contemplated herein. The Corporation will adopt a Share Option Plan that will govern the terms of all issued share options.

It has become increasingly important for Investors to know that there is no equity 'leaking' out of the company and the first tool that Investors have at their disposal is to put a cap at the number of Stock Options that can be issued to employees, directors, advisors or any other persons that perform services for the Company. Many companies that have limited cash resources use these as a tool to compensate, but they can become extremely dilutive and expensive over time. Note that Investors understand the value of having a pool and sometimes will even insist on it.

The basic rule is to cap the Stock Option Pool at a certain percentage of the outstanding shares in the Company, usually this percentage ranges anywhere from 10 to 20%. From an investor's perspective the rule is the lower the better.

EXAMPLE

" The Company agrees to maintain an Employee Share Option Pool (ESOP) for the purchase of Common Shares that represents no more than 15% of the fully diluted ownership of the Company following the completion of the Offering contemplated herein. Any amendment will be subject to shareholder approval "

Good Practice: The Shareholders Agreement will specify exactly what corporate actions require approval from the Board of Directors and which ones require a certain minimum approval from all shareholders. For instance, the increase of the Stock Option Pool will often require a minimum of 2/3 of all shareholders. This is an important tool to protect the rights of minority shareholders and it is recommended investors ensure these rights are in place.

Investors will also want to ensure that options are issued at Fair Market Value (FMV), ie. the exercise price on the option should never be lower than the price at which the most recent financing was completed. Any exceptions to this require shareholder approval.

Note for Founders: we have written this in such a way that the option pool is defined pre-money by default. Be aware of the so-called "post money option pool shuffle" made famous by the VentureHacks team in educating founders. This is a method where the percentage of options is defined post money, which actually decreases the effective valuation. See the VentureHacks post for more info: LINK

It is also important to note that Investors will want to have an option pool available in order to incent existing and new employees, but are very cautious of 'printing' equity instruments that will dilute them. Again a 10-15% cap is market, in future rounds this means the option pool can be topped up.

7. Decisions Requiring Approval

In addition to the requirements of corporate law, the following decisions of the Corporation will require approval by the Investors and by shareholders holding not less than [data field] of the issued shares as

specified in the Shareholders Agreement:

(1) amending the articles or by-laws of the Corporation;
(2) issuing shares of the Corporation, or issuing securities exercisable or convertible into shares of the Corporation;
(3) declaring dividends;
(4) redeeming or repurchasing any of the Corporation's shares (except upon the departure of a founder and or key employee, as contemplated in section 19 of this term sheet;
(5) making loans or guaranteeing debts (except in the ordinary course of business);
(6) incurring debt if the Company's aggregate indebtedness would be more than $[data field];
(7) entering into a non-arm's length transaction;
(8) entering into a business combination transaction (including an amalgamation or plan of arrangement);
(9) voluntarily liquidating or dissolving the Corporation; and
(10) selling (or otherwise encumbering, disposing of or transferring) all or substantially all of the Corporation's assets.

Optional:

Investors may also be required to sign a Voting Trust where voting rights attached to the Common Shares purchased in this offering are transferred to a trustee for a specified period of time.

Upon closing the Financing all shareholders will enter into a Shareholders Agreement or the new shareholders will agree to become part of an already existing Shareholders Agreement to the extent they are comfortable with it is contents. An existing Shareholders Agreement may be amended or replaced with a new one reflecting the terms agreed upon at the time of closing the Financing. The Shareholders Agreement will also specify a voting threshold for the aforementioned decisions to be formally approved, this usually ranges from 51 to 80%.

Note for Founders: This section will have a serious impact on how you run your business on a day-to-day basis and it will impact the room you have to make certain decisions. Given that these decisions have an impact on the position of Investors it is wise to negotiate each and agree on numerical values for each when entering into the final Shareholders Agreement.

8. Information

Corporation will submit to the Investors the following:

(a) management prepared quarterly financial statements within 30 days of the end of each quarter and accountant (Notice to Reader) prepared year-end financial statements within 90 days of each fiscal year end..

(b) quarterly management reports within 30 days of the end of each quarter.

(c) prepare and share a (board approved) budget at the start of each fiscal year and share any amendments thereto;

Optional:

(d) Corporation will submit reports and updates that the Investor may reasonably ask for from time to time.

If a Voting Trust is in place this information will be shared with the Trustee who will disseminate among the shareholders that are bound by the Voting Trust.

One of the key issues for investors is to understand how they will be kept informed of the Corporation's progress and how they can quickly understand if things are not moving in the right direction and action is warranted.

> *EXAMPLE*
>
> *" Company will submit management prepared quarterly financial statements within 45 calendar days of each quarter end and accountant prepared financial statements within 90 days of each fiscal year end.*
>
> *Company will submit quarterly management reports within 45 calendar days of each quarter end.*
>
> *Company will submit any information, reports and updates that the Investor may reasonably ask for from time to time "*

Good Practice: The challenge in this area is that by the time an Investor receives Company information most events are well in the past. This in particular is an issue if things are not going in the right direction or certain crises emerge (cash crunch, milestones not met, large contracts cancelled). Companies often have a habit to under-report bad news and over-report good news. Some companies make use of online reporting tools (e.g. Klipfolio LINK, Hockeystick LINK, Visible LINK) which track the Company's key performance in real time and offer easy to understand dashboards that will tell how a company is doing.

It is up to the Company and its investors to agree on the best communication tools which will include in-person meetings although it should be noted that company executives will not have the bandwidth to meet individually with each investor on a regular basis.

Note for Founders: A balance has to be found here between what a company can logistically report on a regular basis and what investors want and need to see. Founders may want to set up some systems and processes that will automate information sharing and thus reduce the time spent on this. Most of this information the company will have to prepare for internal purposes anyways. Note that if an employee exercises his or her share options, they will become a shareholder and be entitled to the same level of access to company information.

From time to time in person meetings with investors will be beneficial for both parties, a party or social event together with the AGM is also recommended.

9. Pre-Emptive Rights

Each Shareholder will have a right to participate in a subsequent issuance of securities based on its pro rata ownership, calculated on an as-converted basis for the Investors, and with a right of oversubscription for the Investors of shares unsubscribed by the other Investors.

This is a fairly common clause that ensures that any Investor that participates in this financing round has the right to be invited to participate (mostly on a pro-rata basis) in all future rounds. For most investors this is a 'must-have' clause and companies should in principle not have a major issue with this. It will enable continued alignment between the Corporation, the Investors and any new investors.

Note for Founders: This should not cause a founder any headaches, it is a standard market condition and cements the longer term relationship between the company and its investors.

10. Right of First Refusal

Before any shares of the Corporation are sold by a shareholder [to a third party], those shares must first be offered on a pro-rata basis to all other shareholders (based on the shareholders' then-current holdings of shares, calculated on an undiluted basis).

This too is a fairly standard clause that ensures that if one shareholders wants to sell his or her shares they remain within the current group of shareholders. A variation on this is a clause where these shares are offered to the

Corporation first and then to the other shareholders.

Good Practice: In general it should be a key objective to keep the group of shareholders as small as possible and to prevent getting too many outside shareholders in the corporate register. If and when it happens it is highly recommended to get new shareholders to sign a Voting Trust.

Note for Founders: Same as ‘Pre-Emptive Rights’. This should not cause a founder any headaches, it is a standard market condition and cements the longer term relationship between the company and its investors.

11. Tag-Along (or Co-sale)

If a third party offer is made to purchase shares of the Corporation from a shareholder, then the third party offer must be made on a pro-rata basis to all shareholders (based on the shareholders’ then-current holdings of shares, calculated on an undiluted basis).

These rights essentially protect minority shareholder rights and ensure that when an offer is made to acquire Company shares from one or a group of shareholder this offer is to b extended to all shareholders on a pro-rata basis. All shareholders have the right to ‘tag-along’ and benefit from the offer.

Note for Founders: Same as ‘Right of First Refusal’ and ‘Pre-Emptive Rights’. This should not cause a founder any headaches, it is a standard market condition.

12. Drag-Along Rights.

If a bona fide offer is made by an arm’s length third party to acquire all of the shares of the Company, and the offer is accepted by shareholders holding at least ■% of the shares of the Corporation (on an undiluted basis), then the remaining shareholders of the Corporation will be obligated to sell their shares pursuant to the third party offer.

Drag-Along rights are a crucial part of any investment as they deal with the situation where an offer is made for all outstanding shares of the Corporation. Not all shareholders may agree to the terms of this offer and in order to ensure that a sale of the Corporation can proceed a "drag-along" right is added to the Corporation's Shareholder agreement or Articles of Incorporation which will allow the holders of a certain percentage of all the issued shares (usually in the 51-70% range) of the Corporation to cause the sale of the Corporation. The lower the voting threshold, the easier it will be to ensure all shareholders are ‘dragged-along’.

CASE STUDY

A Montreal-based company that developed a hard and software solution for the corrugated box industry received an offer from an US-based company to acquire all of its outstanding shares. Company management was quite pleased with the offer as was the Board of Directors. Although not as high as hoped for initially the realization was that significant risk was involved to grow the company further which included further financing and penetrating a market that was difficult. The offer was fair and would give a decent return to all founders, employees and angel investors. Some of the investors however felt that a better return could be achieved and were disappointed that the board recommended to accept the offer. One shareholder in particular refused to approve the sale, his industry background was different and the company inferred that he did not fully understand the value of the offer given the company’s prospects in that industry.

The company had at one of its more recent AGM’s adopted an amendment to its articles which stipulated that if an offer were to be made to acquire all of the shares of the Company, and the offer is accepted by shareholders holding at least 70% of the shares of the Company then the remaining shareholders of the Company would be obligated to sell their shares pursuant to the offer. The one shareholder held out by not releasing his signature until five minutes before the official closing of the acquisition. Had he not done that the Company would have had to invoke the ‘drag-along’ clause, which would have been sufficient to close the transaction.

Good Practice: It is strongly recommended this be included in either the Shareholders Agreement or Articles of Incorporation. Not having this risks an eventual liquidity event and although there may be some smaller and disgruntled shareholders that want to stop an acquisition and wait out for a better deal, the rule of thumb is that a board approved transaction should proceed as soon as a majority of ‘shareholders is on board’.

Note for Founders: Agree with the Investors on the threshold.

13. Vesting

All share and share equivalents issued to founders and certain other key persons will be subject to vesting provisions that, to the extent they are not in place, will be incorporated in founder and key person employment agreements, the execution of which will be a condition

precedent to Closing.

Increasingly investors will want to ensure that the key executive and/or founders in the Corporation will continue to work for the Corporation to ensure its future success while ensuring they have a strong incentive to continue to do so. Vesting of shares is a key mechanism to accomplish this and in simple terms it ensures that the shares owned by a founder 'vest' over time, in other words the founder will not have full ownership until the vesting period has been completed. The vesting terms are normally documented in a founder's employment agreement with the Corporation, sometimes in the Shareholders Agreement.

It should be emphasized that vesting is not only used as an incentive to founders and employees to stay with a company and perform, it is enables companies to recoup shares if people move on and allocate the shares so gained to new employees.

Good Practice: From a company's perspective it is good practice to have an agreed vesting schedule in place even before investors come on board. It will deal with intra-founder issues that may emerge regardless of having investors in the company and moreover it will demonstrate to outside investors that the company's founders have pro-actively thought about this issue and dealt with it.

> *EXAMPLE I*
>
> *The most commonly used approach is to agree on a vesting schedule for shares that have already been issued and make them subject to a 'clawback' provision. In this way founder shares can (a) be voted and (b) benefit from the lifetime capital gains exemption under CRA rules. It is standard to let shares vest over 4 years (3 or 5 year vesting schedules are not unusual, often depends on the nature of the business and the negotiation between founders and investors) either by vesting an equal number of shares on a monthly or quarterly basis or cliff vesting. In a 'cliff vesting' a founder or employee becomes fully vested at a specified time rather than partial monthly or quarterly vesting periods, ie. upon completion of 2 or 3 or 5 years of service.*
>
> *In a 'clawback' or 'reverse vesting' scenario an employment or shareholders agreement will incorporate a schedule that will outline that the number of founder's shares that are subject to clawback over a period of time. This number would reduce as time moves on. If the founder or employee is terminated or leaves the company the board of directors would have the right to purchase back the shares that are still subject to vesting at a nominal price, say $0.0001.*

EXAMPLE II

In Quebec a somewhat similar approach is taken , although formulated differently as 'Restricted Shares'. Here is a clause from Anges Quebec for consideration:

" The Shareholders' Agreement will contain standard repurchase option of the shares owned by any Founder (for the purposes herein, the term "Founder" means each of and) in case of death, bankruptcy, incapacity, termination without cause, termination for cause, material breach of the Shareholders' Agreement, unauthorized transfer of shares or seizure of shares. If any Founder resigns at any time prior to the fourth anniversary of the Closing Date, the Restricted Shares (as defined below) owned by any Founder are subject to the right of repurchase by the Corporation at the lower of: (a) the fair market value of a common share at the time of repurchase of such share; or (b) the subscription price of that common share. "Restricted Shares" means all of the Shares held by the Founder less 2.0833% of such shares, which shall cease to be Restricted Shares effective as of the last day of each and every calendar month over a forty-eight (48) month period commencing on the closing date of the contemplated investment. All of the shares held by such Founder that have ceased to be Restricted Shares are subject to the right of repurchase by the Corporation at the Fair Market Value "

Note for Founders: As mentioned this is 'market'. The best way to address the issue is to pre-empt it and have it covered in employment agreements prior to engaging with investors.

14. Due Diligence

This Term Sheet does not provide a description of material information sufficient to describe the business and affairs of the Corporation. Potential investors may conduct such due diligence inquiries as they consider appropriate and the Corporation will provide access, subject to standard confidentiality provisions, to material documentation and information concerning the business, the Corporation and its respective management and third party advisors. Investors should, in conjunction with their professional advisers, make their own assessment of the merits and risks of any proposed investment in the Corporation.

This section gives the investors the right to conduct due diligence and stipulates that the investors have full access to all Corporation information and employees and that Corporation will answer any and all questions that investors may have. The Term Sheet can include a fixed date by which Due Diligence should be completed although the Closing Date as referred to in

Section 4 usually is deemed to be the date on which Due Diligence will be have been completed.

Good Practice: once the Term Sheet has been signed the investors will engage in Due Diligence and it is highly advisable that they ensure the Corporation has a data room set up with all required information and data, preferably using an online sharing service like Google Drive, Dropbox or Box. It is advisable to have this ready early in the process and should include the following at a minimum:

1. **Investor Materials**: Business Plan, Slidedeck, Executive Summary
2. **Corporate or Legal:** Incorporation documents, Share Register and Articles of Incorporation as well as a Capitalization Table.
3. **Financials:** accountant and management prepared historical financials and budgets and forward looking projections (3 to 5 years ideally)
4. **Team:** Founder & Employee Contracts, team biographies and resumes
5. **IP:** Intellectual Property, Patents
6. **Tax File:** with recent tax filings and SR&ED documentation the company uses
7. **Business Development**: Sales Pipeline, Sales deck, Marketing collateral
8. **Commercial Contracts:** all material sales contracts, licensing deals
9. **Media:** press clippings, links to online coverage, reports from third parties
10. **Other:** any other relevant information

Note for Founders: Following the presentation to Investors and the term sheet negotiation, this is the company's chance to shine and make a lasting impression while ensuring that the dollars hit your bank account sooner rather than later. A properly constructed and populated due diligence folder as described above will help accomplish that.

15. Closing Conditions or Condition Precedent

Closing of the financing will be subject to the following conditions, in addition to other customary closing conditions:

1. **Minimum Financing raised**
2. **Completion of Due Diligence**
3. **Execution of Shareholders Agreement**
4. **Execution of employee and key person employment agreements which include NDAs and IP assignment (may include key person insurance)**
5. **Appointment of board of directors**
6. **Conversion or payment of shareholder loans (or any other**

convertible instruments as the case may be)

7. **Confirmation that Corporation is a Canadian Controlled Private Corporation ('CCPC')**
8. **Ensure all legal documentation and corporate minute book is up to date**
9. **Establishment of Stock Option Plan**
10. **Tax credits have been applied for (depends on province)**
11. **Legal clean up and complete corporate minute book**
12. **No material adverse changes**
13. **A number of these are optional and will often depend on each situation, they will need to be negotiated in each investment case.**

There will be quite a few things that the investors will want to see in place before the funds are released to the Corporation. It will be hard to cover all of them in the Term Sheet as there will be a significant number that come up during the due diligence phase, but the list above is fairly comprehensive and market.

16. Subscriptions

The offering is only available to qualified or accredited investors, friends and family or close business associates, in reliance on an exemption from the prospectus requirements in Canada.

Minimum subscription is $25,000 per Investor and are to be filled on a 'first-come, first serve' basis. Individual subscriptions may be scaled back in case of an oversubscription.

It is important for all parties to understand how subscriptions are taken, ie. if there are more funds committed by investors than necessary will the Corporation oversubscribe or scale back?

Good Practice: The standard language is that subscriptions will be filled on a 'first-come, first serve' basis and that they will not be scaled back in case of an oversubscription. In particular in early stage situation the practice is to 'take money when it is on the table' rather than risk a cash shortfall at a later date when fundraising conditions may be less favourable.

Note for Founders: It is important to ensure that the company complies with relevant securities regulations, this is something where lawyers can assist and advise. Again, having money on the table is a good thing so you might as well take it as market conditions may change rapidly.

17. Documentation

Subscription Agreement which will include Representation and Warranties from both Corporation and its founders, and Shareholders Agreement or form to be bound to existing Shareholders Agreement, subject to Investor approval.

This section details what documents the Investor is expected to sign upon completion of the due diligence phase. In most circumstances this will be a Subscription Agreement and a Shareholders Agreement or a form that enables the new investors to become part of and/or adhere to the terms of an existing Shareholders Agreement. The Subscription Agreement will usually also include the necessary Exemption Forms depending on the jurisdiction.

Good Practice & Note for Founders: None, this is standard stuff.

18. Cost and Legal Counsel

Each party to this term sheet agrees to bear its own legal costs,

or:

Corporation agrees to bear its own costs and cover Investor legal cost up to a maximum of $ [data field, see notes]

Although in general – and in particular when using a standardized term sheet – companies and investors do not engage with formal counsel until such time a transaction is closed, it is generally advised to make clear who carries whose legal costs.

Upon closing the Corporation's lawyers will draft and help execute the Subscription Agreement and Shareholders Agreement and ensure the Corporate Register is properly updated. These costs will all be carried by the Corporation.

19. Confidentiality

Corporation and Investor will refrain from publicity and not disclose any information concerning this term sheet without the [written] approval of the other party, except as required by law and provided that the parties may disclose information to their accountants, legal counsel and other professional advisors.

Term sheets will include a standard confidentiality undertaking which is different from a mutual confidentiality undertaking which the Company and potential Investors may have signed at the outset of their discussion and which will generally deal with all information that the parties disclose while negotiating a potential transaction.

20. Expiry

This letter expires at 5PM, Pacific Daylight Time, March 31, 2017.

In order to keep a transaction moving and keep pressure on the parties to make a deal happen most term sheets will expire on a specific pre-agreed date. More importantly, once expired it will give either party the right to renegotiate the terms of what was agreed.

21. Binding Nature

This term sheet is non-binding apart from Sections 18, 19, 20, 21 and 22 which will survive termination of this term sheet.

This section simply explains which clauses are binding and thus survive a termination of the term sheet. Normally these are Cost & Legal Counsel, Confidentiality, Expiry, Binding Nature and Governing Law clauses.

22. Governing Law

This term sheet is governed by the laws of [province] and the laws of Canada.

This is standard and essential term in which the parties specify that any dispute arising under the term sheet shall be determined in accordance with the law of a particular jurisdiction. For Canadian companies bringing on US or overseas investors it is important to ensure that Canadian law is used, both from a practical and cost perspective.

B - OPTIONAL TERMS

B1. Investor (s)

“NAME” and other investors acceptable to the Corporation (collectively the “Investors” and each an “Investor”). The Investors will appoint a

single investor to lead the Investment with the Corporation (the "Lead Investor"). The Lead Investor (in consultation with the other Investors) shall finalize the terms of the Investment, as described herein."

In investor-led deals the investors will insert this clause to outline who they are and what specific role they play and what rights they have. Term sheets that are company-led will generally not have this clause, it is therefore largely an optional clause.

B2. Price Protection Rights

Also Known As: Anti-Dilution

In the event that the Company issues additional securities at a purchase or conversion price less than the applicable Purchase Price, such purchase and conversion price shall be reduced to the price or conversion price at which the new securities are issued.

This is fairly common term and is often negotiated as a downside protection policy by investors who are concerned that if the Corporation does not achieve its objectives or milestones it may have to raise capital below the price at which they have bought in. Essentially this section allows the investors to obtain additional shares in the Corporation as if they had invested at the newer and lower price that is now being offered. There are two key approaches to calculate the downside protection for existing shareholders:

1. Full ratchet is a price protection provision that for any shares sold by a company after the issuing of an option (or convertible security), applies the lowest sale price as being the adjusted option price or conversion ratio for existing shareholders. Full-ratchet anti-dilution protection allows an investor to have his percentage ownership remain the same as the initial investment. This is fairly drastic price protection clause and generally not favourable to the founders who will see their ownership diminish, although it can be argued that they have failed to deliver on the plans that were presented to the original investors who now risk dilution as capital needs to be raised at a lower price than what they had originally invested in.
2. Weighted Average is generally a better and fairer approach and rather than a Full Ratchet as it treats the original investors as if they are participating in the new, lower priced, round rather than just resetting the price of their original investment. Here is the formula:

EXAMPLE

In the event that the Corporation issues additional securities at a purchase price less than the current Class A Preferred Share conversion price, the conversion price will be adjusted in accordance with the following weighted-average formula:

CP2 = CP1 X (A+B) / (A+C).

CP2 = Class A Conversion Price in effect immediately after new issue.

CP1 = Class A Conversion Price in effect immediately prior to new issue.

A = Number of common shares deemed to be outstanding immediately prior to the new issue, calculated on an as converted basis and on a fully diluted basis.

B = Aggregate consideration received by the Corporation with respect to the new issue divided by CP1.

C = Number of shares issued in the subject transaction.

CP2 = CP1 X (A+B) / (A+C).

CP2 = Class A Conversion Price in effect immediately after new issue.

CP1 = Class A Conversion Price in effect immediately prior to new issue.

CASE STUDY

A company in Calgary that developed a cleantech product had just signed a term sheet with a group of angel investors presented to the Dragon's Den and during the show negotiated a valuation for the company that was well below what had been agreed with the investors in the term sheet. Funding had not yet taken place as the investors were just wrapping up due diligence. Although the investors watching the show realized that the Dragon's Den episode was pre-recorded and that valuations agreed on air would often be renegotiated with the Dragons, it raised a bit of concern as they realized that they were actually not protected in case a subsequent investment in this company would take place at a lower price, there was no down-round or price protection.

So when the company asked its investors to partially fund ahead of the closing date (and thus reneging on the closing and fixed amount terms discussed in Sections 3 and 4 here) the investors saw an opening to break open the term sheet and insert a price protection clause which duly happened using the formula presented in this section. The company got *funded and everyone was please with the deal, the deal made at the Dragon's Den never materialized.*

Section B3. Anti-Dilution Rights

The term Anti-Dilution is often mistaken for Price Protection. In its literal sense, Anti-Dilution rights mean the right to maintain a certain ownership position once the Investor has invested a certain amount in a company. Say for instance the Investor owns 5% than the Anti-Dilution right will guarantee that he or she will retain that 5% ownership regardless of subsequent investment rounds at a higher valuation.

Good Practice: This is a rare right that is hardly ever used as it gives an unfair advantage to the Investor that obtains that right. Apart from a negative impact on the founder it will in all likelihood scare future investors away from the Corporation as they would view such a condition unfair to both the Corporation's original founder and to themselves as new investors. That said, some investors will try and negotiate this right (in very high risk and/or very early stage situations), however rarely with success. In some jurisdictions these provisions are valid only if made explicit in the company's articles.

This is not 'market' and any protection when it comes to share price should in most circumstances be restricted to Price Protection as described above.

B3. Board of Directors

The Corporation's Board of Directors currently consists of two (2) directors. Prior to the completion of the Offering the Board of Directors shall be increased in size to three (3) directors, the investors in the Financing shall appoint one of the three directors.

Investors will have the right to appoint an Observer.

It has become good practice for companies to disclose in the Term Sheet who serve on the Board of Directors. This not only serves as information about the people behind the Corporation, it generally sets the stage for governance once the Corporation has completed the Financing. To that end this section will usually outline who will serve on the Board of Directors, or more specifically who on behalf of the investors in the Financing will serve on the Board going forward. This is the opportunity for investors to ensure that their voice is heard on a Board and ensure that the minority position they have is represented on the Board of Directors.

Note that in early stage seed deals this is often not invoked and a Board of

Directors with outsiders often comes about in later rounds, notably Series A. That said in some investor-led deals there will be a requirement to nominate an investor representative to the Corporation's Board and this clause can be used for that purpose.

Good Practice: In most early stage companies and prior to a first round of investment , the original founders usually form the Board of Directors. The first financing offers the opportunity to elect a group of Directors that not only represent the founders, but also other investors and in some case this can be specified and negotiated in a term sheet. It is recommended that investors are satisfied that their interests are sufficiently represented on a Board of Directors.

In general a Board would consist of an uneven number of directors and range in size from anywhere between 3 and 5 directors at the earlier stages of the Corporation. Potential Directors should be aware of Director's liability, Director's compensation (mostly stock options and/or a per meeting fee) and the frequency at which board meetings are held. It will also be important to understand what is expected of directors on an ongoing basis in terms of time commitment and contributions, including managing the expectation of committing further funds.

Most companies will purchase Directors and Officers Insurance ("D&O Insurance) but this would have to be agreed with the new board and the recurring annual cost of it also has to be taken into account.

Investors may also ask to appoint an Observer to board meetings. This person does not have any fiduciary obligations or the right to speak during board meetings. The observer role merely functions as a 'check' on corporate proceedings to see what is going on. In practice observers tend to actively participate in board meetings and that may have some benefits if his or her contributions are productive.

B4. Exclusivity

Also Known As: No Shop

From the date of acceptance of this Term Sheet until the earliest of (a) the Closing Date (b) the formal termination of negotiation by both the Investors and the Corporation, the Corporation will not directly or indirectly solicit, initiate or participate in any discussions or negotiations with, or encourage or respond to any inquiries or proposals by any persons, Corporation or group other than the Investors, concerning any financing or sale of the Corporation without prior

approval of the Investors.

An Investor or a group of Investors will in some case want to ensure that the Corporation continues on the process as outlined in the Term Sheet and not try and seek a better deal from other investors and walk away from the existing deal they have just signed. One way to protect this is to insist on Exclusivity for a certain amount of time, say a few months, upon which that Exclusivity will expire. The Investors may insist on a monetary penalty ('Break-up Fee') if the Company breaks the Exclusivity clause although this is rarely seen in early stage situations.

B5. Tax Credits

Depending on jurisdiction, and whether the Corporation qualifies, the Corporation would insert appropriate language here that outlines its commitment to obtain the relevant tax credits for each eligible investor participating in the Offering.

Example (BC): The Corporation is an Eligible Business Corporation ("EBC") under the terms of the British Columbia "Small Business Venture Capital Act" ("SBVCA") and will apply for a 30% tax investment credit for BC-based investors for investment made up to March 1, 2018.

Tax Credits are increasingly becoming a feature of early stage investment in a number of provinces. Depending on the jurisdiction the purpose of this clause is to ensure that the Company has tax credit capacity available for the investors participating in the financing and that it will make every effort to ensure the tax credits are applied for. Please refer to the separate one-pager that lists all tax credits per province.