

Christine Comaford
A S S O C I A T E S

**FUNDING IS ONLY HALF THE BATTLE:
FUNDING AND FOUNDER FUNDAMENTALS**



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Founder Stock Agreement – SAMPLE

SAMPLE – HAVE YOUR ATTORNEY REVIEW & APPROVE

XYZ CORPORATION, INC. FOUNDER AGREEMENT

THIS FOUNDER AGREEMENT (“Agreement”) is made as of [month] __, [year] (the “**Effective Date**”), by and between **XYZ CORPORATION, INC.**, a [state of incorporation] corporation (the “**Company**”), and [[name]] (the “**Founder**”).

WHEREAS, the Founder (the “**Founder**”) is being granted shares of the Company’s Common Stock (the “**Acquired Shares**”); and

WHEREAS, the Founder and the Company desire to impose certain restrictions on the Acquired Shares, as defined below, and as set forth herein.

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth herein, the parties, intending to be legally bound, hereby agree as follows:

1. The Shares.

(a) Pursuant to the terms Founder’s Stock Exchange Agreement dated as of [month] [day], [year] (the “**Prior Agreement**”), the Founder was issued [amount] shares of the Company’s Common Stock (the “**Acquired Shares**”).

(b) Pursuant to this Agreement, the Company and the Founder hereby agree to terminate the Prior Agreement in its entirety, which shall have no further force and effect.

2. Repurchase Option.

(a) The Acquired Shares shall be subject to the Company’s purchase option set forth in this paragraph 2(a) (the “**Repurchase Option**”). Subject to paragraphs 2(b) and 3, if the Founder’s relationship with the Company (or a parent or subsidiary of the Company), whether as an employee, director or consultant, is terminated either voluntarily or involuntarily, whether as a result of Founder’s resignation, termination, death or disability, prior to the repurchase expiration date, the Company shall have an

irrevocable option, at any time after such termination, to purchase from the Founder or the Founder's personal representative, at the per share price equal to the cost to the Founder (the "**Option Price**"), up to but not more than the number of the Acquired Shares for which the Purchase Option has not lapsed under the provisions of paragraph 2(b), upon the terms set forth herein. The Repurchase Option shall be exercised by the Company or its assignee by delivering written notice to the Founder and, at the Company's option, (i) by delivering to the Founder or the Founder's executor a check in the amount of the aggregate Option Price, or (ii) by canceling an amount of the Founder's indebtedness to the Company, if any, equal to the aggregate Option Price, or (iii) by a combination of (i) and (ii) so that the combined payment and cancellation of indebtedness equals the aggregate Option Price. Upon delivery of such notice and the payment of the aggregate Option Price, the Company shall become the legal and beneficial owner of the Acquired Shares being repurchased and all rights and interests therein or relating thereto, and the Company shall have the right to retain and transfer to its own name the number of Acquired Shares being repurchased by the Company.

(b) The Company's right to exercise the Repurchase Option shall lapse with respect to [amount to be negotiated] of the Acquired Shares on [month] [day], [year], and shall lapse with respect to an additional [amount to be negotiated] shares on the final day of each month thereafter for the next [number of months to be negotiated] months following the Effective Date.

3. Release of Acquired Shares From Repurchase Option.

(a) Termination Without Cause. In the event that the Founder's engagement as an employee, consultant or director of the Company is terminated without Cause within six (6) months after the closing of a merger, consolidation, reorganization, transaction or series of transactions which result(s) in the stockholders of the Company as constituted immediately prior to such event holding less than a majority of the voting power of the surviving entity or the sale, transfer or other disposition of substantially all of the assets of the Company in complete liquidation or dissolution of the Company (a "**Change of Control**"), then the Company's Repurchase Option shall lapse immediately with respect to an additional [number to be negotiated, such as 12-16] months of all remaining Acquired Shares for which the Repurchase Option has not lapsed under the provisions of paragraph 2(b). A transaction shall not constitute a Change in Control if its sole purpose is to change the state of the Company's incorporation, to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately prior to such transaction, or in conjunction with the issuance and sale of the Company's securities for capital raising purposes that result in such a change in voting control. The term "**Cause**" shall mean the termination of the Founder's employment, consulting or directorship because of the occurrence of any of the following: (i) the Founder's commission of a felony involving gross

moral turpitude or which materially affects the ability of the Founder to carry out his obligations to the Company or which, in the reasonable judgment of the Board of Directors of the Company, reflects adversely on the reputation of the Company; (ii) the Founder's refusal (except as a result of sickness, disability or death) to perform, or gross negligence in performing, materially her duties as an employee, consultant or director, which refusal to perform materially is not cured or corrected within ten (10) days of written notice thereof by the Company; (iii) the Founder's commission of an act of fraud, theft, misappropriation or embezzlement related to the business or property of the Company or with respect to the Company or its customers; or (iv) the Founder's material breach of any provision of his agreements with the Company, if any, or of the Company's policies, which breach is not cured or corrected within ten (10) days of written notice thereof by the Company; or (v) the Founder's violation of her common law duty of loyalty to the Company, which if capable of being cured or corrected remains uncured or uncorrected within [number to be negotiated, such as 10] days of written notice thereof by the Company.

(b) Any of the Shares that have not yet been released from the Repurchase Option are referred to as "**Unreleased Shares.**"

(c) The Shares that have been released from the Repurchase Option shall be delivered to the Founder as provided in Section 5(d).

4. Restriction on Transfer.

Except for the transfer of the Acquired Shares to the Company or its assignees contemplated by this Agreement, none of the Acquired Shares or any beneficial interest therein shall be transferred, encumbered or otherwise disposed of in any way until such Acquired Shares are released from the Company's Repurchase Option in accordance with the provisions of this Agreement, other than by will or the laws of descent and distribution or transfers to a living trust of which Founder is a trustor and trustee (in which event such trustee shall be bound to the terms hereof).

5. Escrow of Acquired Shares.

(a) To ensure the availability for delivery of the Founder's Unreleased Shares upon repurchase by the Company pursuant to the Repurchase Option, the Founder shall, upon execution of this Agreement, deliver and deposit with the "**Escrow Agent**" the share certificates representing the Unreleased Shares, together with the stock assignment duly endorsed in blank, attached hereto as **Exhibit A**. The Unreleased Shares and stock assignment shall be held by the Escrow Agent, pursuant to joint escrow instructions between the Company and the Founder substantially in the form of **Exhibit B** attached hereto, until such time as the Company's Repurchase Option expires.

(b) The Escrow Agent shall not be liable for any act it may do or omit to do with respect to holding the Unreleased Shares in escrow while acting in good faith and in the exercise of its judgment.

(c) If the Company or any assignee exercises the Repurchase Option hereunder, the Escrow Agent, upon receipt of written notice of such exercise from the proposed transferee, shall take all steps necessary to accomplish such transfer.

(d) When the Repurchase Option has been exercised or expires unexercised or a portion of the Acquired Shares has been released from the Repurchase Option, upon request the Escrow Agent shall promptly cause a new certificate to be issued for the released Acquired Shares and shall deliver the certificate to the Company or the Stockholder, as the case may be.

(e) Subject to the terms hereof, the Founder shall have all the rights of a stockholder with respect to the Acquired Shares while they are held in escrow, including without limitation, the right to vote the Acquired Shares and to receive any dividends declared thereon. If, from time to time during the term of the Repurchase Option, there is (i) any stock dividend, stock split or other change in the Acquired Shares, or (ii) any merger or sale of all or substantially all of the assets or other acquisition of the Company, any and all new, substituted or additional securities to which the Founder is entitled by reason of the Founder's ownership of the Acquired Shares shall be immediately subject to this escrow, deposited with the Escrow Agent and included thereafter as Acquired Shares for purposes of this Agreement and the Repurchase Option.

6. Representations of the Founder.

The Founder acknowledges that he is aware that the Acquired Shares have not been registered under the Securities Act of 1933, as amended (the "**Act**"), and that the Acquired Shares are "restricted securities" under Rule 144 promulgated under the Act. The Founder represents and warrants to the Company that the Founder is purchasing the Acquired Shares for his own account and that the Founder has no present intention to distribute or sell the Acquired Shares except as permitted under the Act and Section 25102(f) of the California Corporations Code. The Founder further warrants and represents that she has either (i) a preexisting personal or business relationship with the Company or any of its officers, directors or controlling persons, or (ii) the capacity to protect her own interests in connection with the purchase of the Acquired Shares by virtue of the business or financial expertise of any professional advisors to the Founder who are not affiliated with or compensated by the Company or any of its affiliates, directly or indirectly. The Founder further acknowledges that the exemption from registration under Rule 144 will not be available for at least one year from the date of sale of the Acquired Shares and until (i) a public trading market exists for the Common Stock of the Company, (ii) adequate information concerning the Company is available to the public, and (iii) the other terms and conditions of Rule 144 are complied with; and that

any sale of the Acquired Shares may be made only in limited amounts in accordance with such terms and conditions.

7. Legends.

(a) The share certificate evidencing the Acquired Shares, if any, issued hereunder shall be endorsed with the following legends, or legends substantially equivalent thereto (in addition to any legend required under applicable state securities laws):

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “ACT”) AND HAVE BEEN TAKEN BY THE ISSUER FOR INVESTMENT PURPOSES. SUCH SECURITIES MAY NOT BE SOLD OR TRANSFERRED UNLESS: (A) THEY HAVE BEEN REGISTERED UNDER THE ACT OR (B) THE TRANSFER AGENT (OR THE COMPANY IF THEN ACTING AS ITS OWN TRANSFER AGENT) IS PRESENTED WITH EITHER A WRITTEN OPINION REASONABLY SATISFACTORY TO THE COMPANY OR A “NO-ACTION” OR INTERPRETIVE LETTER FROM THE SECURITIES EXCHANGE COMMISSION TO THE EFFECT THAT SUCH REGISTRATION IS NOT REQUIRED UNDER THE CIRCUMSTANCES OF SUCH SALE OR TRANSFER.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN OPTION TO PURCHASE SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE REGISTERED HOLDER, OR THE PREDECESSOR IN INTEREST OF THE REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY. ANY TRANSFER OR ATTEMPTED TRANSFER OF ANY SHARES SUBJECT TO SUCH OPTION TO PURCHASE IS VOID WITHOUT THE PRIOR WRITTEN CONSENT OF THE ISSUER OF THESE SHARES.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO A RIGHT OF FIRST REFUSAL IN FAVOR OF THE COMPANY AND/OR ITS ASSIGNEE(S) AS SET FORTH IN THE COMPANY’S BYLAWS.

THE SALE, PLEDGE, HYPOTHECATION OR TRANSFER OF THE SECURITIES REPRESENTED BY THIS CERTIFICATE IS SUBJECT TO THE TERMS AND CONDITIONS OF A CERTAIN RIGHT OF FIRST REFUSAL AND CO-SALE AGREEMENT BY AND BETWEEN THE SHAREHOLDER, THE COMPANY AND CERTAIN HOLDERS OF STOCK OF THE COMPANY. COPIES OF SUCH AGREEMENT MAY BE OBTAINED UPON WRITTEN REQUEST TO THE SECRETARY OF THE COMPANY.

(b) The Founder hereby agrees that Founder shall not sell, transfer, make any short sale of, grant any option for the purchase of, or enter into any hedging or similar transaction with the same economic effect as a sale, any Common Stock (or other securities) of the Company held by the Founder (other than those included in the registration) for a period

specified by the representative of the underwriters of Common Stock (or other securities) of the Company not to exceed one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Securities Act; *provided* that (i) such agreement shall apply only to the Company's Initial Offering and (ii) all officers and directors of the Company and holders of at least one percent (1%) of the Company's voting securities enter into similar agreements. The Founder agrees to execute and deliver such other agreements as may be reasonably requested by the Company or the underwriter which are consistent with the foregoing or which are necessary to give further effect thereto. In addition, if requested by the Company or the representative of the underwriters of Common Stock (or other securities) of the Company, the Founder shall provide, within ten (10) days of such request, such information as may be required by the Company or such representative in connection with the completion of any public offering of the Company's securities pursuant to a registration statement filed under the Securities Act. The obligations described in this Section 7(b) shall not apply to a registration relating solely to employee benefit plans on Form S-1 or Form S-8 or similar forms that may be promulgated in the future, or a registration relating solely to a Commission Rule 145 transaction on Form S-4 or similar forms that may be promulgated in the future.

(c) The Company (i) shall not be required to transfer on its books, or may issue appropriate "stop transfer" instructions to its transfer agents, if any, with respect to any Acquired Shares that have been sold or otherwise transferred in violation of any of the provisions of this Agreement, and (ii) the Company shall not be required to treat as owner of such Acquired Shares or to accord the right to vote or pay dividends to any purchaser or other transferee to whom such Acquired Shares shall have been so transferred.

8. Tax Consequences.

The Founder has reviewed with his own tax advisors the federal, state, local and foreign tax consequences of this investment and the transactions contemplated by this Agreement. The Founder is relying solely on such advisors and not on any statements or representations of the Company or any of its agents. The Founder understands that she (and not the Company) shall be responsible for the Founder's own tax liability that may arise as a result of the transactions contemplated by this Agreement. The Founder understands that Section 83 of the Internal Revenue Code of 1986, as amended (the "**Code**"), if applicable, taxes as ordinary income the difference between the purchase price for the Acquired Shares and the Fair Market Value of the Acquired Shares as of the date any restrictions on the Acquired Shares lapse. In this context, "restriction" includes the right of the Company to buy back the Acquired Shares pursuant to the Repurchase Option. The Founder understands that if Section 83 is applicable, he may elect to be taxed at the time the Acquired Shares are purchased rather than when and as the Repurchase Option expires by filing an election under Section 83(b) of the Code with the IRS within 30 days from the date of purchase. The form for making this election is attached as **Exhibit B** hereto.

THE FOUNDER ACKNOWLEDGES THAT IT IS THE FOUNDER'S SOLE RESPONSIBILITY AND NOT THE COMPANY'S TO FILE TIMELY THE ELECTION UNDER SECTION 83(b), EVEN IF THE FOUNDER REQUESTS THE COMPANY OR ITS REPRESENTATIVES TO MAKE THIS FILING ON HIS BEHALF. This filing should be made by registered or certified mail, return receipt requested, and the Founder must retain two (2) copies of the completed form for filing with Founder's State and Federal tax returns for the current tax year and an additional copy for Founder's personal records.

9. Adjustment for Stock Split.

All references to the number of Acquired Shares and the purchase price of the Acquired Shares in this Agreement shall be appropriately adjusted to reflect any stock split, stock dividend or other change in the Acquired Shares which may be made by the Company after the date of this Agreement.

10. General Provisions.

(a) This Agreement shall be governed by the internal substantive laws of California without regard to choice of law rules. This agreement represents the entire agreement between the parties with respect to the subject matter hereof.

(b) Any notice, demand or request required or permitted to be given by either the Company or the Founder pursuant to the terms of this Agreement shall be in writing and shall be deemed given when delivered personally, upon transmission by facsimile with confirmed transmission report, one day after being sent via overnight express with a nationally recognized courier service with return receipt requested, or four days after deposited in the U.S. mail, First Class with postage prepaid, and addressed to either the Company or the Founder at the addresses set forth below:

If to the Company:
Att: Chief Executive Officer
[address of company here]

If to the Founder:

Any notice to the Escrow Agent shall be sent to the Company's address with a copy to the other party hereto.

(c) Any successor to the Company (whether direct or indirect and whether by purchase, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets shall assume the obligations under this Agreement and agree expressly to perform the obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" shall include any successor to the Company's business and/or assets which executes and delivers the assumption agreement described in this Section 10(c) or which becomes bound by the terms of this Agreement by operation of law.

(d) Either party's failure to enforce any provision of this Agreement shall not in any way be construed as a waiver of any such provision, nor prevent that party from thereafter enforcing any other provision of this Agreement. The rights granted both parties hereunder are cumulative and shall not constitute a waiver of either party's right to assert any other legal remedy available to it.

(e) The Founder agrees upon request to execute any further documents or instruments necessary or reasonably desirable to carry out the purposes or intent of this Agreement.

(f) Should any provision of this Agreement be found to be illegal or unenforceable, the other provisions shall nevertheless remain effective and shall remain enforceable.

(g) INDEPENDENT COUNSEL. THE STOCKHOLDER ACKNOWLEDGES THAT HE HAS BEEN PROVIDED WITH AN OPPORTUNITY TO CONSULT WITH THE STOCKHOLDER'S OWN COUNSEL WITH RESPECT TO THIS AGREEMENT, AND IS NOT RELYING ON ANY LEGAL ADVICE RENDERED BY THE COMPANY OR ITS AGENTS.

(h) It is the intention of the parties that the Company, upon exercise of the Repurchase Option and payment of the Repurchase Price, pursuant to the terms of this Agreement, shall be entitled to receive the Acquired Shares, in specie, in order to have such Acquired Shares available for future issuance without dilution of the holdings of other shareholders. Furthermore, it is expressly agreed between the parties that money damages are inadequate to compensate the Company for the Shares and that the Company shall, upon proper exercise of the Repurchase Option, be entitled to specific enforcement of its rights to purchase and receive said Acquired Shares.

(i) If any action at law or equity or any other proceeding is necessary to enforce or interpret the terms of this Agreement (including any exhibit hereto), the prevailing

party shall be entitled to reasonable attorney's fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

[remainder of page left intentionally blank]

By the Founder's signature below, the Founder represents that he or she is familiar with the terms of this Agreement, and hereby accepts this Agreement subject to all of the terms and provisions thereof. The Founder has read this Agreement in its entirety, has had an opportunity to obtain the advice of counsel prior to executing this Agreement and fully understands all provisions of this Agreement. The parties have executed this Agreement as of the date first above written.

DATED: [month] [date], [year]

[name], Founder

[COMPANY NAME]

By: _____

Name: _____

Title: _____

Exhibit A

Stock Assignment

The undersigned does hereby assign and transfer to [company name] [_____]
shares of Common Stock of [company name] represented by Certificate No. [___] standing in the
name of the undersigned on the books of said company.

The undersigned does hereby irrevocably constitute and appoint the Secretary of the
Company as attorney to transfer the said stock on the books of said Company, with full power
of substitution in the premises.

Dated: [month] [day], [year]

[name]

Exhibit B

Joint Escrow Instructions

[attorney's name and address]

Ladies and Gentlemen:

As Escrow Agent for both [company name], a [state of incorporation] corporation (the
“**Company**”) and [name] (the “**Stockholder**”), you are hereby authorized and directed to hold
the documents delivered to you pursuant to the terms of that certain Founder Agreement
dated as of [month] [day], [year] (the “**Agreement**”), to which a copy of these Joint Escrow
Instructions is attached as **Exhibit B**, in accordance with the following instructions:

1. In the event the Company or an assignee shall elect to exercise the
Repurchase Option set forth in the Agreement, the Company or its assignee will give to the
Stockholder and you a written notice specifying the number of shares of stock to be
repurchased, the repurchase price, and the time for a closing thereunder at the principal office
of the Company. The Stockholder and the Company hereby irrevocably authorize and direct
you to close the transaction contemplated by such notice in accordance with the terms of said
notice.

2. At the closing, you are directed (a) to date the stock assignments necessary for the transfer in question, (b) to fill in the number of shares being transferred, and (c) to deliver the same, together with the certificate evidencing the shares of stock to be transferred, to the Company against the simultaneous delivery to you of the repurchase price (which may include suitable acknowledgment of cancellation of indebtedness) for the number of shares of stock being repurchased pursuant to the exercise of the Repurchase Option.

3. The Stockholder irrevocably authorizes the Company to deposit with you any certificates evidencing shares of stock to be held by you hereunder and any additions and substitutions to said shares as specified in the Agreement. The Stockholder does hereby irrevocably constitute and appoint you as his attorney-in-fact and agent for the term of this escrow to execute with respect to such securities all documents necessary or appropriate to make such securities negotiable and complete any transaction herein contemplated, including but not limited to any appropriate filing with state or government officials or bank officials. Subject to the provisions of this paragraph 3, the Stockholder shall exercise all rights and privileges of a stockholder of the Company while the stock is held by you.

4. This escrow shall terminate upon the exercise in full or expiration of the Repurchase Option, whichever occurs first.

5. If at the time of termination of this escrow you should have in your possession any documents, securities, or other property belonging to the Stockholder, you shall deliver all of the same to the Stockholder and shall be discharged of all further obligations hereunder; provided, however, that if at the time of termination of this escrow you are advised by the Company that any property subject to this escrow is the subject of a pledge or other security agreement, you shall deliver all such property to the pledgeholder or other person designated by the Company.

6. Except as otherwise provided in these Joint Escrow Instructions, your duties hereunder may be altered, amended, modified or revoked only by a writing signed by all of the parties hereto.

7. You shall be obligated for the performance of such duties as are specifically set forth herein and may rely and shall be protected in relying or refraining from acting on any instrument reasonably believed by you to be genuine and to have been signed or presented by the proper party or parties. You shall not be personally liable for any act you may do or omit to do hereunder as Escrow Agent or as attorney-in-fact for the Stockholder while acting in good faith and in the exercise of your own good judgment, and any act done or omitted by you pursuant to the advice of your own attorneys shall be conclusive evidence of such good faith.

8. You are hereby expressly authorized to disregard any and all warnings given by any of the parties hereto or by any other person or corporation, excepting only orders

or process of courts of law, and are hereby expressly authorized to comply with and obey orders, judgments or decrees of any court. In case you obey or comply with any such order, judgment or decree of any court, you shall not be liable to any of the parties hereto or to any other person, firm or corporation by reason of such compliance, notwithstanding any such order, judgment or decree being subsequently reversed, modified, annulled, set aside, vacated or found to have been entered without jurisdiction.

9. You shall not be liable in any respect on account of the identity, authorities or rights of the parties executing or delivering or purporting to execute or deliver the Agreement or any documents or papers deposited or called for hereunder.

10. You shall not be liable for the outlawing of any rights under any statute of limitations with respect to these Joint Escrow Instructions or any documents deposited with you.

11. Your responsibilities as Escrow Agent hereunder shall terminate if you shall resign by written notice to each party. In the event of any such termination, the Company shall appoint any officer or assistant officer of the Company as successor Escrow Agent, and the Stockholder hereby confirms the appointment of such successor as her attorney-in-fact and agent to the full extent of your appointment.

12. If you reasonably require other or further instruments in connection with these Joint Escrow Instructions or obligations in respect hereto, the necessary parties hereto shall join in furnishing such instruments

13. It is understood and agreed that should any dispute arise with respect to the delivery and/or ownership or right of possession of the securities held by you hereunder, you are authorized and directed to retain in your possession without liability to anyone all or any part of said securities until such dispute shall have been settled either by mutual written agreement of the parties concerned or by a final order, decree or judgment of a court of competent jurisdiction after the time for appeal has expired and no appeal has been perfected, but you shall be under no duty whatsoever to institute or defend any such proceedings.

14. Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery, including delivery by express courier, facsimile with transmission report, or one day after being sent via overnight express with a nationally recognized courier service with return receipt, or five (5) days after deposit in the United States Post Office, by registered or certified mail with postage and fees prepaid, addressed to each of the other parties entitled to such notice at the following addresses, or at such other addresses as party may designate by ten days' advance written notice to each of the other parties hereto.

Company: [company name]
[company address]

Stockholder: _____

Escrow Agent: [attorney's name and address]

15. By signing these Joint Escrow Instructions, you become a party hereto only for the purpose of said Joint Escrow Instructions; you do not become a party to the Agreement.

16. You shall be entitled to employ such legal counsel and other experts as you may deem necessary properly to advise you in connection with your obligations hereunder. You may rely upon the advice of such counsel, and you may pay such counsel reasonable compensation therefor. The Company shall be responsible for all fees generated by such legal counsel in connection with your obligations hereunder.

17. This instrument shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns. It is understood and agreed that references to "you" and "your" herein refer to the original Escrow Agent. It is understood and agreed that the Company may at any time or from time to time assign its rights under the Agreement and these Joint Escrow Instructions.

18. This instrument shall be governed by and interpreted and determined in accordance with the laws of the State of California, as such laws are applied by California courts to contracts made to be performed entirely in California by residents of that state.

Very truly yours,

[company name]

By: _____

Name: _____

Title: _____

FOUNDER:

Name: _____

ESCROW AGENT:

[Attorney's name]

By: _____

Name:

Title:

Exhibit C

Section 83(b) Election

Internal Revenue Service Center
Fresno, CA 93888

Election Under Section 83(b)
of the Internal Revenue Code
of 1986

Ladies and Gentlemen:

I hereby elect under section 83(b) of the Internal Revenue Code of 1986 to include in gross income any excess of fair market value over purchase price with respect to the transfer of the property described below:

1. Name:
2. Address:
3. Social Security Number:
4. Tax Year of Election:
5. Description of Property: Common Stock of [company name]
6. Date of Property Transfer: Effective _____
7. Nature of Property Restrictions: Subject to lapsing repurchase right by [company name]
8. Fair Market Value at the Time of Transfer: \$_____
9. Amount Paid for Property: \$_____
10. A copy of this election has been furnished to [company name]

[month] [day], [year]

Name: [_____]

Founder Agreement – SAMPLE

SAMPLE CONTRACT – HAVE YOUR OWN LEGAL COUNSEL REVIEW BEFORE USING

XYZ, INC.

FOUNDER AGREEMENT

THIS FOUNDER AGREEMENT (“**Agreement**”) is made as of [month] __, [year] (the “**Effective Date**”), by and between XYZ, INC., a [state of incorporation] corporation (the “**Company**”), and [[]] (the “**Founder**”).

WHEREAS, the Founder (the “**Founder**”) is being granted shares of the Company’s Common Stock (the “**Acquired Shares**”); and

WHEREAS, the Founder and the Company desire to impose certain restrictions on the Acquired Shares, as defined below, and as set forth herein.

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth herein, the parties, intending to be legally bound, hereby agree as follows:

1. The Shares.

(a) Pursuant to the terms Founder’s Stock Exchange Agreement dated as of [month] [day], [year] (the “**Prior Agreement**”), the Founder was issued [amount] shares of the Company’s Common Stock (the “**Acquired Shares**”).

(b) Pursuant to this Agreement, the Company and the Founder hereby agree to terminate the Prior Agreement in its entirety, which shall have no further force and effect.

2. Repurchase Option.

(a) The Acquired Shares shall be subject to the Company’s purchase option set forth in this paragraph 2(a) (the “**Repurchase Option**”). Subject to paragraphs 2(b) and 3, if the Founder’s relationship with the Company (or a parent or subsidiary of the Company), whether as an employee, director or consultant, is terminated either

voluntarily or involuntarily, whether as a result of Founder's resignation, termination, death or disability, prior to the repurchase expiration date, the Company shall have an irrevocable option, at any time after such termination, to purchase from the Founder or the Founder's personal representative, at the per share price equal to the cost to the Founder (the "**Option Price**"), up to but not more than the number of the Acquired Shares for which the Purchase Option has not lapsed under the provisions of paragraph 2(b), upon the terms set forth herein. The Repurchase Option shall be exercised by the Company or its assignee by delivering written notice to the Founder and, at the Company's option, (i) by delivering to the Founder or the Founder's executor a check in the amount of the aggregate Option Price, or (ii) by canceling an amount of the Founder's indebtedness to the Company, if any, equal to the aggregate Option Price, or (iii) by a combination of (i) and (ii) so that the combined payment and cancellation of indebtedness equals the aggregate Option Price. Upon delivery of such notice and the payment of the aggregate Option Price, the Company shall become the legal and beneficial owner of the Acquired Shares being repurchased and all rights and interests therein or relating thereto, and the Company shall have the right to retain and transfer to its own name the number of Acquired Shares being repurchased by the Company.

(b) The Company's right to exercise the Repurchase Option shall lapse with respect to [amount to be negotiated] of the Acquired Shares on [month] [day], [year], and shall lapse with respect to an additional [amount to be negotiated] shares on the final day of each month thereafter for the next [number of months to be negotiated] months following the Effective Date.

3. Release of Acquired Shares From Repurchase Option.

(a) Termination Without Cause. In the event that the Founder's engagement as an employee, consultant or director of the Company is terminated without Cause within six (6) months after the closing of a merger, consolidation, reorganization, transaction or series of transactions which result(s) in the stockholders of the Company as constituted immediately prior to such event holding less than a majority of the voting power of the surviving entity or the sale, transfer or other disposition of substantially all of the assets of the Company in complete liquidation or dissolution of the Company (a "**Change of Control**"), then the Company's Repurchase Option shall lapse immediately with respect to an additional [number to be negotiated, such as 12-16] months of all remaining Acquired Shares for which the Repurchase Option has not lapsed under the provisions of paragraph 2(b). A transaction shall not constitute a Change in Control if its sole purpose is to change the state of the Company's incorporation, to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately prior to such transaction, or in conjunction with the issuance and sale of the Company's securities for capital raising purposes that result in such a change in voting control. The term "**Cause**" shall mean

the termination of the Founder's employment, consulting or directorship because of the occurrence of any of the following: (i) the Founder's commission of a felony involving gross moral turpitude or which materially affects the ability of the Founder to carry out his obligations to the Company or which, in the reasonable judgment of the Board of Directors of the Company, reflects adversely on the reputation of the Company; (ii) the Founder's refusal (except as a result of sickness, disability or death) to perform, or gross negligence in performing, materially her duties as an employee, consultant or director, which refusal to perform materially is not cured or corrected within ten (10) days of written notice thereof by the Company; (iii) the Founder's commission of an act of fraud, theft, misappropriation or embezzlement related to the business or property of the Company or with respect to the Company or its customers; or (iv) the Founder's material breach of any provision of his agreements with the Company, if any, or of the Company's policies, which breach is not cured or corrected within ten (10) days of written notice thereof by the Company; or (v) the Founder's violation of her common law duty of loyalty to the Company, which if capable of being cured or corrected remains uncured or uncorrected within [number to be negotiated, such as 10] days of written notice thereof by the Company.

(b) Any of the Shares that have not yet been released from the Repurchase Option are referred to as "**Unreleased Shares.**"

(c) The Shares that have been released from the Repurchase Option shall be delivered to the Founder as provided in Section 5(d).

4. Restriction on Transfer.

Except for the transfer of the Acquired Shares to the Company or its assignees contemplated by this Agreement, none of the Acquired Shares or any beneficial interest therein shall be transferred, encumbered or otherwise disposed of in any way until such Acquired Shares are released from the Company's Repurchase Option in accordance with the provisions of this Agreement, other than by will or the laws of descent and distribution or transfers to a living trust of which Founder is a trustor and trustee (in which event such trustee shall be bound to the terms hereof).

5. Escrow of Acquired Shares.

(a) To ensure the availability for delivery of the Founder's Unreleased Shares upon repurchase by the Company pursuant to the Repurchase Option, the Founder shall, upon execution of this Agreement, deliver and deposit with the "**Escrow Agent**" the share certificates representing the Unreleased Shares, together with the stock assignment duly endorsed in blank, attached hereto as **Exhibit A**. The Unreleased Shares and stock assignment shall be held by the Escrow Agent, pursuant to joint escrow instructions between the Company and the

Founder substantially in the form of **Exhibit B** attached hereto, until such time as the Company's Repurchase Option expires.

(b) The Escrow Agent shall not be liable for any act it may do or omit to do with respect to holding the Unreleased Shares in escrow while acting in good faith and in the exercise of its judgment.

(c) If the Company or any assignee exercises the Repurchase Option hereunder, the Escrow Agent, upon receipt of written notice of such exercise from the proposed transferee, shall take all steps necessary to accomplish such transfer.

(d) When the Repurchase Option has been exercised or expires unexercised or a portion of the Acquired Shares has been released from the Repurchase Option, upon request the Escrow Agent shall promptly cause a new certificate to be issued for the released Acquired Shares and shall deliver the certificate to the Company or the Stockholder, as the case may be.

(e) Subject to the terms hereof, the Founder shall have all the rights of a stockholder with respect to the Acquired Shares while they are held in escrow, including without limitation, the right to vote the Acquired Shares and to receive any dividends declared thereon. If, from time to time during the term of the Repurchase Option, there is (i) any stock dividend, stock split or other change in the Acquired Shares, or (ii) any merger or sale of all or substantially all of the assets or other acquisition of the Company, any and all new, substituted or additional securities to which the Founder is entitled by reason of the Founder's ownership of the Acquired Shares shall be immediately subject to this escrow, deposited with the Escrow Agent and included thereafter as Acquired Shares for purposes of this Agreement and the Repurchase Option.

6. Representations of the Founder.

The Founder acknowledges that he is aware that the Acquired Shares have not been registered under the Securities Act of 1933, as amended (the "**Act**"), and that the Acquired Shares are "restricted securities" under Rule 144 promulgated under the Act. The Founder represents and warrants to the Company that the Founder is purchasing the Acquired Shares for his own account and that the Founder has no present intention to distribute or sell the Acquired Shares except as permitted under the Act and Section 25102(f) of the California Corporations Code. The Founder further warrants and represents that she has either (i) a preexisting personal or business relationship with the Company or any of its officers, directors or controlling persons, or (ii) the capacity to protect her own interests in connection with the purchase of the Acquired Shares by virtue of the business or financial expertise of any professional advisors to the Founder who are not affiliated with or compensated by the Company or any of its affiliates, directly or indirectly. The Founder further acknowledges that the exemption from registration under Rule 144 will not be available for at least one year from

the date of sale of the Acquired Shares and until (i) a public trading market exists for the Common Stock of the Company, (ii) adequate information concerning the Company is available to the public, and (iii) the other terms and conditions of Rule 144 are complied with; and that any sale of the Acquired Shares may be made only in limited amounts in accordance with such terms and conditions.

7. Legends.

(a) The share certificate evidencing the Acquired Shares, if any, issued hereunder shall be endorsed with the following legends, or legends substantially equivalent thereto (in addition to any legend required under applicable state securities laws):

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “**ACT**”) AND HAVE BEEN TAKEN BY THE ISSUER FOR INVESTMENT PURPOSES. SUCH SECURITIES MAY NOT BE SOLD OR TRANSFERRED UNLESS: (A) THEY HAVE BEEN REGISTERED UNDER THE ACT OR (B) THE TRANSFER AGENT (OR THE COMPANY IF THEN ACTING AS ITS OWN TRANSFER AGENT) IS PRESENTED WITH EITHER A WRITTEN OPINION REASONABLY SATISFACTORY TO THE COMPANY OR A “NO-ACTION” OR INTERPRETIVE LETTER FROM THE SECURITIES EXCHANGE COMMISSION TO THE EFFECT THAT SUCH REGISTRATION IS NOT REQUIRED UNDER THE CIRCUMSTANCES OF SUCH SALE OR TRANSFER.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN OPTION TO PURCHASE SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE REGISTERED HOLDER, OR THE PREDECESSOR IN INTEREST OF THE REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY. ANY TRANSFER OR ATTEMPTED TRANSFER OF ANY SHARES SUBJECT TO SUCH OPTION TO PURCHASE IS VOID WITHOUT THE PRIOR WRITTEN CONSENT OF THE ISSUER OF THESE SHARES.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO A RIGHT OF FIRST REFUSAL IN FAVOR OF THE COMPANY AND/OR ITS ASSIGNEE(S) AS SET FORTH IN THE COMPANY’S BYLAWS.

THE SALE, PLEDGE, HYPOTHECATION OR TRANSFER OF THE SECURITIES REPRESENTED BY THIS CERTIFICATE IS SUBJECT TO THE TERMS AND CONDITIONS OF A CERTAIN RIGHT OF FIRST REFUSAL AND CO-SALE AGREEMENT BY AND BETWEEN THE SHAREHOLDER, THE COMPANY AND CERTAIN HOLDERS OF STOCK OF THE COMPANY. COPIES OF SUCH AGREEMENT MAY BE OBTAINED UPON WRITTEN REQUEST TO THE SECRETARY OF THE COMPANY.

(b) The Founder hereby agrees that Founder shall not sell, transfer, make any short sale of, grant any option for the purchase of, or enter into any hedging or similar transaction with the same economic effect as a sale, any Common Stock (or other securities) of the Company held by the Founder (other than those included in the registration) for a period specified by the representative of the underwriters of Common Stock (or other securities) of the Company not to exceed one hundred eighty (180) days following the effective date of a registration statement of the Company filed under the Securities Act; *provided* that (i) such agreement shall apply only to the Company's Initial Offering and (ii) all officers and directors of the Company and holders of at least one percent (1%) of the Company's voting securities enter into similar agreements. The Founder agrees to execute and deliver such other agreements as may be reasonably requested by the Company or the underwriter which are consistent with the foregoing or which are necessary to give further effect thereto. In addition, if requested by the Company or the representative of the underwriters of Common Stock (or other securities) of the Company, the Founder shall provide, within ten (10) days of such request, such information as may be required by the Company or such representative in connection with the completion of any public offering of the Company's securities pursuant to a registration statement filed under the Securities Act. The obligations described in this Section 7(b) shall not apply to a registration relating solely to employee benefit plans on Form S-1 or Form S-8 or similar forms that may be promulgated in the future, or a registration relating solely to a Commission Rule 145 transaction on Form S-4 or similar forms that may be promulgated in the future.

(c) The Company (i) shall not be required to transfer on its books, or may issue appropriate "stop transfer" instructions to its transfer agents, if any, with respect to any Acquired Shares that have been sold or otherwise transferred in violation of any of the provisions of this Agreement, and (ii) the Company shall not be required to treat as owner of such Acquired Shares or to accord the right to vote or pay dividends to any purchaser or other transferee to whom such Acquired Shares shall have been so transferred.

8. Tax Consequences.

The Founder has reviewed with his own tax advisors the federal, state, local and foreign tax consequences of this investment and the transactions contemplated by this Agreement. The Founder is relying solely on such advisors and not on any statements or representations of the Company or any of its agents. The Founder understands that she (and not the Company) shall be responsible for the Founder's own tax liability that may arise as a result of the transactions contemplated by this Agreement. The Founder understands that Section 83 of the Internal Revenue Code of 1986, as amended (the "**Code**"), if applicable, taxes as ordinary income the difference between the purchase price for the Acquired Shares and the Fair Market Value of the Acquired Shares as of the date any restrictions on the Acquired Shares lapse. In this context, "restriction" includes the right of the Company to buy back the Acquired Shares pursuant to the Repurchase Option. The Founder understands that if Section 83 is

applicable, he may elect to be taxed at the time the Acquired Shares are purchased rather than when and as the Repurchase Option expires by filing an election under Section 83(b) of the Code with the IRS within 30 days from the date of purchase. The form for making this election is attached as **Exhibit B** hereto.

THE FOUNDER ACKNOWLEDGES THAT IT IS THE FOUNDER'S SOLE RESPONSIBILITY AND NOT THE COMPANY'S TO FILE TIMELY THE ELECTION UNDER SECTION 83(b), EVEN IF THE FOUNDER REQUESTS THE COMPANY OR ITS REPRESENTATIVES TO MAKE THIS FILING ON HIS BEHALF. This filing should be made by registered or certified mail, return receipt requested, and the Founder must retain two (2) copies of the completed form for filing with Founder's State and Federal tax returns for the current tax year and an additional copy for Founder's personal records.

9. Adjustment for Stock Split.

All references to the number of Acquired Shares and the purchase price of the Acquired Shares in this Agreement shall be appropriately adjusted to reflect any stock split, stock dividend or other change in the Acquired Shares which may be made by the Company after the date of this Agreement.

10. General Provisions.

(a) This Agreement shall be governed by the internal substantive laws of California without regard to choice of law rules. This agreement represents the entire agreement between the parties with respect to the subject matter hereof.

(b) Any notice, demand or request required or permitted to be given by either the Company or the Founder pursuant to the terms of this Agreement shall be in writing and shall be deemed given when delivered personally, upon transmission by facsimile with confirmed transmission report, one day after being sent via overnight express with a nationally recognized courier service with return receipt requested, or four days after deposited in the U.S. mail, First Class with postage prepaid, and addressed to either the Company or the Founder at the addresses set forth below:

If to the Company:
Att: Chief Executive Officer

[address of company here]

If to the Founder:

Any notice to the Escrow Agent shall be sent to the Company's address with a copy to the other party hereto.

(c) Any successor to the Company (whether direct or indirect and whether by purchase, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets shall assume the obligations under this Agreement and agree expressly to perform the obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" shall include any successor to the Company's business and/or assets which executes and delivers the assumption agreement described in this Section 10(c) or which becomes bound by the terms of this Agreement by operation of law.

(d) Either party's failure to enforce any provision of this Agreement shall not in any way be construed as a waiver of any such provision, nor prevent that party from thereafter enforcing any other provision of this Agreement. The rights granted both parties hereunder are cumulative and shall not constitute a waiver of either party's right to assert any other legal remedy available to it.

(e) The Founder agrees upon request to execute any further documents or instruments necessary or reasonably desirable to carry out the purposes or intent of this Agreement.

(f) Should any provision of this Agreement be found to be illegal or unenforceable, the other provisions shall nevertheless remain effective and shall remain enforceable.

(g) INDEPENDENT COUNSEL. THE STOCKHOLDER ACKNOWLEDGES THAT HE HAS BEEN PROVIDED WITH AN OPPORTUNITY TO CONSULT WITH THE STOCKHOLDER'S OWN COUNSEL WITH RESPECT TO THIS AGREEMENT, AND IS NOT RELYING ON ANY LEGAL ADVICE RENDERED BY THE COMPANY OR ITS AGENTS.

(h) It is the intention of the parties that the Company, upon exercise of the Repurchase Option and payment of the Repurchase Price, pursuant to the terms of this Agreement, shall be entitled to receive the Acquired Shares, in specie, in order to have such Acquired Shares available for future issuance without dilution of the holdings of other shareholders. Furthermore, it is expressly agreed between the parties that money damages are inadequate to compensate the Company for the Shares and that the Company shall, upon proper exercise of the Repurchase Option, be entitled to specific enforcement of its rights to purchase and receive said Acquired Shares.

(i) If any action at law or equity or any other proceeding is necessary to enforce or interpret the terms of this Agreement (including any exhibit hereto), the prevailing party shall be entitled to reasonable attorney's fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

[remainder of page left intentionally blank]

By the Founder's signature below, the Founder represents that he or she is familiar with the terms of this Agreement, and hereby accepts this Agreement subject to all of the terms and provisions thereof. The Founder has read this Agreement in its entirety, has had an opportunity to obtain the advice of counsel prior to executing this Agreement and fully understands all provisions of this Agreement. The parties have executed this Agreement as of the date first above written.

DATED: [month] [date], [year]

[name], Founder

[COMPANY NAME]

By: _____

Name: _____

Title: _____

Exhibit A

Stock Assignment

The undersigned does hereby assign and transfer to [company name] [_____]
shares of Common Stock of [company name] represented by Certificate No. [___] standing in the
name of the undersigned on the books of said company.

The undersigned does hereby irrevocably constitute and appoint the Secretary of the
Company as attorney to transfer the said stock on the books of said Company, with full power
of substitution in the premises.

Dated: [month] [day], [year]

[name]

Exhibit B

Joint Escrow Instructions

[attorney's name and address]

Ladies and Gentlemen:

As Escrow Agent for both [company name], a [state of incorporation] corporation (the
“**Company**”) and [name] (the “**Stockholder**”), you are hereby authorized and directed to hold
the documents delivered to you pursuant to the terms of that certain Founder Agreement
dated as of [month] [day], [year] (the “**Agreement**”), to which a copy of these Joint Escrow
Instructions is attached as **Exhibit B**, in accordance with the following instructions:

1. In the event the Company or an assignee shall elect to exercise the
Repurchase Option set forth in the Agreement, the Company or its assignee will give to the

Stockholder and you a written notice specifying the number of shares of stock to be repurchased, the repurchase price, and the time for a closing thereunder at the principal office of the Company. The Stockholder and the Company hereby irrevocably authorize and direct you to close the transaction contemplated by such notice in accordance with the terms of said notice.

2. At the closing, you are directed (a) to date the stock assignments necessary for the transfer in question, (b) to fill in the number of shares being transferred, and (c) to deliver the same, together with the certificate evidencing the shares of stock to be transferred, to the Company against the simultaneous delivery to you of the repurchase price (which may include suitable acknowledgment of cancellation of indebtedness) for the number of shares of stock being repurchased pursuant to the exercise of the Repurchase Option.

3. The Stockholder irrevocably authorizes the Company to deposit with you any certificates evidencing shares of stock to be held by you hereunder and any additions and substitutions to said shares as specified in the Agreement. The Stockholder does hereby irrevocably constitute and appoint you as his attorney-in-fact and agent for the term of this escrow to execute with respect to such securities all documents necessary or appropriate to make such securities negotiable and complete any transaction herein contemplated, including but not limited to any appropriate filing with state or government officials or bank officials. Subject to the provisions of this paragraph 3, the Stockholder shall exercise all rights and privileges of a stockholder of the Company while the stock is held by you.

4. This escrow shall terminate upon the exercise in full or expiration of the Repurchase Option, whichever occurs first.

5. If at the time of termination of this escrow you should have in your possession any documents, securities, or other property belonging to the Stockholder, you shall deliver all of the same to the Stockholder and shall be discharged of all further obligations hereunder; provided, however, that if at the time of termination of this escrow you are advised by the Company that any property subject to this escrow is the subject of a pledge or other security agreement, you shall deliver all such property to the pledgeholder or other person designated by the Company.

6. Except as otherwise provided in these Joint Escrow Instructions, your duties hereunder may be altered, amended, modified or revoked only by a writing signed by all of the parties hereto.

7. You shall be obligated for the performance of such duties as are specifically set forth herein and may rely and shall be protected in relying or refraining from acting on any instrument reasonably believed by you to be genuine and to have been signed or presented by the proper party or parties. You shall not be personally liable for any act you may do or omit to do hereunder as Escrow Agent or as attorney-in-fact for the Stockholder while

acting in good faith and in the exercise of your own good judgment, and any act done or omitted by you pursuant to the advice of your own attorneys shall be conclusive evidence of such good faith.

8. You are hereby expressly authorized to disregard any and all warnings given by any of the parties hereto or by any other person or corporation, excepting only orders or process of courts of law, and are hereby expressly authorized to comply with and obey orders, judgments or decrees of any court. In case you obey or comply with any such order, judgment or decree of any court, you shall not be liable to any of the parties hereto or to any other person, firm or corporation by reason of such compliance, notwithstanding any such order, judgment or decree being subsequently reversed, modified, annulled, set aside, vacated or found to have been entered without jurisdiction.

9. You shall not be liable in any respect on account of the identity, authorities or rights of the parties executing or delivering or purporting to execute or deliver the Agreement or any documents or papers deposited or called for hereunder.

10. You shall not be liable for the outlawing of any rights under any statute of limitations with respect to these Joint Escrow Instructions or any documents deposited with you.

11. Your responsibilities as Escrow Agent hereunder shall terminate if you shall resign by written notice to each party. In the event of any such termination, the Company shall appoint any officer or assistant officer of the Company as successor Escrow Agent, and the Stockholder hereby confirms the appointment of such successor as her attorney-in-fact and agent to the full extent of your appointment.

12. If you reasonably require other or further instruments in connection with these Joint Escrow Instructions or obligations in respect hereto, the necessary parties hereto shall join in furnishing such instruments

13. It is understood and agreed that should any dispute arise with respect to the delivery and/or ownership or right of possession of the securities held by you hereunder, you are authorized and directed to retain in your possession without liability to anyone all or any part of said securities until such dispute shall have been settled either by mutual written agreement of the parties concerned or by a final order, decree or judgment of a court of competent jurisdiction after the time for appeal has expired and no appeal has been perfected, but you shall be under no duty whatsoever to institute or defend any such proceedings.

14. Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery, including delivery by express courier, facsimile with transmission report, or one day after being sent via overnight express with a nationally recognized courier service with return receipt, or five (5) days after deposit in the

United States Post Office, by registered or certified mail with postage and fees prepaid, addressed to each of the other parties entitled to such notice at the following addresses, or at such other addresses as party may designate by ten days' advance written notice to each of the other parties hereto.

Company: [company name]
[company address]

Stockholder: _____

Escrow Agent: [attorney's name and address]

15. By signing these Joint Escrow Instructions, you become a party hereto only for the purpose of said Joint Escrow Instructions; you do not become a party to the Agreement.

16. You shall be entitled to employ such legal counsel and other experts as you may deem necessary properly to advise you in connection with your obligations hereunder. You may rely upon the advice of such counsel, and you may pay such counsel reasonable compensation therefor. The Company shall be responsible for all fees generated by such legal counsel in connection with your obligations hereunder.

17. This instrument shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns. It is understood and agreed that references to "you" and "your" herein refer to the original Escrow Agent. It is understood and agreed that the Company may at any time or from time to time assign its rights under the Agreement and these Joint Escrow Instructions.

18. This instrument shall be governed by and interpreted and determined in accordance with the laws of the State of California, as such laws are applied by California courts to contracts made to be performed entirely in California by residents of that state.

Very truly yours,

[company name]

By: _____

Name: _____

Title: _____

FOUNDER:

Name: _____

ESCROW AGENT:

[Attorney's name]

By: _____

Name:

Title:

Exhibit C

Section 83(b) Election

Internal Revenue Service Center
Fresno, CA 93888

Election Under Section 83(b)
of the Internal Revenue Code
of 1986

Ladies and Gentlemen:

I hereby elect under section 83(b) of the Internal Revenue Code of 1986 to include in gross income any excess of fair market value over purchase price with respect to the transfer of the property described below:

1. Name:
2. Address:
3. Social Security Number:
4. Tax Year of Election:
5. Description of Property: Common Stock of [company name]
6. Date of Property Transfer: Effective _____
7. Nature of Property Restrictions: Subject to lapsing repurchase right by [company name]
8. Fair Market Value at the Time of Transfer: \$_____
9. Amount Paid for Property: \$_____
10. A copy of this election has been furnished to [company name]

[month] [day], [year]

Name: [_____]

Funding Strategy Worksheet

Financing your company is key to growth. There are several ways to finance your business. Below are some ideas as mentioned in the session. Put a checkmark next to the ones you will target:

- | | |
|---|---|
| <input type="checkbox"/> Venture capital | <input type="checkbox"/> Merchant cash advances |
| <input type="checkbox"/> Angel investors | <input type="checkbox"/> Asset-based borrowing (line of credit and factoring) |
| <input type="checkbox"/> Government grants | <input type="checkbox"/> Customer investment |
| <input type="checkbox"/> Bank loans | <input type="checkbox"/> Customer sales (revenue) |
| <input type="checkbox"/> Friends & family loans | <input type="checkbox"/> Other _____ |
| <input type="checkbox"/> SBA loans | |
| <input type="checkbox"/> Micro-loans . | |

Answer the following questions about your **capital acquisition strategy**:

1. How much financing do you need?

2. When do you need the money? _____
3. From whom do you want the money? _____

4. What compromises will you accept in exchange for the money? _____

List your Top 5 potential funding sources, how much you want to raise from each, and when.

Funding Source	How Much to Raise	When

Summary of Terms for Proposed Private Placement of “Series A” Preferred Stock – SAMPLE

SAMPLE VENTURE CAPITAL TERM SHEET FOR PRIVATE EQUITY FINANCING:

Note the items **highlighted in green** are specific to this deal, and are called out for your educational purposes. Terms can be quite complex, which is why you will not initiate a financing without the guidance of an attorney!

[VENTURE CAPITAL FIRM NAME]

SUMMARY OF TERMS FOR PROPOSED PRIVATE PLACEMENT
OF SERIES A PREFERRED STOCK OF **YOUR COMPANY, INC.**

<DATE>

Issuer: Your Company (the “Company”)

Type of Security: **Series A-1 and A-2** Convertible Preferred Stock (collectively, the “Series A Preferred”), initially convertible on a 1:1 basis into shares of the Company’s Common Stock (the “Common Stock”).

Amount of Financing: Venture Capital Firm and its affiliate partnerships (“Affiliate Partners”) and TBD Investor (collectively, the “Investors”) shall invest an aggregate of **\$3.0 million**, representing an approximate **32.7%** ownership position on a fully diluted basis, including shares reserved for any employee option pool (the “Financing”). The estimated individual investment amounts for each Investor are as follows:

Investor	Amount of Investment:
Debenture Conversion:	Up to \$2,333,646.00*
Venture Capital Firm:	Up to \$1,750,000.00
TBD Investor:	\$1,250,000.00
Total:	\$5,333,646.00

***Assumes \$350K in new convertible debentures**

An approximate capitalization table showing the Company’s projected capital structure immediately following **(assuming the conversion of all outstanding debentures and a 30:1 reverse stock split)** the Closing of Series A Preferred Financing is attached as Exhibit A.

Closing: It is anticipated that the closing of the Financing (the “Closing”) shall

occur on or before <date>.

Price:

The Series A-1 purchase price shall be \$0.90 per share (the “A-1 Original Purchase Price”). The outstanding debentures shall convert into Series A-2 at \$0.60 per share (the “A-2 Conversion Price”).

The A-1 Original Purchase Price represents a fully-diluted pre-money valuation of \$6.2 million and a fully-diluted post money valuation of \$9.2 million.

TERMS OF SERIES APREFERRED STOCK

Dividends:

The holders of the Series A-1 and A-2 Preferred shall be entitled to receive noncumulative dividends in preference to any dividend on the Common Stock and any other capital stock of the Company (“Junior Stock”) at the rate of 10% of the Original Purchase Price per annum, when and as declared by the Board of Directors. The holders of Series A Preferred also shall be entitled to participate pro rata in any dividends paid on the Junior Stock on a common stock equivalent basis.

Liquidation Preference:

In the event of any liquidation, dissolution, or winding up of the Company, the holders of the Series A-1 Preferred shall be entitled to receive in preference to the holders of Series A-2 Preferred and the Junior Stock a per share amount equal to the Original Purchase Price plus any declared but unpaid dividends (the “Series A-1 Liquidation Preference”). Thereafter, the Series A-2 Preferred shall be entitled to receive in preference to the holders of the Junior Stock a per share amount equal to the A-2 Conversion Price plus any declared but unpaid dividends (the “Series A-2 Liquidation Preference”). Thereafter, any remaining assets shall be distributed ratably to the holders of the Junior Stock and the Series A Preferred on a common equivalent basis. The Series A-1 and A-2 Liquidation Preference shall have a 5x cap on participation.

A merger, acquisition, sale of voting control or sale of substantially all of the assets of the Company in which the shareholders of the Company do not own a majority of the outstanding shares of the surviving corporation shall be deemed to be a liquidation.

Voluntary Conversion:

The holders of the Series A Preferred shall have the right to convert the Series A Preferred, at any time, into shares of Common Stock. The initial conversion rate shall be 1:1, subject to adjustment as provided below.

Automatic Conversion:

The Series A Preferred shall be automatically converted into Common

Stock, at the then applicable conversion price, (i) in the event that the holders of at least a majority of the outstanding Series A Preferred consent to such conversion or (ii) upon the closing of a firmly underwritten public offering of shares of Common Stock of the Company at a per share price not less than five (5) times the Original Purchase Price (as adjusted for stock splits, dividends and the like) per share and for a total offering of not less than \$30 million (before deduction of underwriters commissions and expenses) (a “Qualified IPO”).

Antidilution Provisions:

The conversion price of the Series A-1 and A-2 Preferred will be subject to a standard broad based weighted average adjustment to reduce dilution in the event that the Company issues additional equity securities (other than shares reserved at Closing as employee shares described under “Employee Pool” below and other customary carve-outs, including: (i) the issuance of securities pursuant to stock splits, stock dividends, or similar transactions; (ii) the issuance of securities to financial institutions or lessors in connection with commercial credit arrangements, equipment financings, commercial property lease transactions, or similar transactions; (iii) the issuance of securities pursuant to currently outstanding warrants, notes, or other rights to acquire securities of the Company; (iv) the issuance of securities in connection with acquisition transactions; (v) the issuance of common stock in a public offering; (vi) the issuance of securities in strategic partnership transactions or (vii) the issuance of common stock in any other transaction in which exemption from the antidilution provisions is approved by the affirmative vote of at least a majority of the then-outstanding shares of Preferred Stock) at a purchase price less than the applicable Series A-1 conversion price. The conversion price will also be subject to proportional adjustment for stock splits, stock dividends, recapitalizations and the like.

Redemption at Option of Investors:

At the election of the holders of at least a majority of the Series A Preferred, the Company shall redeem the outstanding Series A Preferred on the fifth anniversary of the Closing. Such redemptions shall be at a purchase price equal to the Original Purchase Price plus declared and unpaid dividends.

Voting Rights:

The Series A Preferred will vote together with the Common Stock and not as a separate class except as specifically provided herein or as otherwise required by law. Each share of Series A Preferred and corresponding warrants, if any, shall have a number of votes equal to the number of shares of Common Stock then issuable upon conversion of such share of Series A Preferred.

Board of Directors:

The size of the Company’s Board of Directors shall be initially set at five

(5).

At each meeting for the election of directors, the holders of the Series A-1Preferred, voting as a separate class, shall be entitled to elect two members of the Company's Board of Directors which director shall be designated each by Venture Capital Firm and TBD Investor; the holders of the Series A-2Preferred, voting as a separate class, shall be entitled to elect one member of the Company's Board of Directors; the holders of Common Stock, voting as a separate class, shall be entitled to elect one member, whom shall be the then current CEO of the Company; and the remaining director shall be nominated by the CEO of the Company and will be elected by the holders of Common Stock and the Series Preferred, voting together as a single class (the "Industry" Board Seat). The size of the Board shall be increased or decreased by the holders of Common Stock and the Series A Preferred, voting together as a single class.

The Company shall reimburse expenses of the Board for costs incurred in attending meetings of the Board of Directors and other meetings or events attended on behalf of the Company.

Protective Provisions:

For so long as any shares of Series A Preferred remain outstanding, consent of the holders of at least a majority of the Series A Preferred shall be required for any action that (i) alters or changes the rights, preferences or privileges of the Series A Preferred, (ii) increases or decreases the authorized number of shares of Common or Preferred Stock, (iii) creates (by reclassification or otherwise) any new class or series of shares having rights, preferences or privileges senior to or on a parity with the Series A Preferred, (iv) results in the redemption or repurchase of any shares of Common Stock (other than pursuant to equity incentive agreements with service providers giving the Company the right to repurchase shares upon the termination of services), (v) results in any merger, other corporate reorganization, sale of control, or any transaction in which all or substantially all of the assets of the Company are sold, (vi) amends or waives any provision of the Company's Articles of Incorporation or Bylaws relative to the Series A Preferred, (vii) increases or decreases the authorized size of the Company's Board of Directors, (viii) results in the payment or declaration of any dividend on any shares of Common or Preferred Stock, or (ix) results in the issuance of debt in excess of \$100,000.

Information Rights:

So long as an Investor continues to hold shares of Series A Preferred or Common Stock issued upon conversion of the Series A Preferred, the Company shall deliver to the Investor audited annual and unaudited quarterly financial statements, as well as an Annual Budget. Each Investor shall also be entitled to standard inspection and visitation rights. These provisions shall terminate (i) upon a Qualified IPO by the

Company, (ii) at such time when the Company becomes subject to the reporting provisions of the Securities Exchange Act of 1934, as amended, or (iii) upon an Acquisition of the Company.

Registration Rights:

Registration rights will be consistent with normal industry practice and customary for this type of transaction.

Right of First Refusal:

Investors who hold at least 1,000,000 shares of Series A Preferred (a "Major Investor") shall have the right in the event the Company proposes to offer equity securities to any person (other than the shares reserved as employee shares described under "Employee Pool" below) to purchase their pro rata portion of such shares. Any securities not subscribed for by an eligible Investor may be reallocated among the other eligible Investors. Such right of first refusal will terminate upon a Qualified IPO or at such time when the Company becomes subject to the reporting provisions of the Securities Exchange Act of 1934, as amended.

Purchase Agreement:

The investment shall be made pursuant to a Stock Purchase Agreement reasonably acceptable to the Company and the Investors, which agreement shall contain, among other things, appropriate representations and warranties of the Company, covenants of the Company reflecting the provisions set forth herein and appropriate conditions of closing, including a management rights letter and an opinion of counsel for the Company.

Voting Agreement, Investor Rights Agreement:

Prior to closing the financing, all purchasers of the Convertible Preferred Stock and major Common shareholders shall sign a voting agreement to vote their shares for the Company's directors in the future according to the terms in this term sheet. In addition, all Investors and major Common shareholders shall enter into an Investor Rights Agreement.

EMPLOYEE MATTERS

Employee Pool:

The Company will reserve approximately 27% shares of its fully diluted capital stock (following the issuance of its Series A Preferred) available for Common Stock issuances to directors, officers, employees and consultants ("Employee Pool").

Stock Vesting:

All stock and stock equivalents issued *after* the Closing to employees, directors, consultants and other service providers will be subject to vesting as follows (unless different vesting is approved by the majority consent of the Board of Directors): 25% to vest at the end of the first year following such issuance, with the remaining 75% to vest monthly

over the following three years. The repurchase option shall provide that upon termination of the employment of the shareholder, with or without cause, the Company or its assignee (to the extent permissible under applicable securities law qualification) retains the option to repurchase at cost any unvested shares held by such shareholder. Any issuance of shares in excess of the Employee Pool at Closing not approved by the Board (including a majority of the Series A representatives) will be a dilutive event requiring adjustment of the conversion price as provided above and will be subject to the Investors' first offer right as described above.

Restrictions on Sales:

The Company's Bylaws shall contain a right of first refusal on all transfers of Common Stock, subject to normal exceptions. If the Company elects not to exercise its right, the Company shall assign its right to the Investors.

Proprietary Information and Inventions Agreement:

Each current officer, employee and consultant of the Company shall enter into an acceptable proprietary information and inventions agreement.

Co-Sale Agreement:

The shares of the Company's securities held by major Common shareholders shall be made subject to a co-sale agreement (with certain reasonable exceptions) with the Investors such that the Major Common shareholders may not sell, transfer or exchange their stock unless each Investor has an opportunity to participate in the sale on a pro-rata basis. This right of co-sale shall not apply to and shall terminate upon a Qualified IPO or at such time when the Company becomes subject to the reporting provisions of the Securities Exchange Act of 1934, as amended.

Executive Search:

The Company will use its best efforts to hire a full time CFO acceptable to the Investors as soon as practicable following the Closing.

MISCELLANEOUS

Initial Public Offering

In the event that the Company shall consummate a Qualified IPO, the Company shall use its best efforts to cause the managing underwriter or underwriters of such IPO to offer to Major Investors the right to purchase at least (5%) in the aggregate of any shares issued under a "friends and family" or "directed shares" program in connection with such Qualified IPO. Notwithstanding the foregoing, all action taken pursuant to this section shall be made in accordance with all federal and state securities laws, including, without limitation, Rule 134 of the Securities Act of 1933, as amended, and all applicable rules and

regulations promulgated by the National Association of Securities Dealers, Inc. and other such self-regulating organizations.

Assignment:

Each of the Investors shall be entitled to transfer all or part of its shares of Series A Preferred purchased by it to one or more affiliated partnerships or funds managed by it or any or their respective directors, officers or partners, provided such transferee agrees in writing to be subject to the terms of the Stock Purchase Agreement and related agreements as if it were a purchaser thereunder.

Indemnification:

The Company will indemnify Board members to the broadest extent permitted by applicable law and will indemnify each Investor for any claims brought against the Investors by any third party (including any other shareholder of the Company) as a result of the Financing.

Conditions Precedent to Financing:

This summary of terms is not intended as a legally binding commitment by the Investors, and any obligation on the part of the Investors is subject to the following conditions precedent:

1. Completion of legal documentation satisfactory to the prospective Investors.
2. At least an aggregate of \$800,000 in principal of debenture holders shall agree in writing to convert their outstanding debentures into Series A-2 Preferred upon Closing and completion of 30:1 Reverse Split of all outstanding Common Stock of the Company:
 - a. Any debenture holders who agree in writing in advance of the Closing shall have the outstanding interest of the debentures convert at \$0.90 per share of Common Stock.
 - b. Any debenture holders who do not agree before the Closing will have their notes repaid after the Closing, and (pursuant to the terms of their note) will have to keep the cash or accept Common Stock at \$0.60 per share for their principal, and their interest will be repaid in cash or converted to Common Stock at \$1.00 per share.
3. Satisfactory completion of due diligence of the Company by the prospective Investors, including, but not limited to: review and approval of option pool, review of prior financing history of Company, review of intellectual property and related patents, and review of current litigation surrounding Company.
4. Approval of a co-investor ("TBD Investor") by both Venture Capital Firm and the Company.
5. Submission of detailed budget for the following twelve months,

acceptable to Investors.

6. Approval of compensation arrangements for management, including salary, equity, options and vesting schedule.

7. The Company shall furnish evidence of at least \$1 million key man life insurance for the CEO shall be available to the Company upon Closing, but the initial premium does not need to be paid until after Closing.

8. The Company shall furnish evidence of Director and Officer liability insurance for the Investors in an amount not less than \$1 million per incident in coverage shall be available to the Company upon Closing, but the initial premium does not need to be paid until after Closing.

9. Other terms to be agreed upon.

Finders:

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

Investor Counsel:

[Law firm contact information]

Legal Fees and Expenses:

The Company shall bear its own fees and expenses and shall pay a maximum of \$25,000 of fees and expenses of Investor Counsel, if any transactions contemplated by this Summary of Terms for Proposed Private Placement are actually consummated or if the Company terminates transactions contemplated by this Summary of Terms for Proposed Private Placement.

Expiration:

The Investors' expression of interest set forth herein shall expire on <date> at 5:00 p.m. (Pacific Time) unless the Company provides the Investors with a countersigned copy of this Summary of Terms by such time and date.

No Shop Agreement:

Upon acceptance of this Summary of Terms, the Company shall not solicit other potential investors nor disclose the terms of this Summary of Terms to other persons (other than those persons approved by Venture Capital Firm) nor engage in any discussions or execute any agreements related to the sale or transfer of a significant portion of the Company's assets or securities to any other party other than the Investors.

The Company can take in up to an additional \$350,000 in bridge financing prior to the Closing, or the Company and Venture Capital Firm shall negotiate a bridge financing. Due to the number of actual

investors in the Financing, the Company must get the approval of Venture Capital Firm prior to the close of the bridge financing, in order to comply with existing securities laws.

Should both parties agree that definitive documents shall not be executed pursuant to this Summary of Terms, then the Company shall have no further obligations under this section.

Except for the provisions contained herein entitled "Legal Fees and Expenses" and "No Shop Agreement," this Summary of Terms for Proposed Private Placement is non-binding. The investment contemplated under the proposed terms would be subject to the negotiation and execution of a definitive agreement setting forth representations and warranties of the Company and shareholders, covenants and other provisions customary in transactions of this nature.

ACCEPTED AND AGREED:

Venture Capital Firm and Its Affiliates

By: _____

Name: [VC Partner]

Title: Venture Partner

TBD INVESTOR:

By: _____

Name:

Title:

Your Company Name

By: _____

Name:

Title:

Value of Founders Stock Whitepaper

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The authors wish to thank the many people who reviewed and commented on this paper. Their contributions certainly improved the quality and substance of the material; however, any mistakes or errors are due solely to the authors.

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The Classic Value Story

Had you purchased a single share of Cisco Systems in February 1990 for \$22, your investment would today be worth over \$20,000.

Market Valuations

The explosion in e-commerce requirements has spawned a new breed of consulting company that combines traditional IT skills, internet skills, and the necessary business skills to know how to implement e-commerce sites. The stock market sees great potential in these companies as reflected in their share price. Take, for instance, Proxicom. This company went public in February of 1999 and raised nearly \$60M at its IPO. In the first quarter of 2000 its revenues were approximately \$38M. Annualized, this would be \$152M. The company's market capitalization is approximately \$2.6B which gives a ratio of value to revenue of 17.

A Primer on the Relationship of Company Value and Owners' Stock Value

High quality employees are the very lifeblood of today's successful companies. For this reason it is critical that founders and management know how to attract and retain people who are committed to a shared vision of company growth. The vexing question may be how does one create commitment? It is not just a natural trait, but often a response to critical motivators like a sense of shared ownership, personal reward, and the opportunity to participate in building a successful company. What is the key to unlock these motivators — Valuable Stock Options. What makes a stock option valuable is the **value of the company**, so it's important that all

employees be focused and aligned on increasing and maximizing this crucial metric. After all, which is more valuable—twenty percent of a bankrupt company or half percent of a company with a market capitalization of \$1 billion? This white paper is intended as a primer on the value of a start-up company, how value is reflected in the share price and how to resolve the dilemma of dilution as funding and staffing are increased. It illustrates some of the important issues of stock valuation including critical calculations, and why company value is the super ordinate goal. However, the treatment is intentionally simplistic and readers should consult with their CPA, attorney, and stock plan consultant to develop their own cases. To illustrate the points of interest, the following scenario describes a fictional start-up company and shows how the owners deal with some of the questions of stock and value as they progress from start-up phase to an IPO. The example does not represent a typical case, but is rather a compendium of some of the perplexing problems that founders might face. A pre-revenue company whose owners cannot fund product development, marketing and staffing will often need “outside investment.” They must consider how much money is needed and select the most favorable sources. For high technology companies, the primary source is venture capital. The amount of investment is determined by financial projections and may take anywhere from one to four infusions. Very often the total investment will require selling more than half the company and, hence, giving up control. Therefore, there needs to be careful consideration about how much money to take and when to take it. With each infusion, which is called a “round of financing,” founders and managers may face difficult questions, some of which will have a direct bearing on their personal wealth. It is important, therefore, to understand how the investment increases the value of the company, now or in the future, and what the investment will cost. As the example illustrates, the cost of capital can sometimes result in loss of control and will certainly result in a reduction of ownership.

A Fictional Study: Stock Ownership, Value and Dilution The Seed Round

Imagine that five people start a company that intends to provide a knowledge management tool to help criminal justice agencies solve crimes. The unique selling proposition will be the ability to convert data to knowledge, and then use AI techniques to develop scenarios for how a crime may have been committed. Financial projections indicate a need for a \$10 million investment to complete product development, initial marketing and staffing.

Table 1

Founding Investment – The Seed Round

Investors	# of Shares	Share	This Round	%	Current Value
		Price	Investment	Ownership	
Founder #1 F	1,000,000	\$0.02	\$20,000	20%	\$20,000
Founder #2 F	1,000,000	\$0.02	\$20,000	20%	\$20,000
Founder #3 F	1,000,000	\$0.02	\$20,000	20%	\$20,000
Founder #4 F	1,000,000	\$0.02	\$20,000	20%	\$20,000
Founder #5 F	1,000,000	\$0.02	\$20,000	20%	\$20,000
Total	5,000,000		\$100,000	100%	\$100,000

The five founders enlist the help of an executive coach to help them think through the important issues in starting and managing their new company. The coach begins by counseling them on developing their vision, goals, and objectives and then reviews the stock structure and ownership.

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As part of their visioning process they agree on a number of common “outcomes,” one of which is that they each want to become financially independent as a result of this venture. With this in mind, their preferred goal is to create a publicly traded company, which means planning for an [IPO](#). With regard to each founder’s company ownership, their coach suggests that before any other stock is sold or promised, they must make an agreement on the number of shares each founder will own. He argues that delaying this until after the company has grown or other people are involved can create friction among founders. They incorporate as a “C” corporation and [authorize](#) 21 million shares. Each person agrees to make an initial investment of \$20,000 with a share price of 2 cents, giving each founder 1,000,000 shares (see Table 1). This is the [seed](#) investment of \$100,000. The coach, with an eye on quickly building company credibility, suggests that they form a board of directors comprised of two of the founders and three industry/business experts to assist in guiding their decision-making.

The First Round

The technically biased founders are keen to start product development, but their adviser

counsels that the seed money will quickly be consumed and stresses the need to always try to anticipate future financial requirements. Two of the five founders take responsibility for seeking and raising additional funding while the others begin product development.

Table 2

First Round – Post Money

Investors	# of Shares	Share Price	This Round Investment	% Ownership	Current Value
Founder #1	1,000,000			10%	\$2,000,000
Founder #2	1,000,000			10%	\$2,000,000
Founder #3	1,000,000			10%	\$2,000,000
Founder #4	1,000,000			10%	\$2,000,000
Founder #5	1,000,000			10%	\$2,000,000
VC #1	5,204,082	\$2.00	\$10,000,000	51%	\$10,408,164
Total	10,204,082		\$10,000,000	100%	\$20,408,164

Through their networking and PR activities the two founders find a venture capitalist (VC) that will invest \$10 million in the [first round](#), but with conditions. He thinks the product idea is good and the founders technically strong, but the team lacks management skills. He offers the investment on the following conditions:

- 1 Bringing in key managers, including a CEO, CFO and VP of Sales and Marketing.
- 2 Ownership of 51 percent of the company. The VC wants to reduce the investment risk by retaining control of important strategic and financial decisions.

Note that after this first round investment, 51 percent of the company is valued at \$10 million and, hence, the value of the company is now approximately \$20 million (see [Table 2](#)).

Valuation and First Round Funding

The founders discuss with their advisor how much of the company they will have to sell for the \$10 million. Unfortunately for our fictitious team, they lack management skills and a track record of starting and building companies. Investors focus on: i) The Team, ii) The Market, and iii) The Product Idea. Most investors consider [the team to be by far the most important](#)—common sense dictates if the team has good business sense, they will be in a good market with a good product. The value the founders bring is reduced because they do not have a strong management team, and this is reflected in the investor demand for 51 percent of the company. So now the founders are faced with the opportunity to get the investment they need, but it will cost them control of the company. What should they do? For some people this can be a hard decision, one that should clarify their commitments. Their adviser points out that they still have a

lot to learn about running a company and much of that can be acquired in the current enterprise. He suggests that if they can successfully grow this company and take it to an IPO, it will leave them with the experience and the resources to start other companies. In effect they are getting paid to learn and still have an opportunity to significantly increase their personal wealth. The cost is giving up control. After long deliberations, they decide to accept the funding offer.

Dilution

Selling part of the company creates **dilution** of ownership. After the investment, each founder's ownership share has been reduced from 20 percent to 10 percent, but the value of their holdings has not changed. Each now owns 10 percent of a \$20 million company, whereas previously each owned 20 percent of a \$10 million company. In the future, as the value of the company increases, so will each founder's stock value.

Table 3

Dilution Effect of Adding the Management Team

Founder #1		1,000,000	8%				
Founder #2		1,000,000	8%				
Founder #3		1,000,000	8%				
Founder #4		1,000,000	8%				
Founder #5		1,000,000	8%				
VC1		5,200,000	43%				

		4,082				
CEO		800,000	7%			
CFO		500,000	4%			
VP S&M		500,000	4%			
Total		12,004,082	100%			

Dilution may appear at first sight to be an undesirable sacrifice, but that perspective is very limiting and can sometimes restrict a company's growth. There are two factors which need to be carefully balanced when selling part of a company: the amount of ownership sold, and the value which is bought by the sale. The goal is to make sure that when stock is sold, the dilution effect is offset by an increase in company value. For example stock may be sold in return for an infusion of capital, the addition of key employees, or the addition of some critical asset like a strategic partnership. The addition of the new managers is a good example of dilution bringing increased value. Three key managers are to be added to the team: a CEO, CFO and VP of Sales and Marketing. Since each of the managers hired has previous start-up experience, they will expect to make a substantial amount of money over and above their normal compensation. The total equity required to capture these three critical managers is 15 percent. [Table 3](#) illustrates the result of adding these managers to the ownership list. What is not shown "on paper" is the value that this team has added. This might easily be seen by considering future investment requirements. When more money is needed, new investors will take a strong look at the management team. It must meet some minimum requirements; but above that, the more prestigious the team, the more likelihood of a higher future valuation.

Stock Incentives

Attracting and retaining new employees will require a stock option plan. As part owners of the company, people can feel that their efforts are making a difference, both to the company and to their own net worth. This provides great motivation for employees to make maximum possible contribution. Unlike founders' stock, the options program provides an opportunity for employees to capitalize on the growth in value of the company without such a high risk and high degree of commitment. With a stock option plan, employees are granted the option to buy stock at a fixed price. When the shares are traded on a public market, if the share price rises above this purchase price, there is an opportunity to realize substantial gains. Such options usually "vest" over a period of time, allowing employees to buy their options at the set price once they are vested. By setting this vesting period in the future, the company can use "Golden Handcuffs" to retain the committed contribution of employees.

Table 4

Dilution Effect of Adding the Options Pool

Founder #1		1,000,000	7%				
Founder #2		1,000,000	7%				
Founder #3		1,000,000	7%				
Founder #4		1,000,000	7%				
Founder #5		1,000,000	7%				
VC1		5,204,082	37%				
CEO		800,000	6%				
CFO		500,000	4%				
VP S&M		500,000	4%				
Options Pool		2,000,000	14%				
Total		14,004,082	100.00%				

These “golden handcuffs” are important in the attraction and retention of key talent. It is important to note that such stock options are created by setting aside a pool of shares from which options can be allocated. The dilution effects of such a pool are shown in Table 4.

The Second Round

Product development continues, but as so often happens, challenges arise and the company misses deadlines. This delays the product roll-out, which in turn delays initial revenues. Now the company faces a cash flow problem as well as a lot of strategic problems, such as losing marketshare because they will be late to market. The investor insists that it’s important to get into the market as early as possible, and requests a revised business plan showing how time lines can be moved up with the additional funding. The new plan indicates a need for an additional \$15 million investment. In spite of founder objections about further dilution, the board agrees to seek the additional funding; this is the [second round](#).

Table 5

Second Round – Post Money

Valuation and the Second Round

Once again the board has to estimate the value of the company so that it can set a share price for the second round of financing. Since the company has met key development milestones and has an experienced management team, the risk of the investment is being reduced. This leads the board to expect a significantly higher company valuation. Significant signs of success might be demonstrating that the technology can be productized, that beta site customers are being signed up, and that no unforeseen significant problems have been discovered. The board assesses that although there is slippage in the development schedule, everything is going according to plan, and they decide to offer shares at \$6. Notice how the price to get into this deal has escalated from the original 2 cents with high risk, to a present \$6 with much reduced risk. The initial investor decides to put a small amount into this next round, but asks the team to seek another investor to help spread the risk. The experienced management team has little trouble securing this additional investment. [Table 5 shows the resulting dilution when this second investment is completed. It is important to note that the table shows a theoretical value of the stock; however, since there is no market on which to sell these shares, this is an “on paper” value](#)

Mezzanine Round

The company completes development, launches the product, and receives very good market acceptance. However, the cost of rapid growth starves cash flow—a common problem with emerging companies—and the company goes back to the private placement market for a [mezzanine round](#) of funding.

Table 6

Mezzanine Round – Post Money

One of the skills in navigating a company from start up to success is to reach a position in which the revenues exceed the total of the expenses, cost of future development, and required profits. Until that point is reached, the expenses must be covered by investment. Our fictitious company has consumed all its investment money completing product development and launching the product. Now there are insufficient revenues to “cover expenses.” This is a paradox because they are growing rapidly, have plenty of orders, and yet will not be able to pay their expenses without further investment. The root cause of the problem is that the cost of increased marketing, expanded sales channels, and additional operations is more than the growing revenue can support. Eschewing other alternatives, the board decides their best option is to go back to the private market for another round of investment—a **mezzanine** round. They anticipate that this final investment will give enough momentum to make the company self-sufficient and position it for an IPO. The mezzanine round is completed raising \$9 million at \$9 a share. Notice that if we price all outstanding shares at \$9, then the value of the company is approximately \$156 million. With sales at \$50 million per annum, this gives a ratio of value to revenue of approximately 3:1, currently a conservative figure for a company with a “hot” product. In addition, the value of the founders’ stock has increased considerably; compare [Table 6](#) with [Table 1](#) to see the increase in valuation. The applications for the product are far wider than first anticipated and the company grows more rapidly than expected, but this brings new concerns. The company must now defend its position and attempt to stop any competitors from developing a “beachhead” into the market. To fund future investment opportunities the company decides to seek a further capital infusion through public investment. With this action the founders will complete one of the “outcomes” they envisioned when the company was started.

Initial Public Offering

Becoming a publicly traded company brings significant changes, not the least of which is that in the future the results and operations of the company will be exposed to public scrutiny. The process of raising public money is also vastly different from a private placement. The company must find an investment bank to underwrite the offering and manage the offering process. In this case, the board started interviewing investment banks early in the life of the company and has already selected and built a relationship with its first choice. The most critical factor for the offering will be the condition of the market. Stocks of different types move in and out of favor so it is important for the IPO to occur when there is a strong demand for similar stocks. If the demand is weak, the initial share price can be depressed. Clearly, the bank cannot control the market, but prior to the IPO it does “show” the company to the market through a limited number of presentations in a nationwide “roadshow.” This process is intended to help create a “market” for shares of the newly public company. The timing turns out to be good; in the two months prior to the offering several other companies with similar technologies have come on the market at \$18 a share and higher, and all analysts who follow this field are “bullish” on these companies. Anticipating strong demand the investment bank sets the initial price at \$20 a share for an offering of 3 million shares. Their acumen is fulfilled; the offering opens at \$20 and

has risen to \$25 a share by close of market on the first day's trading. The summary of the new valuation at the IPO is shown in Table 7.

Table 7

IPO Valuation

The company has now raised an additional \$60 million for future growth and expansion. In addition, anyone who owns shares now has an opportunity of selling them in order to realize personal gain; however, this is done with some caveats:

- 1 After an IPO, SEC regulations require that insiders cannot sell stock for six months.
- 2 When insiders sell stock, then others outside the company might ask why this person wants to sell if it represents a good investment. Thus, selling stock can send the wrong signals to the public market and depress the share price. Notice in the example that the shares for the public market did not come from existingshareholders, the intention being to send a strong signal to the market that "this is a valuable stock, and knowing what I know I expect it to rise to much higher value in the future."

Summary

The example illustrates some of the key points to think about with regard to financing a start-up company, building value, and allocating stock ownership. Points of particular note are:

- 1 When you make stock allocations, balance the dilution and the corresponding value you are buying. Make projections for several rounds of funding to estimate what will be needed in the future. Founders are often shortsighted in their initial stock grants to employees and give away too much, too early, without a real valuation of the company. Evaluate each dilution in terms of the future value it will bring.
- 2 Do some soul-searching and ask yourself how much control you need. Can you continue managing and leading your company even if you do not have the majority of voting shares at the board level? Be careful with this issue. A "for profit" business, in most cases, never gives any one person complete control. Even where a business is owned by one person, they are still accountable to customers—there is no absolute control. Can you work with the investors and any new managers who might join the company?
- 3 Complete all stock negotiations and ownership issues among founders at the outset of the company to avoid any disagreements later on
- 4 Make allowance for future stock options to provide incentives for new and existing employees.
- 5 Focus on increasing the value of the company. Make this the super ordinate goal and have it permeate every employee's vision of the future of the company. Note that, of necessity, this discussion only considers the "wealth" side of the rewards for starting a company. Other factors (fulfillment, vision, passion, an interest in growing companies) may play an important role in decision-making, but their consideration would make this discussion unnecessarily complex.

6 Business plans usually underestimate the amount of money required to complete product development and get to market. Think carefully about projections. Try to avoid increasing numbers by percentage, but rather think about the constituents of the expenditure or revenue and estimate how much is required.

7 Be realistic in making market penetration/sales growth projections. Use “S” Curves to help think about market ramp up and exploding growth. This is particularly important when thinking about cash flow, which is the “lifeblood” of a start-up business.

In Conclusion

One of the motivators for founders and employees of a high tech startup is to make significant amounts of money from the appreciation of company share price. To reach this goal, founders and management must focus on maximizing the value of the company at all stages of its growth. Dilution appears at first sight to be a negative effect, but instead should be seen as an investment process in which every time the stock is diluted there is value added to the company. Stock options to new employees should be based on clear expectations that these new team members will increase the value of the company through their contribution. Taking additional investment or granting stock for strategic partnerships should be viewed through the “lens of added value.” To help with the decision making process, simply ask the question, “If it doesn’t add value, why are we doing it?” This philosophy of adding value can percolate down through all parts of the company to all employees. As owners they can be directly involved in asking questions about how the investment of cash or stock will increase the company value. In their own role in the company they can be asking themselves, “How am I adding value to this company?” which is a far more powerful question than, “Did I do my job today?” The bottom line is value, and if you are not delivering value, then why are you in business?

Glossary of Terms

Authorized Stock: The maximum amount of stock a corporation may issue. The fixed amount is stated in the company’s certificate of incorporation. **Face Value:** The amount of money for which a share can be redeemed in cash. **First Round Funding:** The first major investment in a company; usually follows the seed round. Used for initial development. **IPO:** Initial Public Offering **Issued Stock:** The total number of a company’s publicly held stock shares plus the number of shares the company holds as treasury stock. **Market Capitalization:** A company’s worth as indicated by the price of its outstanding shares of stock. **Mezzanine Round:** A pre-IPO round of funding. The stage of a company’s development just prior to its going public, in VENTURE CAPITAL language. Venture capitalists entering at that point have a lower risk of loss than at previous stages and can look forward to early capital appreciation as a result of the MARKET VALUE gained by an INITIAL PUBLIC OFFERING. **Outstanding Stock:** All of a company’s ownership shares of stock that have been publicly purchased or that are owned by the company’s officers/employees. Shares that the company has repurchased are considered outstanding stock. **Par Value:** A stock certificate’s face value. **Preferred Stock:** Stock shares that represent a portion of ownership in a company. These shares normally carry fixed dividends and claims. In start-up companies with VC investments, it is the claims which are important. Preferred shares are usually purchased at a much higher price than common shares and carry rights intended to help protect the preferred shareholder. The ratio of the price between common and preferred can be a complex issue with income tax implications and is beyond the scope of this paper. **Second Round Funding:** The investment made after the first round. Often used to complete development and begin marketing a product. In many situations this round precedes an IPO or Mezzanine Round. **Seed Round:** The first money put into a new business venture, usually directly from the founders or a loan. **Share:** A single stock unit that represents a portion of company ownership. **Stock:** A unit of company ownership. **Stock Split:** Occurs when stock shares are divided into a smaller or larger number of stock shares. As an example, a company may issue a two for one split in which every shareholder would receive two shares for every share they turned in, and the par value of a share would be halved. When the number of shares is reduced, this is called a reverse split. **Treasury Stock:** Stock a company issues

and then buys back, at which time it is placed in the company's treasury where it earns no dividends and carries no voting privileges. It is included in the count of "Issued Stock."**Underwriting:** Investment Bankers assume the risk of buying new issues of securities from a corporation and distributing them to the public. Underwriters profit from the difference between the purchase and selling price. **Vesting:** Rights an employee receives for working at a company a specified length of time. The rights normally includesuch things as pension payments, participation in stock plans, and profit sharing. The term is often associated with the period that it takes for an employee or founder to have the right to own the shares they have been granted. As an example, an investor may want to keep a founder working at a company for a certain period, say four years. To accomplish this, the investor might insist that as part of funding, the founder would become entitled to 25 percent of their shares every year, thus it takes four years to own the stock. Sometimes this can be done retroactively; that is, even if the founder put up the seed money and owns the stock, there can still be a period of "re-vesting." This process is often referred to as "Golden Handcuffs." For employees, the same process is often applied; their stock options might vest over a number of years.

Reference Sources

The Wall Street Dictionary, Robert L. Shook & RJ Shook. New York Institute of Finance. The American Heritage® Dictionary of the English Language, Third Edition copyright © 1992 by Houghton Mifflin Company. Electronic version licensed from INSO Corporation. All rights reserved.

Information Sources www.myStockOptions.com — A web site for people who have stock options; provides information and calculation tools. www.edgar-online.com/ipoexpress/ — Part of the EDGAR

Preliminary Due Diligence Checklist

[Name of Company]

Preliminary Due Diligence Checklist

[Date]

In connection with the proposed sale of Series __ Preferred Stock by [Name of Company] (the "Company"), please supply the following materials.

	<u>Previously Provided</u>	<u>Provided Herewith</u>	<u>To Be Provided</u>	<u>N/A</u>	
(A)					<u>Basic corporate documents:</u>
	[]	[]	[]	[]	(1) Articles of Incorporation, including amendments.
	[]	[]	[]	[]	(2) By-laws, including all amendments.
	[]	[]	[]	[]	(3) Minutes of all meetings of directors, committees of directors, and shareholders, including copies of notices of all such meetings where written notices were given, and copies of all Written Consents.
	[]	[]	[]	[]	(4) List of states and foreign countries in which qualified to do business.

- | | | | | | |
|--------------------------|---|--------------------------|--------------------------|-----|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (5) | All Business Plans. |
| | | | | (B) | <u>Subsidiary corporation documents</u> : Same as those listed under paragraph A above. |
| (C) | <u>Documentation on previous issuances of common stock, preferred stock, warrants, options, debt, or any other securities, including:</u> | | | | |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (1) | Schedules setting forth all issuances or grants of stock and options by the Company, listing the names of the issuees or grantees, the amounts issued or granted, the dates of the issuances or grants, and the consideration received by the Company in each case. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | Lists of all current record and beneficial owners of shares, including addresses and number of shares owned. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (3) | Same information as specified in (C)(2) above for holders of any other outstanding securities and warrants. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (4) | List of all options currently outstanding, including names and addresses of option holder and number of options held by each. |

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(5)	Samples of stock certificates, warrants, options and any other outstanding securities.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(6)	Copies of any voting trust, shareholder or other similar agreement covering any portion of the Company's shares.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(7)	All communications with shareholders since inception.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(8)	Stock option plans and forms of option agreements which have been used.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(9)	Stock purchase agreements which have been used for sales of any equity.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(10)	Any other agreements relating to sales of securities by the Company, including Buy-Sell and Right of First Refusal agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(11)	Permits or other state or federal securities law filings for issuance or transfer of Company's securities.

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|--------------------------|--------------------------|--------------------------|--------------------------|------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (9) | Any other agreements relating to registration rights. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (10) | Other employee benefit plans of any sort and related agreements. |
| | | | | (D) | <u>Material contracts, agreements, information and literature:</u> |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (1) | List of major suppliers, distributors and manufacturers. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | List of major customers and revenues received from each such customer for the last three fiscal years and forecast for the current fiscal year. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (3) | List of major competitors by product. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (4) | Percentage of sales contributed by each major product for the last three fiscal years and forecast for the current fiscal year. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (5) | License and technology transfer agreements and other agreements regarding technology with founders, corporate partners, or other parties. |

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(6)	New products which are expected to be introduced in the next two years and forecast revenues for these products.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(7)	Literature concerning the industry generally, and seasonal or cyclical aspects particularly.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(8)	Any studies relating to the Company's products.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(9)	Bank lines of credit.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(10)	Loan agreements, including those with officers, directors or employees.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(9)	Title reports for any real property owned by the Company or to be transferred to the Company prior to the consummation of the offering.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(10)	Documentation regarding the purchase or transfer of real property.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(11)	Lease agreements for offices, stores and manufacturing facilities.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(12)	Lease agreements for significant manufacturing

equipment, computer hardware and other equipment, furniture and automobiles.

[]	[]	[]	[]	(13)	Contracts with major distributors.
[]	[]	[]	[]	(14)	Contracts with major customers.
[]	[]	[]	[]	(15)	Sample contracts with other customers.
[]	[]	[]	[]	(16)	Contracts with major suppliers or manufacturers.
[]	[]	[]	[]	(17)	Sample contracts with other suppliers or manufacturers.
[]	[]	[]	[]	(18)	Insurance policies.
[]	[]	[]	[]	(19)	Employment contracts for officers and agreements with consultants.
[]	[]	[]	[]	(20)	Pension, profit sharing or retirement plans.

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(21)	Management incentive or bonus plans.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(22)	Confidentiality agreements with employees and other service providers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(23)	Information regarding governmental, administrative or regulatory proceedings.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(24)	Partnership agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(25)	Joint venture agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(26)	Research and Development agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(27)	Technical Cooperation agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(28)	Permits and distributorship agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(29)	Import/export licenses.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(30)	Advertising and marketing literature.

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(31)	List of patents or pending applications (both domestic and foreign).
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(32)	Trademarks/servicemarks, trademark/servicemark registrations or pending applications (both domestic and foreign).
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(33)	List of trade names.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(34)	Copyrights, copyright registrations or pending applications.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(35)	Product warranties.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(36)	Product literature distributed or to be distributed to the public.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(37)	Acquisition agreements.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(38)	Agreements regarding divestiture of divisions.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	(39)	Asset purchase agreements.

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|--------------------------|--------------------------|--------------------------|--------------------------|------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (40) | Documentation of merger with any predecessor corporation. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (43) | Agreements regarding sales to government entities. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (41) | Franchise documents. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (42) | Settlement documents. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (43) | Other material contracts outstanding. |

(E) Documentation relating to pending or threatened litigation, assessments or claims, including:

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|--------------------------|--------------------------|--------------------------|--------------------------|-----|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (1) | Copies of documentation and pleadings relating to any lawsuit (including names and addresses of all law firms handling litigation [including regular intellectual property counsel] for the Company). |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | Correspondence, memoranda and notes concerning any dispute with any employees, suppliers, competitors, or customers regarding any claim, or any claim or |

potential claim as to the licensing or use of technology.

[]	[]	[]	[]	(3)	Correspondence with auditors regarding threatened or pending litigation, assessments or claims.
[]	[]	[]	[]	(4)	Correspondence, memoranda or notes concerning United States government contract violations.
[]	[]	[]	[]	(5)	Correspondence, memoranda or notes concerning inquiries from federal or state tax authorities.
[]	[]	[]	[]	(6)	Correspondence, memoranda or notes concerning inquiries from federal or state occupational safety and hazard officials.
[]	[]	[]	[]	(7)	Correspondence, memoranda or notes concerning any claim or potential claim involving the prior employment or inventions of any employee or consultant of the Company.

[]	[]	[]	[]	(7)	Correspondence, memoranda or notes concerning inquiries from federal or state authorities regarding equal opportunities violations.
[]	[]	[]	[]	(8)	Correspondence, memoranda or notes concerning warranty claims.
[]	[]	[]	[]	(9)	Correspondence, memoranda or notes concerning inquiries from federal or state officials regarding consumer product safety violations.
[]	[]	[]	[]	(10)	Correspondence, memoranda or notes concerning inquiries from federal or state environmental officials.
[]	[]	[]	[]	(11)	Correspondence, memoranda or notes concerning inquiries from federal authorities regarding anti-trust violations.

[]	[]	[]	[]	(12)	Correspondence, memoranda or notes concerning inquiries from federal or state agencies regarding compliance with of any other law, rule or regulation.
[]	[]	[]	[]	(13)	Correspondence, memoranda or notes concerning any litigation or potential litigation involving a key supplier, distributor or customer that may have a material impact on the Company.
[]	[]	[]	[]	(14)	Correspondence, memoranda or notes concerning any litigation or claims involving the import or export of the Company's products.
[]	[]	[]	[]	(15)	Attorneys' opinion letters to auditors in connection with audits.
[]	[]	[]	[]	(17)	Attorneys' opinion letters to Company concerning the potential effects of any significant proposed or pending changes in any state or federal law, rule or regulation.
[]	[]	[]	[]	(16)	Attorneys' letters to management on status of lawsuits.

(F) Audit documentation:

- | | | | | | |
|--------------------------|--------------------------|--------------------------|--------------------------|-----|--|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (1) | Management letters from accountants concerning internal accounting controls in connection with all audits since the Company's inception (including predecessor companies). |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | All letters that have been sent to the Company in connection with all audits since the Company's inception (including predecessor companies). |

(G) Employee documentation:

- | | | | | | |
|--------------------------|--------------------------|--------------------------|--------------------------|-----|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (1) | Correspondence, memoranda or notes concerning labor or employment disputes. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | Correspondence, memoranda or notes concerning any pending or threatened work stoppage(s). |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (3) | Collective bargaining agreements. |

[]	[]	[]	[]	(4) Employment, non-competition or any similar agreements with employees including non-competition or any similar agreements between any key employee and an employee other than the Company.
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(H) Financial documentation:

[]	[]	[]	[]	(1) Balance sheet, income statement and statement of changes in financial position since inception.
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[]	[]	[]	[]	(2) Tax returns since inception.
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[]	[]	[]	[]	(5) List of banks or other lenders with whom Company has a financial relationship (briefly describe nature of relationship—lines of credit, etc.).
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[]	[]	[]	[]	(6) Most recent projected financial and cash flow statements.
-----	-----	-----	-----	---

(I) Miscellaneous:

[]	[]	[]	[]	(1) Analyses of the Company or its industries prepared by investment bankers, management consultants, accountants or others,
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including marketing studies, credit reports and other types of reports, financial or otherwise.

- | | | | | | |
|--------------------------|--------------------------|--------------------------|--------------------------|-----|---|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (2) | All significant recent management, marketing, sales or similar reports or memoranda relating to broad aspects of the business, operations or products of the Company. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (3) | All press releases issued by the Company. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (4) | Any other documents or information which, in your judgment, are significant with respect to any portion of the business of the Company or which should be considered and reviewed in making disclosures regarding the business and financial condition of the Company to prospective investors. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (5) | Directors' and Officers' Questionnaire. |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | (6) | Indemnification agreements with directors and officers. |

Company Financing Overview Sample A

Company Overview: **COMPANY A**

All the world's travel deals in one place.

Pain: We all know the top players – Top Player 1, Top Player 2, etc. They all access the same travel inventory in virtually the same way. But you want a **deal**, not just standard rates and fares – where do you go to find these?

Solution: Enter Company A. Company A is the easiest place to search for, discover and book travel deals online. Company A is at the intersection of the hot “Travel Deals” category and the strong monetization of “Meta-Search”.

Company Information:

Company A

XXXX Blank Rd.
Blank, CA XXXXX
XXX.XXX.XXXX
www.companyA.com
executive1@companyA.com

Basic Details:

Founded In: 2008
Of Employees: 4

Funding History:

Total Amount Raised to Date:

Participants	Amount
Individuals:	\$15k
VCs:	None
Others:	None

Total Seeking: \$1.0M - \$1.5M
Committed Funds (If Any): \$100k
Use of funds: Production, build team

Financials:

Cumulative Revenue: Pre Launch
Burn Rate: \$1500 /mo
Cash Flow Positive in: 2009

3-Year Revenue Forecast:

Year 1:	\$135k
Year 2:	\$2.1M
Year 3:	\$6.8M

Team:

EXECUTIVE 1 – PRESIDENT

Co-founder, ex-VP Sales at Company X. 10+ years internet based start-up experience with 8+ years in travel industry.

EXECUTIVE 2 – CTO

16+ years in software engineering and consulting. Has been developing high-volume Web applications since 1995.

EXECUTIVE 3 – VP ENGINEERING

Front End/UI Engineering Manager at Company X. 7-years at Company Y User Experience and Design, Platform Engineering & Ad Systems Front End Web Development veteran.

Product/Service

No other site provides such a powerful, comprehensive solution to finding travel deals. Instead of the equivalent of an online “classifieds” newspaper section for deals where publishers manually pick deals to post online, Company A is using proprietary technology to aggregate travel deals from all over the web and marry them with advanced personalization, social tools and destination content to give individual context to travel deals. Giving control to the users through the discovery process leads to increased interaction,

Defensibility

Companies that might attempt to implement a “Deal Search” solution fall into two categories, Deal Publishers and Meta-Search. Deal publishers have built their companies on an advertising model, not a technology platform. Meta-Search companies have technology solutions, but implementation of deal search is cannibalistic to their current business. In either case, Company A has created an advanced technology platform not easily duplicated without great engineering effort and substantial changes to fundamental business.

Competition

Competition X, a public company (CompX), generated 2007 revenues of \$79 million, experienced 95% YOY growth, and has built a successful deals destination site proving demand for and the existence of a large and profitable deals market. However, CompX as well as other travel deals sites do a poor job in delivering a personalized, intelligent, searchable, comparative and comprehensive travel deals product for the consumer. In short, no one has developed a technology solution to the Deals category of online travel.

Business Model

Online travel has the advantage of a proven monetization mechanism giving Company A the capability of generating revenue from day one. Revenue is weighted toward a CPA (pay for performance) model initially, with movement toward a CPC (shared risk) model in the near future. Because of this, Company A will be able to generate positive revenue within one year of launch.

Milestones

Company A is launching our “Closed Beta” the week of 10/12 (which will be available for investor access) and is on track for launch of our “Public Beta” 12/1/08. Our API interface for partner content distribution will be available in January 2009, and in March 2009 we will be releasing our “Production” version of the service.

Company Financing Overview Sample B

Company Overview: **Company B**

Company B is a social matchmaking platform that allows online gamers to discover compatible gaming partners, which drastically improves online gaming experiences and retention.

Pain: Currently, 75% of 70M active online gamers in the US are dissatisfied with their current multiplayer experience. They are frequently mismatched with gaming partners that are incompatible in skills, personalities, and schedules. Additionally, online gamer communities are segmented by games, genres, consoles, and geographic locations.

Solution: Company B developed a proprietary matchmaking algorithm that matches users on the 10 dimensions most important to online gamers. Because Company B's matchmaking algorithm is cross-games and cross-platforms, Company B is in the unique position of creating a global community for all gamers.

Company Information:

Company B

XXXX Blank Street
Blank, CA XXXXX
(XXX) XXX-XXX
<http://www.Company B.com>
team@Company B.com

Basic Details:

Founded In: May 2008
Of Employees: 2

Funding History:

Total Amount Raised to Date:

Participants	Amount
Company X	\$17,500

Total Seeking: \$500,000
Committed Funds (If Any): Strong interest from multiple Angel investors
Use of funds: Hiring developers, designers, and biz dev. Moderate marketing.

Financials:

Cumulative Revenue: \$0
Burn Rate: Currently \$5,000 / month
Cash Flow Positive in: Q1, 2010

3-Year Revenue Forecast:

2009: \$0.5M
2010: \$22M
2011: \$108M

Team:

Executive 1, Co-Founder, Executive 1 has been an active online gamer for 13 years. Executive 1 received a B.S. in Electrical and Computer Engineering from Cornell University.

Executive 2, Co-Founder, previously worked at a high-tech firm and led the firm's international expansion effort. Executive 2 has over 10 years of online gaming experience. Executive 2 received a B.S. in Operations Research and Industrial Engineering from Cornell University.

Product/Service

Company B developed two proprietary matchmaking algorithms: the first algorithm determines the user's gamer personality, and the second algorithm matches users on 10 dimensions that are most important to online gamers. In addition, Company B offers a complete platform that includes key features desired by online gamers:

- A unified gamer identity, across all games and platforms.
- Community and member management tools
- Event organization tools and User-Generated Content

Defensibility

Company B developed two proprietary matchmaking algorithms using statistical analysis and gamer psychology research, which we are in the process of filing for provisional patents.

Additionally, Company B also utilizes a "reputation" system similar to Company X's seller rating. Once a user gains reputation on Company B, the switching cost of going into another social network becomes increasingly higher.

Competition

Competition comes from a variety of existing and new social networks for gamers. Company B's unique differentiation has gained more users than the competitors in a small fraction of the time it took them, and even smaller fraction of costs.

Business Model

1. Company B collects detailed user demographic data and gaming preferences, which allows highly targeted advertisements with high CPM, and lead generations.
2. Company B's targeted demographic is well positioned for sponsored advertisements, a popular advertising method in the gaming industry.

Milestones

Company B launched beta in the beginning of August 2008. By only posting on two forums for feedback, over 25,000 online gamers across the globe have come and used the matchmaking system. Traffic statistics:
Unique visitor (August): 10,000
Weekly growth (August): 23%
Weekly growth (September): 56%
Monthly growth (August – September): 25%

Company Financing Overview Sample C

Company Overview: Company C

Company C enables web collaboration on Smartphones.

Pain: Business can't always wait for a structured, pre-arranged time for a web meeting to take place.

Solution: A purpose built cloud-based thin client platform that delivers a superior user experience on a Smartphone

Company Information:

Company C Inc.

XXX Blank Road,
Blank, CA
XXX.XXX.XXXX
www.Company C.com
executive1@Company C.com

Basic Details:

Founded In: May 2008
Of Employees: 3FT/3PT

Funding History:

Total amount raised to date: \$0
Total Seeking: \$500K
Committed Funds: \$0
Use of funds: Salary
Valuation Expectations: \$1.5M Pre

Financials:

Cumulative Revenue: \$0
Burn Rate: \$0
Cash Flow Positive in: Q3 2011

3-Year Revenue Forecast:

Year 1: \$311,000
Year 2: \$2,880,000
Year 3: \$14,510,000

Team:

Executive 1 – CEO

A serial entrepreneur, Executive 1 has successfully delivered from \$0-50M in revenue.

Executive 2 – VP Technology

Executive 2 worked at Company X as the first software engineer. Prior, Executive 2 worked at Company Y as 8th employee and opening up India office. Executive 2 worked at Company Z earlier in his career.

Executive 3 – VP Marketing

Executive 3 worked at Company X (8th emp) as Director of Business Development/Sales. Prior, Executive 3 worked at Company Y as Director of BizDev.

Product/Service

Company C has developed a purpose built software system for mobile that runs on top of Virtual Machines in the cloud (hosted by X Company). Our thin client computing system has a dedicated agent on the smartphone that includes host of optimization techniques. These techniques include Forward Error Correction, Intelligent push, image compression and auto sensing of bandwidth which collectively deliver a sub 5 second download.

Defensibility

We are in the process of filing 2 patents which cover: User Interface interaction and cloud server/ agent proxy for desktop conferencing. The Company C system is custom built for mobile collaboration which cannot easily be replicated. Specifically, optimizing for mobile requires a host of optimization techniques (see above) that must work in sync with transcoding desktop conferencing for mobile. Our custom platform, combined with first mover advantage, makes a defensible advantage.

Competition

We anticipate the competition coming from the legacy web conference providers like Competition 1, Competition 2, Competition 3 and Competition 4. There have been announcements, but no solutions have been released by our competitors.

Business Model

Via a SaaS model, Company C will have a two pronged strategy. One, partner with service providers that will private label our solution and market to their customer base. Two, Company C will market and sell directly to the prosumer and small enterprise segment.

Milestones

1. Product/market validation by C-level at Company X and Company Y.
2. Alpha product is available.
3. End user survey indicating 60% of users desire a smartphone based solution for web meetings.
4. Company launch at Company Z on November 12, 2008

Valuation Calculation – Financials

Valuation Calculation – Investment Scorecard



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