

# Term Sheet (Model Form)

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**[DATE]**

**NEWCO, INC.**

## **MEMORANDUM OF TERMS FOR PLACEMENT OF CONVERTIBLE PREFERRED**

This memorandum summarizes the principal terms with respect to a private placement of equity securities of Newco (the "Company") by a group of Investors (the "Investors").

### **Introduction**

The Company was incorporated in Delaware on [\_\_\_\_]. It presently has an authorized capitalization consisting of [\_\_\_\_] shares of Common Stock ("Common"), [\_\_\_\_] shares of which have been issued to [\_\_\_\_] shareholders, and [\_\_\_\_] shares of preferred stock, [\_\_\_\_] shares of which have been issued to [\_\_\_\_] shareholders.

The Founders of the Company have purchased and paid for in full [\_\_\_\_] shares of the Company's Common at a price of [\_\_\_\_] per share. In addition there are outstanding options to purchase in the aggregate [\_\_\_\_] shares of Common at prices ranging from \$[\_\_\_\_] to \$[\_\_\_\_] per share of Common.

### **Proposed Private Placement**

The Company and the Investors propose a private placement of shares of Preferred Stock on the following terms:

#### **Amount**

\$[\_\_\_\_]

#### **Type of Security**

Series A Preferred Stock ("Preferred"), convertible into Common Stock representing [\_\_\_\_]% of the outstanding securities of the Company on a fully diluted basis.

*In a well drafted term sheet, clarity can be enhanced if the parties agree on a cap table, viz.:<sup>[1]</sup>*

## Price Per Share

\$[\_\_\_\_\_] ("Original Purchase Price").

## Milestones

It is contemplated that the \$[\_\_\_\_\_] Price to Investors will be available in two take-downs, the first \$[\_\_\_\_\_] on the occasion of a letter of intent or interest including a comprehensive marketing plan from a major manufacturer to join in a business partnership with Newco Inc. to market [Product] (the "Product"). The second \$[\_\_\_\_\_] , comprising the balance of the funds, will be advanced coincident with the execution by the Company of a formal strategic alliance with such major manufacturer.

## Milestones: Rights, Preferences, Privileges and Restrictions of Preferred Stock

**1. Dividend Provisions:** The holders of the Preferred will be entitled to receive dividends at the rate of \$[\_\_\_\_\_] per share per annum whenever funds are legally available and when and as declared by the Board. No dividend shall be paid on the Common at a rate greater than the rate at which dividends are paid on Preferred (based on the number of shares of Common into which the Preferred is convertible on the date the dividend is declared). Dividends on the Preferred will be in preference to dividends paid on the Common. Dividends on the Preferred will be cumulative.

*If dividends are cumulative, what happens upon voluntary conversion by the holder? Accumulated dividends disappear? They are paid in cash (usually without interest)? They entitle the holder to, pro tanto, more stock? What happens upon a merger in which the issuer does not survive? Upon a redemption at the option of the holder? The Company? See following discussion:*

**2. Liquidation Preference:** In the event of any liquidation or winding up of the Company, the holders of Preferred will be entitled to receive in preference to the holders of Common an amount ("Liquidation Amount") equal to the Original Purchase Price plus any dividends declared [cumulated] on the Preferred but not paid [and then to share with the holders of the Common in the remaining assets on an as-if-converted basis]. A consolidation or merger of the Company, in which the Company does not survive, or a sale of all or substantially all of its assets shall be deemed to be a liquidation or winding up for purposes of the liquidation preference.

*The language in brackets makes the preferred a participating preferred.*

**3. Conversion:** A holder of Preferred will have the right to convert Preferred, at the option of the holder, at any time, into shares of Common. The total number of shares of Common into which Preferred may be converted initially will be determined by dividing the Original Purchase Price by the conversion price. The initial conversion price [plus the total amount of accrued but unpaid dividends] will be the Original Purchase Price. The conversion price of shares of the Preferred will be subject to proportional adjustment for stock splits, stock dividends and similar events, and to adjustment on a weighted average basis for issuances at a purchase price less than the then-effective conversion price.

*The language in brackets is highly dilutive to the common, and of relatively recent original... roughly the equivalent of PIK dividends. See also the Note on Participating Preferred.*

**4. Automatic Conversion:** Preferred will be automatically converted into Common, at the then applicable conversion price, in the event of an underwritten public offering of shares of the Common of the Company at a public offering price per share (prior to underwriter commissions and expenses) that is not less than

seven times the Original Purchase Price in an offering greater than \$[\_\_\_\_\_] (a "Qualified IPO").

*The Preferred may be mandated to convert upon the vote of a certain percentage of the holders.*

**Alternative 1: "Full Ratchet" Antidilution:**

**5. Antidilution Provisions:** The conversion price of the Preferred will be subject to adjustment on a full ratchet basis to prevent dilution if the Company issues additional shares, subject to certain exceptions (including: (i) the issuance of capital stock to employees, consultants, officers or directors of the Company pursuant to stock purchase or stock option plans or agreements approved by the Board (including options granted prior to the financing), (ii) the issuance of securities in connection with acquisition or merger transactions, (iii) the issuance of securities to financial institutions or lessors in connection with commercial credit arrangements, equipment financings or similar transactions, (iv) shares issued upon conversion of shares of Series A Preferred ("Preferred Stock"), (v) the issuance of securities in a public offering, (vi) the issuance of securities pursuant to the Warrants and currently outstanding options, warrants, notes or other rights to acquire securities of the Company, (vii) stock splits, stock dividends or similar transactions or (viii) the issuance of the Warrants). No adjustment to the conversion price will occur for any issuance of additional shares at a purchase price in excess of the current conversion price.

*"Full ratchet" anti-dilution protection was not the norm in a venture capital business until recently. It anticipates a reduction in the conversion price of a convertible preferred (and therefore an increase in the number of common shares issued to the holder upon conversion) on a dollar for dollar basis with the difference between the price per share paid, either expressly or notionally, in the so called "down round" (the dilutive round) and the price per share and the conversion price of the convertible preferred immediately prior to the down round. Thus for example if the conversion price is currently \$10 per share (which divided into the initial cost of a convertible preferred share of \$100 means 10 shares of common stock issued for each share of convertible preferred traded in) and the price per share in the dilutive round is \$5 then the conversion price becomes automatically \$5 meaning that 20 shares will be issued versus 10 upon conversion. The reason full ratchet anti-dilution protection is viewed as unfair is it does not take into account the amount of the financing in the down round. Hypothetically, and in fact in accordance with the documents, the issuance of even one share (as against say 5,000,000 shares outstanding) at a price of \$5 in the example cited would ratchet down the conversion price of all of the entire convertible preferred shares outstanding from \$10 to \$5. The weighted average anti-dilution provisions take into account the relative amount of the financing and therefor the perceived injury to the existing holders of convertible preferred; the full ratchet provision does not.*

**Alternative 2: Weighted Average Antidilution:**

**5. Antidilution Provisions:** The conversion price of the Preferred will be subject to adjustment to prevent dilution in the event that the Company issues additional shares (other than Reserved Employee Shares) at a purchase price less than the then applicable conversion price. The conversion price will be subject to adjustment on a weighted basis, which takes into account issuances of additional shares at prices less than the applicable conversion price.

**Alternative 3: "Pay-or-Play":**

**5.** If the Company issues additional shares (other than Reserved Employee Shares) at a purchase price less than the then applicable conversion price, holders who "Participate" in such issuance will have the conversion price of their shares of Preferred adjusted on a [WEIGHTED AVERAGE or FULL RATCHET] basis.

A holder shall be deemed to decline to "Participate" in an issuance if such holder does not offer to purchase

at least the same percentage of such issuance as constitutes such holder's percentage of the Conversion Shares (as determined under "Information and Registration Rights" below). If a holder declines to Participate, the Preferred held by such holder shall automatically be converted into Common at the then applicable (*i.e.* prior to the transaction) conversion price.

*See Note on Pay-or-Play*

**6. Voting Rights:** Except with respect to election of Directors, a holder of Preferred will have the right to that number of votes equal to the number of shares of Common issuable upon conversion of its Preferred. Election of Directors will be as described under "Board Representation and Meetings" below.

**7. Events of Default:** In the event of the occurrence of any of the "Events of Default" listed below, the Investors will be entitled to elect a majority of the members of the Board of Directors. "Events of Default" shall be (i) the voluntary termination of employment of the Founder, (ii) the termination of employment of the Founder for cause, or (iii) the death or complete disability of the Founder. The rights upon the occurrence of an Event of Default will expire on a Qualified Public Offering or a merger or like reorganization in which the Company does not survive.

**8. Protective Provisions:** Consent of the holders of at least a majority of the Preferred will be required for any action which (i) alters or changes the rights, preferences or privileges of the Preferred materially and adversely, (ii) increases the authorized number of shares of Preferred, (iii) creates any new class of shares having preference over or being on a parity with the Preferred, or (iv) involves sale by the Company of a substantial portion of its assets, any merger of the Company with another entity, or any amendment of the Company's articles of incorporation.

## Redemption

On the fifth, sixth and seventh anniversaries of the closing, each holder of Preferred shall be entitled to demand that one-third of the number of shares of Preferred originally purchased by such holder be redeemed by the Company, at a price equal to Original Purchase Price [plus accumulated but unpaid dividends]. To the extent that the Company may not at any such date legally redeem such Preferred, such redemption will take place as soon as legally permitted.

## Information and Registration Rights

*If the Company has shares outstanding with information and registration rights.*

- **Merger of Rights:** It shall be a condition of closing that the information and registration rights provisions of the agreement dated [date] between the Company and certain purchasers of the Company's stock will be merged with the registration rights of the Preferred Investors to be set forth in a Registration Rights Agreement (the "Rights Agreement") to be drafted by counsel to the Preferred Investors. All shares subject to such information and registration rights provisions shall be "Conversion Shares" as such term is used below. The Rights Agreement shall provide that:

*Inconsistent voting rights in connection with multiple demand registrations is a common drafting infelicity.*

- **Information Rights:** So long as an investor holds Preferred or at least 5% of the Conversion Shares, the Company will timely furnish such investor with budgets and monthly financial statements. The obligation of the Company to furnish budgets and monthly financial statements will terminate upon a public offering of Common.
- **Demand Registration Rights:** If, at any time after the earlier of the Company's initial public offering

and the date three years from the purchase of the Preferred (but not within 6 months of the effective date of a registration), Investors holding at least 50% of the Conversion Shares request that the Company file a Registration Statement for at least 20% of the Conversion Shares (or any lesser percentage if the anticipated aggregate offering price, net of underwriting discounts and commissions would exceed \$[\_\_\_\_]), the Company will use its best efforts to cause such shares to be registered. The Company will not be obligated to effect more than three registrations (other than on Form S-3) under these demand right provisions.

- **Registrations on Form S-3:** Holders of at least 25% of the Conversion Shares will have the right to require the Company to file an unlimited number of Registration Statements on Form S-3 (or any equivalent successor form).
- **Piggyback Registration:** The holders of the Conversion Shares will be entitled to "piggyback" registration rights on registrations of the Company, subject to the right of the Company and its underwriters, in view of market conditions, to reduce the number of shares of the Investors proposed to be registered.
- **Registration Expenses:** The registration expenses (exclusive of underwriting discounts and special counsel fees of a selling shareholder) of three demand registrations and three piggybacks will be borne by the Company, and all other expenses of registered offerings shall be borne pro rata among the selling shareholders and, if it participates, the Company.
- **Transfer of Registration Rights:** The registration rights may be transferred to a transferee (other than a competitor of the Company) who acquires at least 20% of the shares held by a holder of Conversion Shares. Transfer of registration rights to a partner of any investor will be without restriction as to minimum shareholding.
- **Future Purchasers:** Subsequent purchasers of the Company's securities to whom the Company grants information and registration rights shall become parties to the Rights Agreement upon consent of the holders of 66 2/3% of the Conversion Shares.
- **Other Registration Provisions:** Other provisions will be contained in the Purchase Agreement with respect to registration rights as are reasonable, including cross-indemnification, the Company's ability to delay the filing of the demand registration for a period of not more than 120 days, the agreement by Preferred holders if requested by the underwriter in a public offering not to sell any unregistered Conversion Shares they hold for a period of up to 120 days following the effective date of the Registration Statement of such offering, the period of time during which the Registration Statement will be kept effective, underwriting arrangements and the like. The registration rights will only apply to Common issued upon conversion of Preferred and the Company shall have no obligation to register an offering of Preferred.

## Board Representation and Company Meetings

The corporate documents of the Company will provide that the authorized number of directors will be [\_\_\_\_]. So long as 25% or more of the Preferred issued in the financing remain outstanding, the Preferred (voting as a class) will elect [\_\_\_\_] directors, the Common (voting as a class) will elect [\_\_\_\_] directors, and the remaining [\_\_\_\_] directors will be elected by both the Common and the Preferred, each voting together as one class. If at any time, less than 25% of the Preferred remains outstanding, all of the directors will be elected by the Preferred and Common voting together as one class, and the Preferred will be entitled to vote as if all of the Preferred were converted to Common. The Board will meet at least quarterly. The bylaws will provide that any two directors or holders of at least 25% of the Preferred may call a meeting of the Board of Directors. In case of an Event of Default, the rights of the Preferred to elect a majority of the board will be as stated above.

## Employment Agreements; New Hires

The Company has or will have employment agreements with the following persons: [NAMES]. The Company will elect persons acceptable to the Investors to the following positions:

- [POSITIONS]

## **Employee Shares; Benchmarks**

If the Company meets certain benchmarks (set forth below), the Compensation Committee of the Company's Board of Directors shall grant incentive stock options to purchase a number of shares (the "Employee Shares") of Common Stock of the Company to the Founder (the "Founder") and the Company's employees which will result in the Founder and such employees owning [\_\_\_\_\_] % of the Company's outstanding capital stock after the Third Round Financing (as defined below). The Founder and Co-Founder shall receive shares which will result in each owning [\_\_\_\_\_] % and [\_\_\_\_\_] % of such capital stock, respectively, and will be granted options to acquire shares equal in number to [\_\_\_\_\_] % of such percentages at Closing. Such "early" options will only become exercisable, however, if the benchmarks set forth below are met. None of the remaining options shall be granted to the Founder, Co-Founder, or other employees until closing of the Third Round Financing and will be granted at an exercise price equal to the fair market value of the Common Stock at that time. Shares acquired by the Founder and Co-Founder upon their exercise of the "early" options shall vest for three years from closing of the Third Round Financing minus the amount of time each has been employed by the Company.

**Benchmarks:** For the Employee Shares to become exercisable or to be granted the following benchmarks must be met:

1. Second Round Financing
  1. Price of \$0.50 per share
  2. Proceeds of \$[\_\_\_\_\_]
  3. New investor participates
  4. Closes within 9 months of First Round Financing
2. Third Round Financing
  1. Price of \$0.00 per share
  2. Proceeds of \$[\_\_\_\_\_]
  3. New investor participates
  4. Closes within 12 months of Second Round Financing

If the Company shall not satisfy the Second Round Financing benchmarks but shall satisfy the Third Round Financing benchmarks, then the number of Employee Shares issued shall be reduced from shares resulting in ownership of [\_\_\_\_\_] % to [\_\_\_\_\_] %. The Compensation Committee shall meet every six months to reevaluate the criteria set forth above and may, in its sole discretion, alter it. However, the Committee may not change the benchmarks so that they become more difficult for the Company to meet.

## **Compensation Committee**

The Board of Directors shall appoint a Compensation Committee consisting of the two representatives of the Preferred and the Independent Director which shall be responsible for administering the benchmarks, granting the Employee Shares, and compensation of all officers of the Company. Until the closing of the Second Round Financing, the Preferred shall only have one representative serving on the Committee.

## **Key-Person Insurance**

It shall be a condition of the closing that the Company obtain \$[\_\_\_\_\_] of key-person insurance on each of

[NAMES].

## **Stock Restriction Agreements**

The Founders and all other holders of Common of the Company who are employees of, or consultants to, the Company will execute a Stock Restriction Agreement with the Company pursuant to which the Company will have a repurchase option to buy back at cost a portion of the shares of Common Stock held by such person in the event that such shareholder's employment with, or consulting to, the Company is terminated prior to the expiration of 48 months from the date of the purchase of the Preferred or date of first employment or consulting, whichever is later (the "Measuring Date"). A portion of the shares will be released from the repurchase option based upon continued employment by the Company as follows: 25% will be released from the repurchase option at the end of 12 months from the Measuring Date, 25% will be released at the end of 24 months from the Measuring Date and thereafter 1/24th of the remaining shares will be released from the repurchase option per month. In addition, the Company will have a right of first refusal with respect to any employee's or consultant's shares proposed to be resold. The price at which the Company may exercise its right of first refusal will be equal to the lower of (i) the price offered by the proposed third party purchaser and (ii) the price most recently set by the Board of Directors as the fair market value of the Common. The right of first refusal will terminate upon a qualified IPO.

***Note On Reverse Vesting:** Reverse vesting is often taken to be an aggressive and abusive tactic by venture capitalists to assert control over the founder, entrepreneur and other employees who, prior to the round in question, enjoyed vesting shares... a method of turning the founder into an employee and giving the VCs the opportunity to treat him/her accordingly. However, there are perfectly sound economics behind reverse vesting, the same economics behind vesting in the first instance, and the same involved in the question of accelerated vesting on changes of control. The ultimate rewards of the key managers, their equity positions, are subject to vesting, and the ownership interests of the other equity holders are more valuable. The New York Yankees, for example, are a much more valuable franchise if the key players are signed to long-term contracts and cannot take the money and run, so to speak. Reverse vesting does have a control aspect to it; but often the VCs are in control in any event. The more significant imperative behind reverse vesting is economic. The VCs in the round are attempting to improve the enterprise value of the company allocated to their shares.*

## **Restrictions on Transfer**

The present holders of the Company's common will agree to restrictions on transfer (with customary exceptions) in favor of the Company and/or the Series A Preferred in the event of any voluntary or involuntary transfer.

## **Market Standoff Agreement**

It will be a condition of closing that the Company will cause all present holders of the Company's Common and all present holders of options to purchase, or rights to convert into, the Company's Common to execute a Market Standoff Agreement with the Company pursuant to which such holders will agree, if so requested by the Company or any underwriter's representative in connection with the first two public offerings of the Company's Common, not to sell or otherwise transfer any securities of the Company during a period of up to 120 days following the effective date of the applicable registration statements. The Company will covenant that all future purchasers of stock prior to the Company's initial public offering will execute such a Market Standoff Agreement.

## **Reserved Employee Shares**

The Company may reserve up to [\_\_\_\_\_] shares of its Common (the "Reserved Employee Shares") including shares presently reserved for issuance upon the exercise of outstanding options for issuance to Employees.

The Reserved Employee Shares will be issued from time to time under such arrangements, contracts or plans as are recommended by management and approved by the Board. Issuance of shares to employees in excess of the Reserved Employee Shares will be dilutive events requiring adjustment of the conversion price as provided above and will be subject to the Investors' right of first refusal described below. Holders of Reserved Employee Shares will be required to execute Stock Restriction Agreements as described above.

## **Preemptive Right**

If the Company offers equity securities (other than Reserved Employee Shares, or in connection with an acquisition of technology or a business), each holder of Preferred [and each Founder] will be entitled to purchase the same percentage of such offering as such holder purchased of the shares of Preferred issued in this private placement. This right will terminate upon a initial public offering.

## **Right of Co-Sale**

If any Founder proposes to sell his shares of the Company, each holder of Preferred will be entitled to participate in such sale by selling the same percentage of his Preferred as such Founder is selling of such Founder's Common. This right will terminate upon the Company's initial public offering.

## **Sale of the Company (Drag Along Rights)**

If an unaffiliated third party makes a bona fide offer for all the stock or substantially all the assets of the Company (or to lease its product line on an exclusive basis) and the holders of the Preferred elect to sell, the Founders shall have 30 days to match the offer and, failing their ability to do so (with financing in place), they shall sell their shares or vote to sell assets or lease product to other third party on the same terms.

*There are several issues, as yet untested, as drag-along rights, the preferred and common are likely to be offered different prices. Can the preferred force a drag-along if the common shareholders object to the price difference? Forum Discussion*

## **Proprietary Information and Inventions Agreement**

Each officer, director and key employee of the Company will enter into a proprietary information and inventions agreement in a form reasonably acceptable to the Company and the Investors.

## **Negative Covenants**

So long as 10 percent or more of the shares of Series B Preferred remain outstanding, without the approval of a majority in interest of the holders, the Company will not take any action that: (i) Alters or changes the rights, preferences or privileges of the shares of Series A Preferred materially and adversely, (ii) increases or decreases the number of authorized shares of Series B Preferred (it being acknowledged that a sufficient number of shares shall be authorized to permit the Company to convert the Class A and Class B Mandatory Convertible Promissory Notes and to raise additional funds to close the financing at \$10,000,000), (iii) authorizes the issuance of securities having a preference over or on a par with the shares of Series A Preferred, (iv) amends the Company's Certificate of Incorporation such that the holders of the Series A



Preferred are affected materially and adversely, (v) amend the Company's By-Laws such that the holders of the Series A Preferred are affected materially and adversely, (vi) authorize a merger, consolidation, reorganization or sale of the Company or substantially all of its assets, (vii) change the size of the Board.

## **Warrants**

The holders of Series A Preferred shall be granted warrants (the "Warrants") to purchase additional shares of Common Stock equal to (i) [50%] multiplied by (ii) the number of shares of Series A Preferred, they owned as of the closing. The Warrants shall have an exercise price equal to [\$.50] per share and shall be exercisable for the [\$.50] per share for the three year period following the closing.

## **The Purchase Agreement**

The purchase of the Preferred will be made pursuant to a Stock Purchase Agreement drafted by counsel to the Investors and reasonably acceptable to the Company and the Investors. The Purchase Agreement will contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein, and appropriate conditions including qualification of the shares under applicable Blue Sky laws, the filing of a Certificate of Amendment to the Company's Articles of Incorporation to authorize the Preferred, and opinions of counsel.

One should be aware that some of the typical provisions found in a term sheet, i.e., "customary representations and warranties," can constitute less than precise instructions to the draftsmen of the Stock Purchase Agreement.

## **Expenses**

The Company and the Investors will each bear their own legal and other expenses with respect to the transaction (except that, assuming a successful completion of the offering, the Company will pay at the Closing the reasonable legal fees incurred by a single counsel to all Investors).

## **Finders**

The Company and the Investors will each indemnify the other for any finder's fees for which either is responsible.

## **No Shop, No Solicit**

### *Cross-reference Note on 'No Shop, No Solicitation' Clauses*

Newco, Inc. a Delaware corporation ("Newco"), and XYZ Partners, LP (herein the "Fund"), are currently involved in negotiations with respect to an investment by the Fund in Newco's equity securities.

The Company recognizes that the Investors have and will expend considerable resources and executive time in negotiating a definitive agreement with respect to the investments (herein the "Investment," which term includes, as the context may allow or require, any acquisition of Newco securities or assets by way of a merger, sale of assets, consolidation or like transaction, by the Fund in Newco and performing its due diligence review of Newco. Accordingly, following the execution of this Term Sheet, Newco and its shareholders, directors, members, employees, financial advisors, brokers, stockholders or any person acting on their or its behalf (the "Principals"), shall immediately halt any discussions with other potential Investor in (including persons interested in an Acquisition) Newco (including persons with whom Newco or its

Principals may have had discussions prior to the date hereof), except to advise such person that a prospective Investor has been granted the exclusive right to negotiate concerning a proposed Investment (without identifying the Fund) and that Newco and its Principals are legally bound to a "quiet period" covering any Investment transaction. Without limiting the generality of the foregoing, Newco and/or its Principals will not hold any discussions with, or provide any information to, any person, or respond to any inquiry made by any person, concerning a proposed Investment or cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt by any third party to do or seek any of the foregoing.

The Fund, Newco and the Principals hereby agree to proceed in good faith toward negotiation and execution as soon as possible after the date hereof of the definitive documents [based on the Term Sheet] related to the consummation of the Investment, including the stock purchase agreement and any additional agreements deemed necessary or advisable by the parties (the "Investment Documents") that will contain mutually agreeable terms, representations, conditions, covenants and indemnities.

If at any time prior to [date] (the "Expiration Date") Newco is approached by any third party concerning participation in a transaction involving its assets or business, or securities issued or to be issued by Newco, then Newco shall promptly inform the Investors of the nature of such contact and the parties thereto, and shall furnish the Investors a copy of any inquiry or proposal, or, if not in writing, a description thereof, including the name of the counterparty or parties (any such person, together with all other third parties referred to in this and the preceding paragraphs, being referred to herein as a "Competing Person").

It is understood and agreed that money damages would not be a sufficient remedy for any breach of this Section by Newco or any of its Principals and that the Fund shall be entitled to seek equitable relief, including injunction and specific performance, as a remedy for any such breach. Such remedies shall not be deemed to be the exclusive remedies for a breach of this letter agreement but shall be in addition to all other remedies available at law or equity. Without limiting the generality of the foregoing, in the event of breach of the provisions hereof by Newco and/or any of its Principals, accompanied by an investment in Newco securities by a Competing Person at any time within 24 months following the Expiration Date, Newco will issue to the Fund a five (5) year transferable warrant to purchase shares of Newco common stock equal to [2%] of Newco's common stock (on a fully diluted basis, following the Investment by the Competing Person), the exercise price of such warrant to be equal to the price per share described in Section 3.

## **Closing**

The closing of the transaction is expected to occur on or before [DATE].

## **Nonbinding Character**

The parties expressly agree that, except with respect to the provisions of paragraphs 28, 29, 30 and 31, no binding obligations will be created until a document entitled "final agreement of purchase and sale" is executed with the requisite formality and delivered by both parties. Without limiting the generality of the foregoing, it is the parties' intent that, until that event, no agreement shall exist between them and that there be no obligations whatsoever based on such as parol evidence, extended negotiations, "handshakes," oral understanding, or courses of conduct (including reliance and changes of position). No legally binding obligations whatsoever are to be created, implied, or inferred, until a document explicitly entitled "final" has been executed and delivered.

In addition, neither party is under any obligation to negotiate in good faith or to use any quantum of effort, including but not limited to "best efforts," to reach an agreement. Either party is free to negotiate with a third party at the same time it is negotiating with the other party to this document and, except as explicitly

herein provided, to solicit interest from any available source. Either party may reveal information, whether labeled "confidential" or otherwise, obtained in the course of the transaction unless there is a specific agreement, signed by both parties with the requisite formality, to keep a particular item of information confidential.

## **Counsel to the Company**

Smith & Jones L.P., New York City

## **Counsel to the Investors**

The Company and the investors will each bear their own legal and other expenses with respect to the financing, (except that, if the transaction is completed, the Company will pay reasonable legal fees and actual expenses incurred by a single legal counsel to the investors, provided that such legal fees shall not exceed \$35,000 (including any legal fees incurred in connection with any review of the Company's employment agreements with Management) and such actual expenses shall not exceed \$2,500. Further, the Company shall pay up to \$10,000 of the investors' third-party expenses related to the financing. The overall cap shall therefore be \$47,500. This provision shall be binding on the parties.

[<sup>1</sup>] Insert Cap Table Here (Appendix 1).

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