

The NVCA Venture Capital Forms: Will East Coast Meet West Coast?

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A report from the Venture Capital Transactional Issues and Documentation subcommittee of the of the Private Equity and Venture Capital Committee of the Business Law Section of the American Bar Association.

The **Venture Capital Transactional Issues and Documentation** subcommittee of the of the Private Equity and Venture Capital Committee of the Business Law Section of the American Bar Association met at the recent Business Law Section Spring Meeting in Las Vegas. Morse, Barnes-Brown & Pendleton's Jon Gworek, subcommittee chair, set forth an ambitious agenda headlined by special guest **Sarah Reed**.

Sarah is General Counsel of Charles River Ventures in Boston, MA, and more importantly for purposes of the meeting is the Founder of the **National Venture Capital Association's forms project**. Sarah joined the meeting to share her perspective on the NVCA forms project inception, early history and evolution, current makeup and internal processes.

Sarah described how the forms project was born out of necessity—her own specifically. Having not done a great number of transactions prior to landing her position at Charles River Ventures, and feeling somewhat overwhelmed with the vast array of transactional documents she was seeing in her capacity as GC at CRV, she envisioned a future in which documentation would be more standardized and deals could proceed more efficiently. A more standard set of documents, she reasoned, would also allow the deal lawyers to focus on the aspects of the transaction that really mattered to their clients—the major business points, proper diligence and attention to the client's questions and needs moving through a complex transaction often for the first time.

Sarah knew she needed buy in of the law firms, yet recognized there might be some natural hesitancy from lawyers who had invested heavily in their own firm's forms and might feel threatened by the simplification of the documentation process. While it took some effort, Sarah was able to get a critical mass of influential private practice lawyers to agree to participate in the process. Sarah described how an initial group of 12 or so lawyers held up in rooms for all day drafting sessions, drawing from multiple different forms with the objective being to put together a solid and balanced set of documents that lawyers could be comfortable working off of regardless of whether they represented the issuing company or the investor. The process of arriving at the first published NVCA documents was an iterative one, with working groups breaking off from the full group tasked with specific documents. The first set of documents was posted by the NVCA in 2003.

While the data is imperfect to be sure, efforts that have been made to identify and classify the source of documents in use today indicates that roughly 60% of transactions in the Northeast US are based on the NVCA forms. While the data is less readily available for West Coast deals and more anecdotal, the incidence of use is significantly lower there—perhaps as low as 5%.

Sarah reported that while the early days were long and arduous for the drafting committee and the committee met annually to continue to update and improve the documents, frontloading those early efforts appears to have paid off as this will be the first year that the committee has no formal session scheduled. While the committee continues to monitor developments coming out of the Delaware Chancery Court, and takes up for consideration changes periodically, the need to convene the group is more intermittent. In fact Sarah mentioned that when the committee proposes changes now, the changes are agreed upon and run through the documents by a smaller working group of the committee and then run by the full committee for clearance. When the committee does get together now, the group—which Sarah estimates at around 50 lawyers, primarily in-house but supplemented with a select group private practice lawyers who are doing a lot of deals and are close with certain of the GC's—the committee is able to discuss other topics of mutual interest to VCGC's.

There was a lively discussion about how issues get vetted by the group and how decisions are made when a change in documentation suggested by a legal development or practice presents a conflict between the interests of the issuing company and the investor. Sarah made it clear that the committee's objective is to maintain a set of documents that reflects what is actually going on in the market. They are not looking to set the market. Where there are recognized and legitimate variations in the market, the committee has attempted to provide drafting options and footnotes to educate the draft person to the range of possibilities.

Sarah described one specific example of how the documents have evolved over time to reflect the market. When the first version of the NVCA forms was released, there was a provision for founders' representations and warranties. Sarah acknowledged that the practice of seeking founders' representations has become so infrequent that the committee has decided to take this provision out of the body of the NVCA Form Stock Purchase Agreement as it was no longer indicative of market; instead, there is a footnote in the SPA flagging the possibility of founder reps, particularly in transactions where, for example, the founder may have come out of a competitive company, and sample reps are provided in an addendum.

Sarah also described one instance in which the committee may, unintentionally, have moved the "standard market" practice. The specific provision at issue was the pay-to-play provision. The original NVCA charter called for the preferred stock to convert into shadow preferred with lesser rights when an investor failed to support a company at its *pro rata* level. Sarah and other committee members were experiencing difficulty in practice with this provision and were seeing and hearing reports from law firm practitioners that the provision was complex and time consuming to customize. Recognizing that pay-to-play triggers are relatively unusual, the committee opted to take the shadow preferred provision out opting instead for a much simpler yet more draconian penalty whereby the preferred stock converts to common stock. In order to correct a sense that this decision may have been inconsistent with market practice, the NVCA forms will going forward include two charters, one with each type of pay-to-play feature.

Sarah commented on the discrepancy between East Coast and West Coast use of the NVCA documents. Her sense was that certain West Coast firms were not as receptive to the forms at the outset as East Coast firms, and took some pride in holding onto their proprietary forms. A West Coast practitioner participating in the meeting generally agreed with this comment, but added that the reaction Sarah had observed coming from West Coast firms was also driven largely by discrepancies in what is (or was then) "market" between the East and West Coast. It was his sense that the documents were more true to capturing the East Coast market than West Coast, with somewhat more conservative and investor friendly terms and conditions. This same person also indicated that the last time he reviewed the NVCA documents they were more balanced in his view, going so far as to even say that they "were not that bad"! A sign that East may meet West someday after all.

There was an interesting discussion with Sarah about whether the adoption and wide spread use of the NVCA documents had contributed to a more efficient process as measured by actual transaction costs. The questioner lamented the fact that certain respected members of the

venture community were espousing a view that venture capital transactions should cost no more than five thousand dollars of legal fees. Sarah responded that she did not know exactly what the impact was on cost, but that certainly it was never her expectation that the forms would allow transactions to get done for such little cost.

The discussion was certainly a lively one and ended up taking up most of the hour leaving little time for the rest of the agenda. But it was well worth it. Thanks to all of those who participated in our very informative discussion with Sarah Reed, and a special thanks to Sarah for taking time out of her Saturday to share her valuable insights and great story with us.

For more information, please contact **Jonathan D. Gworek**, Subcommittee Chair.