



## NACO Common Docs

In Q1 of 2017, NACO created a task force of members and stakeholders, including leading law firm partners, to develop nationally applicable and accepted best practices for structuring Angel stage deals.

The goal of the project was to develop standards that guide investors to structure deals that:

- Align the interests of the investor and investee;
- Position the company for future investment and growth;
- Protect the rights of the investor;
- Reduce the friction inherent in negotiating deal terms;
- Advisor Agreements;
- Automated Template tools.

The following organizations partnered with NACO and provided the necessary resources to make this initiative possible.

National Best Practice Partners:

Canada



Founding Partners

MLT AIKINS  
WESTERN CANADA'S LAW FIRM



MCINNES  
COOPER

Bennett  
Jones

FASKEN  
MARTINEAU

BCF BUSINESS  
LAW

CARAVEL LAW

## STANDARD NACO TERM SHEET for PREFERRED SHARES [DATE]

### A- MINIMUM REQUIRED TERMS

**1. Issuer**

[Name] (the "Corporation")

**2. Business**

The Corporation is a [city]-based [Insert brief description of business].

**3. Financing**

The Corporation is offering to issue [500,000] Class AA preferred shares (the "Preferred Shares") of the Corporation (the "Common Shares") at \$[1.00] per share (the "Purchase

[Name] (the "Corporation")

## 2. Business

The Corporation is a [city]-based [Insert brief description of business].

## 3. Financing

The Corporation is offering to issue [500,000] Class AA preferred shares (the "Preferred Shares") of the Corporation (the "Common Shares") at \$[1.00] per share (the "Purchase Price"), for a total of \$[500,000] (the "Offering" or the "Financing") to a group of investors (the "Investors") at a pre-money valuation of \$[2,200,000] and a post-money valuation of \$[2,700,000], representing a fully diluted [18.52]% ownership in the Corporation post-money. The Corporation's share capital consists of Common Shares and options to purchase Common Shares ("Options"). As of the date of this term sheet, the Corporation has [2,000,000] Common Shares issued and outstanding, [200,000] 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. A capitalization table is attached as a schedule to this term sheet.

## 4. Closing Date

The Corporation will not close the Financing unless subscriptions for the aggregate minimum amount of \$[500,000] are received from Investors. The Financing will close no later than [Date], unless otherwise agreed by the parties to this term sheet.

## 5. Liquidation Preference

In the event of any voluntary or involuntary liquidation, dissolution or winding-up of the Corporation, the holders of the Preferred Shares will be entitled to receive in preference to the holders of any other class of shares [1.0]x the Purchase Price plus unpaid dividends on each such share (the "Liquidation Preference").

*Note: a 1x Liquidation Preference is standard but it can be higher*

After payment of the Liquidation Amount, the holders of Preferred Shares participate pro-rata with holders of the common shares on an as-converted basis in the distribution of the remaining assets.

## 6. Conversion Rights

- (a) The Preferred Shares will be convertible into Common Shares at any time at the option of the Investors at an initial conversion rate of one Common Share for each Preferred Share, subject to adjustments for anti-dilution and subject to proportional adjustments for stock splits, stock dividends, and similar events.
- (b) All Preferred Shares will be automatically converted into Common Shares, at the then applicable conversion rate, (i) upon the closing of a firmly underwritten public offering of Common Shares of the Corporation at a per share price not less than [3.0]x the Purchase Price (as adjusted for stock splits, dividends and similar events) and for a total offering of not less than \$[30] million (before deduction of underwriters commissions and expenses) or (ii) if the holders of at least [66⅔]% of the then outstanding Preferred Shares vote in favor of such conversion.

*Optional*

- (c) *If within three years of the last Closing Date of this Offering the Corporation issues securities having rights, privileges or priorities that are senior to the rights, privileges or priorities of the Preferred Shares, the Investors will be entitled to exchange their Preferred Shares for such number of senior securities as would have been issued to the Investors if they had originally purchased such senior securities for the total amount raised under the Financing.*

## 7. Voting Rights

The holders of Preferred Shares will be entitled to receive notice of and attend any meeting of the shareholders of the Corporation and will be entitled to vote together with the Common Shares as a single class.

or

**The holders of Preferred Shares will vote together with the Common Shares on an as-converted basis as a single class, and not as a separate class, except (i) holders of a majority of the then outstanding Preferred Shares will be entitled to elect one member of the Board, (ii) as provided under "Protective Provisions" above or (iii) as required by law.**

## 8. Price Protection Rights

Shares as a single class.

or

**The holders of Preferred Shares will vote together with the Common Shares on an as-converted basis as a single class, and not as a separate class, except (i) holders of a majority of the then outstanding Preferred Shares will be entitled to elect one member of the Board, (ii) as provided under “Protective Provisions” above or (iii) as required by law.**

## **8. Price Protection Rights**

Also Known As: Anti-Dilution

*If the Corporation issues additional securities at a purchase or conversion price less than the Purchase Price (subject to customary exclusions), the conversion price of the Preferred Shares will be subject to a [full ratchet / weighted average] adjustment to reduce the dilution of the Investors based on the price or conversion price at which the new securities are issued.*

*There are two common ways to adjust the share allocation in a scenario like this: (1) weighted average (broad-based or narrow-based) and (2) full ratchet. See notes.*

## **9. Dividends**

The Preferred Shares will accrue dividends as may be declared by the Corporation. No dividends are contemplated at present.

or:

The Preferred Shares will carry an annual preferential cumulative dividend of [**6 - 8**] % of the Purchase Price (the “**Preferential Dividend**”). Once the Preferential Dividend is fully paid, the holders of Preferred Shares have the right to receive, *pari passu* with the holders of Common Shares, on an as-converted basis, any other dividends declared by the Corporation.

*Note that if dividends are agreed to be part of the deal they will accrue and become part of the amount that will convert to Common Shares as outlined in Section (2) above.*

## **10. 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.

## **11. Share Option Pool**

The Corporation agrees to maintain a Share Option Plan providing for an option pool for the purchase of Common Shares that represents no more than [**•**] % of the fully diluted ownership of the Corporation [*prior to*][*after*] the completion of the Financing. All options issued under the Stock Option Plan are and will be subject to customary vesting provisions and will have an exercise strike price equivalent to the fair market value at the time of grant.

At closing, the Corporation will adopt a new [**or amended**] Share Option Plan that will govern the terms of all issued Options.

## **12. Protective Provisions**

In addition to the other modifications required to reflect this term sheet, the [**Amended**] Shareholders’ Agreement of the Corporation will include the requirement that approval of holders of at least [**66 2/3**] % of the then outstanding Preferred Shares is required before any of the following actions are taken (with respect to the Corporation or its subsidiaries):

- (a) amending the articles or by-laws of the Corporation;
- (b) creating or authorizing the creation of or issue any other security convertible into or exercisable for any equity security, having rights, preferences or privileges senior to or on parity with the Preferred Shares, or increase the authorized number of Preferred Shares;
- (c) declaring dividends or returning capital;
- (d) redeeming or repurchasing any of the Corporation’s shares (except upon the departure of a founder and or a key employee);
- (e) making loans or guaranteeing debts (except in the ordinary course of business);
- (f) incurring debt if the Corporation’s aggregate indebtedness would be more than \$[**•**];
- (g) entering into a non-arm’s length transaction;
- (h) entering into a sale of the Corporation or business combination transaction (including an amalgamation or plan of arrangement);
- (i) voluntarily liquidating or dissolving the Corporation; and
- (j) selling (or otherwise encumbering, disposing of or transferring) all or substantially all of the Corporation’s assets.

## **13. Information**

- (g) entering into a non-arm's length transaction;
- (h) entering into a sale of the Corporation or business combination transaction (including an amalgamation or plan of arrangement);
- (i) voluntarily liquidating or dissolving the Corporation; and
- (j) selling (or otherwise encumbering, disposing of or transferring) all or substantially all of the Corporation's assets.

### **13. Information**

The Corporation will provide the Lenders with the following:

- (a) annual reviewed (or audited, if available) consolidated financial statements for the Corporation (including its income statement, balance sheet and cash flow statement) within 90 days of the Corporation's financing year-end;
- (b) management prepared (in accordance with GAAP) quarterly financial statements within 30 days of the end of each quarter and accountant prepared year-end financial statements (audited if required by law, but if waived Notice to Reader at a minimum) within 90 days of each fiscal year end;
- (c) quarterly management reports within 30 days of the end of each quarter;
- (d) a (board-approved) budget at the start of each fiscal year and any amendments thereto; and
- (e) any other document reasonably requested by the Lender.

*Optional:*

- (f) *reports and updates that the Lenders may reasonably ask for from time to time;*
- (g) *access to a metrics platform (Hockeystick, Klipfolio, Google Docs) to share regularly updated data (if appropriate for business); and*
- (h) *monthly updates.*

If a voting trust is in place this information will be shared with the trustee who will disseminate among the Lenders that are bound by the voting trust.

### **14. Pre-Emptive Rights**

Each Investor will have a right to participate in a subsequent issuance of securities based on its pro rata ownership and with a right of oversubscription for the Investors of shares unsubscribed by the other Investors.

*Include the "as converted" language if the Investors hold convertible securities. Note that some provinces have mandatory pre-emptive rights.*

### **15. 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 such shareholders' then-current holdings of Common Shares, subject to any restrictions in the Corporation's articles.

### **16. 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 Common Shares).

### **17. 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 Corporation, and the offer is accepted by shareholders holding at least [**•**] % of the then outstanding Common Shares [**calculated on an as-converted basis for the Investors but otherwise**] calculated on an undiluted basis, then the remaining shareholders of the Corporation will be obligated to sell their Common Shares pursuant to the third party offer.

### **18. Vesting**

All Common Shares and share equivalents (including options) issued to founders and certain other key persons will be subject to customary 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.

### **19. Due Diligence**

This term sheet does not provide a description of material information sufficient to describe the business and affairs of the Corporation. 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

in place, will be incorporated in founder and key person employment agreements, the execution of which will be a condition precedent to closing.

#### **19. Due Diligence**

This term sheet does not provide a description of material information sufficient to describe the business and affairs of the Corporation. 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.

#### **20. Closing Conditions**

Closing of the Financing will be subject to the following conditions, in addition to other customary closing conditions, including but not limited to:

- (a) minimum Financing raised;
- (b) completion of due diligence;
- (c) execution of unanimous shareholders agreement by the Investors and all other shareholders (the "**Shareholders Agreement**");
- (d) execution of employee and key person employment agreements which include vesting provisions (if applicable), NDAs and IP assignment (and may include key person insurance);
- (e) appointment of a board of directors;
- (f) conversion or payment of shareholder loans (or any other convertible instruments as the case may be);
- (g) confirmation that the Corporation is a Canadian Controlled Private Corporation (CCPC);
- (h) completion of all legal documentation and corporate minute book being up to date;
- (i) establishment of new/amended Share Option Plan;
- (j) tax credits have been applied for (depends on province); and
- (k) no material adverse change.

*A number of these are optional and will often depend on each situation, they will need to be negotiated in each investment case.*

#### **21. Subscriptions**

The Offering is only available to accredited investors and friends, family or close business associates, in reliance on an exemption from the prospectus requirements in Canada as outlined in National Instrument 45-106.

The minimum subscription is \$[25,000] per Investor. Individual subscriptions may be scaled back in case of an oversubscription.

#### **22. Documentation**

At Closing, the following agreements will be entered into:

- (a) Subscription agreements, which will include customary representations and warranties from the Corporation and the Investor, with a survival period of [two] years.
- (b) Shareholders Agreement or joinder to the existing Shareholders Agreement, subject to Investor approval.
- (c) Share Option Plan, subject to Investor Approval.

*Optional*

- (d) *Employment agreements as contemplated above.*

#### **23. Cost and Legal Counsel**

The Corporation agrees to bear its own costs and cover the Investor's legal costs up to a maximum of \$[●] in the aggregate.

or

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

#### **24. Confidentiality**

The Corporation and the Investors 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

maximum of \$[●] in the aggregate.

or

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

**24. Confidentiality**

The Corporation and the Investors 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.

**25. Expiry**

This term sheet expires at [Time] on [Date].

**26. Binding Nature**

This term sheet is non-binding, except for Sections 23, 24, 25, 26 and 27, which are intended to be binding and which will survive termination of this term sheet.

**27. Governing Law**

This term sheet is governed by the laws of [Province] and applicable federal laws of Canada.

**B - EXTENDED TERMS**

**B1. Redemption Rights**

*If the Corporation has not been sold or listed on a public stock exchange after 5 (five) years following the Closing Date, each Investor will have the right at its option, from time to time, and subject to applicable law, to require the Corporation to redeem some or all of its Preferred Shares. Upon each such redemption the Corporation will pay the holder of such Preferred Shares being redeemed the higher of: (i) an amount equal to the Purchase Price plus declared and unpaid dividends; and (ii) an amount equal to the then fair market value of the Common Shares issuable upon conversion of such Preferred Shares. [Note: to avoid the discussion about the difference in value between a Common Share and a Preferred Share]*

*Optional:*

*To the extent that the Corporation's available cash flow does not permit a full redemption, the remainder will be paid in the form of a one-year promissory note to each unredeemed holder of Preferred Shares bearing interest at a rate of [10]% per annum, and the holders of a majority of Preferred Shares will be entitled to elect a majority of the Corporation's Board of Directors until all principal and interest owing under such notes are paid in full.*

*Alternatively the Corporation can be given the same right to redeem the Preferred Shares at its sole option. This is a negotiation item.*