The Evolution of the NVCA Documents

A Brief Description of the Changes to the Crowdsourced Gem of Venture Capital Practice

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The table below is a summary of the primary changes that have been made to the National Venture Capital Association's model venture capital documents since they were originally released in 2003.[2] In an effort to assess the overall impact of these changes, we have undertaken to categorize them based on one of three underlying purposes- changes made to clarify the documents and/or eliminate opportunities for avoidance of the underlying intent; changes that reflect shifts in venture capital practice; and changes that simply reflect efforts to generally refine and improve the documents. The category in which we have placed each change identified below is indicated in parentheses following the description of such change using the following annotations:

"AA"= Anti-Avoidance/Clarifying

"CP"= Changes in Practice

"GI" = General Improvements

Practitioners might disagree as to how the various changes highlighted below should be characterized. We have indicated in certain places in the table where the decision we made seemed particularly susceptible to two different characterizations. Not surprisingly, how a change should be characterized – and more specifically whether it is a substantive change or not – depends largely on the perspective of the reader and the prior understanding the reader brings to the document regarding the intent of the relevant provision both before and after the change was introduced. This perspective is likely shaped by whether the practitioner is bringing an "investor friendly" or "company friendly" orientation to the exercise. We have endeavored to be objective. We have also been selective in the changes that we have highlighted. The NVCA drafting committee has been meticulously and painstakingly updating these documents for over a decade. Itemizing and characterizing all these changes was beyond the scope of this exercise. We have no doubt itemized certain changes that may not be as substantial as other changes that we have chosen to omit from the list.

A disproportionate number of the changes that have been made, and that are listed below, may best be described as "general improvements" rather than clarifying changes or changes to reflect new practice. These changes reflect refinements in the documents based on venture capital practitioners' evolving understanding of the terms and conditions in practice, coupled with upgrades to reflect legal developments. Many of these general improvements are simply in the form of additional drafting options that reflect the creative alternatives that have crept into common practice and can be helpful in working through issues that come up in negotiations during the documentation phase of any venture capital transaction.

Many of the changes have been driven by developments in the law. Changes that were introduced in response to developments in the law fall into all of the above categories, with certain of these changes designed to clarify, or close off anti-avoidance opportunities, that were exposed as a result of litigation (e.g., *Benchmark; Levy; Fletcher; ThoughtWorks*), other changes reflecting changes in practice that are in reaction to these legal developments (e.g., *Trados*), and still a third group falling into the category of general improvements necessitated or informed by these legal developments (e.g., Rule 506 "bad actor" provisions).

The nature of the changes that reflect shifts in practice suggest that the NVCA forms have been evolving in a direction that is more "friendly" to the company and its founders. For example, the stock purchase agreement no longer provides for founder representations and warranties, and a footnote indicates that such representations and warranties are not standard. In addition, the drag along feature has been substantially modified from the original "forced sale" provision, which would allow the preferred stockholders to unilaterally decide when to invoke the drag, to a provision that now requires each of the board of directors, the preferred stockholders and the common stockholders to be in general agreement before the drag may be triggered. While there have been new provisions introduced that reflect a practice shift in favor of investors as well, most of these changes appear to relate either to issues of secondary commercial importance, or are in the form of drafting options intended to flag issues for consideration rather than establish a new standard of practice.

Regardless of whether practitioners agree with the modifications that have been made over the 10 plus years, or not, the deliberate process the NVCA model forms committee has gone through in updating and modifying these documents has resulted in a product that is a must-have resource to any venture capital practitioner. A careful review of the changes reveals just how deliberate and exacting an effort this has been. The forms are the byproduct of a unique, cooperative effort undertaken by many of the most experienced and sophisticated venture capital practitioners in the country. Today this cooperative effort, and the collection of input and know-how it involved, would accurately be called "crowdsourcing." But the forms project was an effort that started well before such term was in vogue. In this regard, the project was ahead of its time. Lawyers who proceed with venture capital transactions without using these forms at some level, even if just as a reference resource, do so at their own peril given the depth of knowledge and insight they contain. We should all be thankful such a resource exists, and hope that the documents continue to be maintained with the same standard of care so that practitioners continue to have access to this invaluable tool. In the end this will allow our clients to get to the intended result of the negotiated for bargain as efficiently as possible. That is the ultimate goal.

TABLE

Stock Purchase Agreement

Provision	Description of Change Reflected in Current NVCA	
Section 1.4 – Use of Proceeds	Provision inserted regarding use of financing proceeds.	(GI)
Reps & Warranties Sections 2.2(b); (e); (f) – Capitalization	Cap rep expanded to provide for disclosure of vesting schedules of issued/outstanding stock options and restricted stock. Bracketed drafting option re: 409A-compliant plans inserted. Rep as to waiver of third party rights of first refusal inserted.	(GI) (GI) (GI)
Section 2.5(c) – Valid Issuance of Shares	Rep as to Rule 506 "bad actor" compliance inserted.	(GI)
Section 2.8 – Intellectual Property	Footnote inserted re: purposes of open source reps and proposed narrower drafting alternatives.	(GI)
Section 2.28 – Foreign Corrupt Practices Act	FCPA representation added.	(GI)

Section 2.29 – Data Privacy	Data privacy representation added.	(GI)
Old Section 3 – Representations and Warranties of Founders	Addendum with optional founders' reps/warranties inserted (w/ FN indicating that these *are not standard or typical*). The original version of the forms included a bracketed drafting provision related to founders representations and warranties with footnote indicating that these are fairly typical/standard in Series A financing transactions in the Northeast US. This original provision was removed.	(CP)
Section 3.12 – Consent to Promissory Note Conversion and Termination	Bracketed drafting provision inserted providing for exchange of previously issued promissory note as payment for shares (and termination of note upon execution of SPA by investor).	(GI)
Section 6.4 – Counterparts	Provision added permitting email and/or other ESIGN-compliant execution methods.	(GI)
Section 6.15 – Dispute Resolution	Footnote as to potential availability of confidential arbitration in DE Chancery Court inserted (pending new legislation in reaction to *Delaware Corporation for Open Government v. Strine* decision).	(GI)
Section 6.16 – No Commitment for Additional Financing	Bracketed drafting provision inserted clarifying/confirming that investors have not made any commitment to follow-on financing.	(AA)
Section 6.17 – Waiver of Conflicts	Bracketed drafting provision inserted referencing company's counsel's historical representation of investor(s) and waiver of any related conflicts.	(CP)

Certificate of Incorporation

Provision	Description of Change Reflected in Current NVCA	
Section 2.5 – Deemed Liquidation Events	2.5.1(b) – Provision inserted expanding definition of "Deemed Liquidation Event" to include sales/dispositions of subsidiaries (if substantially all assets are held by subsidiary). 2.5.4 – Provision inserted re: allocation of escrow and contingent consideration in connection with Deemed Liquidation Event. [This provision was the subject of widespread negotiation when initially introduced suggesting that some practitioners may have viewed this as a change in practice].	(AA) (AA)
Section 3.2 – Election of Directors	Provision inserted clarifying that directorships will remain vacant until stockholders with designation rights vote to fill vacancy (in response to *Teltronics* decision).	(AA)
Section 3.3 – Series A Preferred Stock Protective Provisions	Provision inserted clarifying that acts/transactions in contravention of preferred stock protective provisions shall be "void ab initio" (in response to *Fletcher* decision). [Some practitioners might view this as a change in practice]. Provision inserted re: no reclassification of pari passu or junior securities (so as to circumvent liquidation preference). Provision inserted prohibiting creation of subsidiary that is not wholly-owned by the corporation.	(AA) (AA) (AA)
Section 3.3.1	Provision inserted preventing circumvention of liquidation preference waterfall via a merger with no independent economic substance other than subverting the terms of the preferred stock (in response to *Benchmark Capital Partners* decision).	(AA)
Section 4.4.1(d) – Exempted Securities	Bracketed drafting provisions inserted expanding the categories of "exempted securities" for diluting issuances.	(CP)

Section 5A. – Pay-to-Play	Removal of drafting option in the pay-to-play provision that would convert the preferred stock of non-participating investors into shadow preferred stock.	(CP)
Section 6 – Redemption	Bracketed drafting provision inserted re: determination of redemption price (greater of original issue price and FMV). Provision inserted requiring corporation to use all of its assets to satisfy redemption request (in response to *ThoughtWorks* decision). Separate footnote also added in response to *ThoughtWorks* re: other drafting options and limited efficacy of redemption provisions for companies under financial strain. [Some practitioners might view this as a change in practice].	(GI) (AA)
TENTH	Bracketed drafting provision inserted re: mandatory indemnification of directors/officers.	(GI)
TWELFTH	Bracketed drafting provision inserted re: selection of Delaware Court of Chancery as exclusive forum for adjudication of stockholder disputes.	(GI)

Right of First Refusal and Co-sale Agreement

Provision	Description of Change Reflected in Current NVCA	
Section 2.2(d) – Allocation of Consideration	Provision inserted re: allocation of consideration in accordance with the liquidation preference waterfall of the charter (including for this purpose a drafting option that mimics 2.5.4 of the Certificate of Incorporation) in the event the transfer results in a Change of Control.	(AA)
Section 3.3 – Prohibited Transferees	Bracketed drafting provision inserted re: prohibition on transfers to competitors.	(GI)
Section 4 – Lock-Up	Provision inserted re: pre-IPO lock-up of shares.	(GI)
Section 6.4 – Dispute Resolution	Footnote as to potential availability of confidential arbitration in DE Chancery Court inserted (pending new legislation in reaction to *Delaware Corporation for Open Government v. Strine* decision).	(GI)
Section 6.9 – Assignment of Rights	Provision inserted re: assignments/transfers of shares being conditioned upon assignee/transferee signing on the ROFR.	(GI)

Voting Agreement

Provision	Description of Change Reflected in Current NVCA	
Section 1.5 – No Liability for Election of Recommended Directors	Provision inserted specifying that nominating/designating investors do not have liability for the actions/inaction of their Board designees.	(CP)
Section 1.6 – No "Bad Actor" Designees.	Provision inserted re: Rule 506 "bad actor" compliance.	(GI)
Section 3 – Drag-Along Rights	Generally speaking, scope of drag-along provisions have been significantly modified and expanded: (1) The most significant change in this provision was to modify the initial drag from a "forced sale" provision in which all the common stockholders, including the founders, could be forced to sell the company in the event the preferred stockholders approve a sale of the company, to a provision that is primarily designed to enable the company to bring along minority stockholders ("stray cats and dogs") contingent upon the BOD, the preferred stockholders and the common stockholders all approving a sale.	(CP)

	(2) Insertion of new Section 3.3 setting forth exceptions to drag requirements (i.e. limited reps/warranties required in connection with sale transaction; limitation of indemnification obligations; required delivery of same form of consideration to each holder of each class/series of stock in connection with sale transaction, etc.).	(CP)
	(3) Insertion of new Section 3.4 with restrictions on sales of control of the company (requiring proceeds of third-party sales resulting in Change of Control – where the company is not otherwise a party to the transaction – to be run through the liquidation preference waterfall).	(AA)
	(4) Insertion of "sale rights" addendum as drafting alternative in response to *In re Trados* decision.	(CP)
Section 4 – Remedies	New section inserted related to available remedies in the event that investors do not vote shares of stock in accordance with provisions set forth in Voting Agreement. Specifically, new provisions include covenants to use best efforts to ensure parties enjoy rights under Voting Agreement and a bracketed drafting provision re: granting of an irrevocable proxy and POA.	(AA)
Section 5 – "Bad Actor" Matters	New section inserted re: Rule 506 "bad actor" compliance.	(GI)
Section 6 – Term	New section inserted specifying termination of Voting Agreement upon IPO or sale of the company.	(GI)
Section 7.16 – Dispute Resolution	Footnote as to potential availability of confidential arbitration in DE Chancery Court inserted (pending new legislation in reaction to *Delaware Corporation for Open Government v. Strine* decision).	(GI)

Investors' Rights Agreement

Provision	Description of Change Reflected in Current NVCA	
Section 3.2 – Inspection	Bracketed drafting provision inserted creating inspection rights exception in cases where Major Investors are deemed competitors.	(GI)
Section 4.1 – Rights to Future Stock Issuances	Bracketed drafting provision inserted re: investor's right to apportion pro rata allocation to other parties (can apportion to affiliates provided that they are not competitors or FOIA parties; apportioned parties must sign ROFR, Voting Agreement, etc. as condition to apportionment). Bracketed drafting provision inserted re: alternative calculation method for pro-rata allocation of shares (basing calculation on shares held by just Major Investors rather than all holders of preferred stock).	(GI) (GI)
Section 5.1 – Additional Covenants (Insurance)	Bracketed covenant inserted re: maintenance of prescribed level of D&O insurance.	(GI)
Section 5.5 – Matters Requiring Investor Director Approval	Bracketed drafting provision inserted prohibiting management bonuses payable upon a DLE. Provision inserted prohibiting entry into any corporate strategic relationship involving payment of $[100,000].	(CP) (GI)
Section 5.6 – Board Matters	Covenant inserted requiring reimbursement of director expenses related to attending Board meetings.	(GI)
Section 5.8 – Expenses of Counsel	Bracketed drafting provision inserted re: payment of expenses of investor counsel in connection with sale of the company (and providing documents/information to investor counsel throughout the course of negotiations).	(CP)

Section 5.9 – Indemnification Matters	Provision inserted re: priority of company's indemnification obligations to Board vis-à-vis indemnification obligations of investors designating directors (in response to *Levy* decision).	(AA)
Section 5.9 – Right to Conduct Activities	Bracketed drafting provision inserted clarifying that VC investors may invest in similar/competing businesses.	(AA)
Section 5.9 – FCPA	Bracketed drafting provision inserted re: FCPA compliance.	(GI)
Section 6.3 – Counterparts	Provision added permitting email and/or other ESIGN-compliant execution methods.	(GI)
Section 6.11 – Dispute Resolution	Bracketed drafting provision inserted re: selection of Delaware Court of Chancery as exclusive forum for adjudication of stockholder disputes.	(GI)

1. © Copyright 2015, Jonathan D. Gworek and Scott R. Bleier. Thanks also to Sarah Reed, General Counsel and Chief Operating Officer of MPM Capital and founding chairperson of the NVCA model venture capital documents initiative, for offering her comments and historical perspective to this article.

2. Updated documents were taken from the NVCA website on March 16, 2015, and compared to the forms originally posted in December, 2003. While this article focuses just on changes since the initial documents were posted in 2003, that initial set of documents was itself the byproduct of an exhaustive, de novo review of prevailing venture capital documentation and reflected a number of significant changes in practice at that time. For example, the initial SPA adopted a much simpler set of representations and warranties following an exercise in which representations considered more appropriate for M&A transactions were stripped out. Also, noticeably missing from the initial NVCA Certificate of Incorporation was the "no-impairment" clause which was eliminated because it was viewed as "the last refuge" for parties who felt aggrieved but had no substantive rights to assert.