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NVCA Revises Model Forms Post-*Moelis* Ruling

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The National Venture Capital Association (NVCA) is the self-designated flagship trade association of the venture capital (VC) industry. Its primary mission includes promoting consistency and efficiency in VC financing transactions. Consistent with this mission, the NVCA has developed a widely used set of annotated model legal documents as the starting point for negotiating VC financing transactions.

The suite of model forms created by the NVCA includes the following principal documents (collectively, the NVCA Documents):

Amended and Restated Certificate of Incorporation (the COI);

Stock Purchase Agreement (the SPA);

Investors' Rights Agreement (the IRA);

Voting Agreement (the VA); and

Right of First Refusal and Co-Sale Agreement (the ROFR).

The NVCA periodically publishes updates to the model forms to reflect, among other things, changes in industry norms and best practices, as well as developments in applicable law.

In January 2024, the NVCA released substantive updates to the NVCA Documents. In April 2024, following the Delaware Court of Chancery's recent holding in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, No. 2023-0309-JTL (Del. Ch. Feb. 23, 2024) (Moelis), the NVCA further revised the COI, SPA, and IRA to address the potential impact of *Moelis*. This article provides a high-level summary of these updates.

COI

The COI sets forth the powers, preferences, and special rights of each class and series of the company's capital stock. These include, but are not limited to, liquidation preferences, dividend rights, redemption rights, and certain voting rights.

Key Revisions:

- *Dividends*:
  - General clarifications were made to the calculation of dividends payable with respect to the preferred stock.
  - A new "Dividend Amount" definition was introduced, which clarifies that the dividend payable with respect to any series of preferred stock is equal to a designated percentage of the original issue price of such series of preferred stock.

- The NVCA has suggested that the preferred stock should not get two annual dividends in a given year (if the company declares more than one common stock dividend in that year). Thus, new language proposes that the determination of entitlement to dividends should be made on a calendar year basis.
- The COI provides that dividends to holders of preferred stock are on a pro rata, *pari passu* basis by default. The NVCA notes that this language should be adjusted if a series of preferred stock has a senior preference with respect to dividends.

- *Liquidation*:

  - As with the payment of dividends, preferential payments to preferred stockholders in the event of a liquidation are on a *pari passu* basis by default.
  - A clause was added to provide that, for purposes of determining the voting threshold with respect to a "Deemed Liquidation Event," the holders of the specified percentage of preferred stock vote together as a single class on an as-converted to common stock basis, which takes into account any anti-dilution adjustments when determining the number of votes attributable to each share of preferred stock.
  - "Statutory conversion, transfer, domestication, or continuance" has been added to the definition of "Deemed Liquidation Event definition," because, as the NVCA notes, these events can have the same effect on preferred stockholders as a merger.
  - The NVCA has included a newly defined term, "DLE Redemption Date" (defined as the 150th day after a Deemed Liquidation Event), and the NVCA also inserted language providing for an extension of the DLE Redemption Date in the event the definitive agreements governing a Deemed Liquidation Event contain contingent indemnification obligations and prohibitions on distribution of available proceeds while such obligations are in effect.
  - The mechanics for the company's providing notice to holders of preferred stock in the event of a redemption connected to a liquidation have been incorporated directly into the section relating to affecting a Deemed Liquidation Event. In addition, cross-references to the redemption section that include certain redemption mechanics have been removed from the liquidation provisions. The rationale behind these changes is that the redemption provisions are often deleted from the form, which can create inadvertent issues with inter-sectional consistency.

- *Voting – Election of Directors*:

  - The NVCA has created the concept of "At-Large Directors," separate from the series-specific directors, to clarify the process for filling vacancies in such board seats.
  - "Requisite Directors" definition has been added to simplify director votes throughout the COI. Optional, bracketed language allows the draft to set the threshold as appropriate.

- *Voting – Preferred Stockholder Protective Provisions*:

  - Domestication, transfer, continuance, waiver, and statutory conversion have been added to the list of acts that require preferred stockholder approval as a separate class or series. This provision was previously limited to "any merger or consolidation or any other Deemed Liquidation Event."
  - Additional changes were made to the remaining protective provisions, including those relating to: (i) the creation of, issuance, or changes to capital stock other than with respect to shares that would rank junior to the preferred shares regarding special rights, powers, and preferences; (ii) actions of subsidiaries; (iii) creation or adoption of any equity (or equity-linked) compensation plan (including increases to shares issuable thereunder); and (iv) indebtedness, liens, and security

interests.

- *Optional Conversion*:

  - The section relating to fractional shares has been revised to provide the calculation for the number of shares of common stock issuable to a preferred stockholder upon conversion of such preferred stock. The language clarifies that: (i) the number of shares issuable upon conversion will be the nearest whole number; and (ii) no fractional shares will be issued.
  - "Exempted Securities" provisions have been revised to, among other things, incorporate the Requisite Directors concept.
  - Shares issued in connection with a "Qualified IPO" (a definition introduced in the mandatory conversion provisions) have been added as a bracketed option in the list of Exempted Securities.
  - Language has been added to the provisions relating to the deemed issue of additional shares of common stock to contemplate the treatment of options or convertible securities with alternative conversion terms.

- *Mandatory Conversion*: A new "Qualified IPO" definition has been added to clarify the existing language of the COI. Further, the NVCA has included optional language that classifies a direct listing transaction as a mandatory conversion event for the outstanding preferred stock because direct listings have become more common in the public markets.

- *Officer Liability*: The Delaware General Corporation Law (DGCL) was amended in August 2022 to include certain officers in the scope of persons who can be exculpated from breaches of the duty of care. Optional, bracketed language has been incorporated to reflect this development.

- *Preferred Directors on Committees*:

  - To address *Moelis*, optional bracketed language provides that, with certain stipulations, any committee of the board must include any then-serving preferred director who wishes to serve on such a committee, unless the sole purpose of the committee is to consider a matter where such a preferred director has a conflict of interest, or the preferred director voluntarily declines such service.

In *Moelis*, the court invalidated certain provisions of a stockholder agreement that required the prior approval of a key stockholder on the grounds that they impeded the board in the exercise of its independent judgment in managing the business and affairs of the company.

The bracketed language suggested by the NVCA is to be used in lieu of the bracketed language found in Section 5.6 in the prior model IRA. Unlike in the prior model IRA, which also required the company to cause the creation of audit and compensation committees and to ensure that only non-management directors serve on those committees, the bracketed provision here speaks only to the inclusion of preferred directors on committees. To the extent creation of such committees must be required, the NVCA recommends incorporating such covenants by reference to the applicable provision of the COI. Another option is to make the creation of such committees closing conditions in the SPA.

SPA

The SPA provides the fundamental terms and conditions of the purchase and sale of the preferred stock to the investors. These terms include the number of shares being sold, the purchase price for such shares, the closing date, conditions to closing, and certain representations and warranties by the company and the investors.

Key Revisions:

- *Convertible Securities*:

  - Reflecting the increasing ubiquity of convertible securities, such as convertible notes and Simple Agreements for Future Equity (SAFEs), in VC transactions, the NVCA has added new definitions for "Convertible Security" (and the corollaries, "Convertible Securities" and "Convertible Security Shares"). The revisions include substantive mechanics for the cancellation and conversion of Convertible Securities into the applicable number of Convertible Security Shares, replacing the prior representations that provided for consent to promissory note/SAFE conversion and termination.
  - Optional, bracketed language provides a process for the company to obtain relevant tax documentation for purposes of complying with any tax reporting or withholding obligations triggered by the conversion of Convertible Securities.
  - Revisions include a provision affecting the amendment to the Convertible Securities to ensure that any slight variations from the formulas for conversion won't present any issues.

- *Use of Proceeds*: The provision that formerly provided that the company would use the proceeds from the sale of shares for product development and other general corporate purposes has been removed.

- *Key Employees*: The "Key Employees" concept has been removed in favor of a new "Knowledge Parties" definition and "Officer" definition, which includes specifically titled executives, such as CEO, President, and CFO, and any other person who reports directly to the board of directors of a corporation.

- *Fees and Expenses*: The representation relating to reimbursement of legal fees for investor counsel has been revised to include a deadline for payment.

- *Dispute Resolution*. The provisions relating to dispute resolution have been revised, particularly with respect to the arbitration provisions.

- *Representations and Warranties*:

  - Capitalization. The capitalization representations have been revised, including the addition of a sentence that eliminates the need to list, in the disclosure schedule to the SPA, the Convertible Securities being listed in the schedule of purchasers.
  - Intellectual Property.
    - The NVCA has created a series of new definitions regarding intellectual property (IP). These include "Company-Controlled Intellectual Property" relating to IP rights owned by the Company or exclusively in-licensed to the Company, "Company-Registered Intellectual Property," referring to Company-Controlled Intellectual Property registered by the Company with any governmental authority and applications for such registration, and "Intellectual Property Rights" which incorporates concepts from the prior SPA's "Company Intellectual Property" definition, which has been streamlined in the current SPA.
    - Optional knowledge qualification (with respect to patents and trademarks) has been included regarding whether the company has infringed any third party's IP rights. To the extent the investor has indicated that specific patents or other registered IPs are crucial to the success of the company, the NVCA suggests adding a validity and enforceability representation regarding such patents.

    - Representations that previously referenced, somewhat generically, valid licenses to software programs other than commercially available software products have been substantially broadened to contemplate several specific categories of "Standard Outbound Agreements" and "Standard Inbound Agreements."
    - Artificial intelligence tools increasingly play an important role in the growth of early-stage companies, whether as assistive technologies or core components of companies' businesses. To that end, the NVCA has added a new optional representation and related definition of "Generative AI," which includes representations as to the company's inclusion or use of personal information or IP with respect to such tools.
    - A representation regarding the company's efforts to safeguard confidential information and trade secrets has been added.
    - Substantive changes have been made to the representations related to the assignment by current and former employees and consultants to the Company of IP developed by such service providers and the NVCA has suggested sample language in the event the company needs to represent that it does not use or need certain IP created by service providers. Relatedly, the former standalone "Employee Agreements" section and related "Confidential Information Agreements" definition have been removed and substantially reincorporated into the newly revised IP section.
    - The representation relating to "Open-Source Software" has been modified to incorporate the newly created IP definitions and concepts mentioned above and clarify that it is intended to trigger disclosure of any "copyleft" obligations.
  - Data Privacy. Among other changes, a new "Privacy Requirements" definition expands on the prior language and includes language regarding compliance with applicable laws related to artificial intelligence and automated decision-making, again highlighting the increasing relevance of AI tools and systems. The optional, bracketed representation related to compliance with the Health Insurance Portability and Accountability Act of 1996 (HIPAA) has been expanded, to the extent the company transmits protected health information as defined under 45 C.F.R. § 160.103.
  - Health Care Laws. Given that an increasing number of venture-backed companies are subject to health care laws, the NVCA has added a new optional, bracketed representation related to compliance with "Healthcare Laws," including laws related to fraud and abuse, kickbacks, and other rules under HIPAA.
  - Export Control Laws. A provision which required the company to represent that it complied with the appropriate export classifications with respect to exported products, software, and technologies has been removed. The rationale is that most companies could not reasonably make this representation.
  - Sanctions. Sanctions are now a key component of many governments' foreign policy. Evincing this development, a new representation (including related definitions of "Sanctions" and "Sanctioned Party") has been added to the effect that the company has complied with applicable laws and regulations pertaining to trade and economic sanctions administered by the United States and other jurisdictions.
  - FCC Regulation and Compliance. An optional representation regarding the company's compliance with required licenses and authorizations as required by the Federal Communications Commission or analogous foreign agencies or bodies has been included.

- *Conditions to Purchasers' Obligations at Closing*:

  - In the wake of *Moelis*, the creation by the board of an audit committee and a compensation committee has been included as an optional closing condition.

IRA

The IRA sets out the information rights, registration rights, rights of first offer or preemptive rights afforded to investors, as well as various post-closing covenants of the company.

Key Revisions:

- *Registration Rights and Rights to Future Stock Issuances*:

  - Corresponding with the revisions to the COI, the "Deemed Liquidation Event" and "Direct Listing" definitions have been added to the definitions section, and the terms have been incorporated throughout the IRA as optional, bracketed text. Similarly, the NVCA has added provisions regarding suspension of registration rights and preemptive rights for any newly defined "Sanctioned Party," including provisions related to compliance with newly defined "Sanctions" relating to applicable laws and regulations pertaining to trade and economic sanctions administered by the United States, European Union or United Kingdom.

- *Information and Observer Rights*:

  - A new "Approved Annual Budget" definition replaces the prior, more general "Budget" definition.
  - The prior optional, bracketed language regarding certification by the CEO and CFO that the financial statements were prepared in accordance with GAAP has been removed and the delivery period for unaudited annual financial statements to Major Investors has been extended to 180 days.
  - The NVCA has added language requiring companies to upload information reasonably requested by a Major Investor to a portfolio management platform, likely reflecting the growing use of such software by investors to track and manage their investments.
  - In the optional, bracketed section relating to waiver of statutory information rights, the NVA has added a provision requiring the company to provide upon demand from any Non-Major Investor a statement showing their relative holdings despite any prior waiver under Section 220 of the DGCL.

- *Additional Covenants*:

  - Requisite Preferred Director Vote. Added a new definition and pulled this concept from the new provision in the COI.
  - Financial matters. Addition of a new "Approved Cash Management Policy" concept (replacing generic investment policy approved by the board language), and the Approved Annual Budget concept, which means the Budget, as approved by the Requisite Preferred Director Vote.
  - DEI. An optional, bracketed covenant has been added regarding the company's efforts to adopt and maintain policies and procedures relating to diversity, equity, and inclusion.
  - Cybersecurity. The cybersecurity has been revised to expand the definition of "Systems" used to process protected data, remove the previous "Cybersecurity Solutions" definition, and further streamline the provision, including the removal of previously bracketed optional, language that contemplated requirements that the NVCA has acknowledged would be difficult, if not impossible, for many emerging companies to meet.

- *Dispute Resolution*: Revisions have been made to the alternate dispute resolution provisions provided in the addendum to the IRA for parties who prefer to resolve disputes under the Delaware Rapid Arbitration Act. These revisions have also been added to the VA and the ROFR.

- *Board Matters*. In light of *Moelis*, new bracketed language contemplates that the covenant relating to the formation of committees has been made subject to the exercise by the board of its fiduciary duties. Relatedly, the company's obligations set forth in the provisions relating to insurance, qualified small business stock, implementation of committees, implementation of certain policies (including those relating to anti-harassment and DEI), and compliance with certain other covenants, are also made subject to exercise by the board of its fiduciary duties. With such limitations, the NVCA hopes to reduce the likelihood that such covenants would be found to be unenforceable constraints on the board's duties in violation of Section 141 of the DGCL.

VA

The VA provides certain voting rights, including rights related to the appointment of members of the board of directors, drag-along rights, and certain other rights and remedies.

- The recitals and introduction have been streamlined and simplified.
- A definitions section has been added, which includes certain new definitions, including "Qualified Key Holder" (which contemplates Key Holders providing services to the company), and "Sanctions" and "Sanctioned Party" (and related definitions).
- The NVCA has simplified the board composition provisions and included new provisions regarding vacancies and removal of board members.
- Most substantively, the drag-along provisions regarding appraisal rights and the agreement to refrain from challenging the enforceability of the drag-along provision have been revised.
- The Adoption Agreement previously appended to the end of the agreement has been removed.

ROFR

The ROFR sets forth, among other things, certain rights of first refusal and co-sale, and other transfer restrictions applicable to the investors and certain key stockholders of the company.

The revisions to the ROFR were limited to definitional clarifications, revisions to the Key Holder Lock-Up agreement, provisions relating to dispute resolutions, and the new definitions for "Sanctions" and "Sanctioned Party" have been added.

Conclusion

The NVCA Documents provide a valuable resource to venture capital firms and their attorneys. Companies looking to raise capital through preferred stock offerings also benefit from knowing that they are starting from a comprehensive set of documents that standardize these transactions and streamline the process of fundraising. These periodic updates to the NVCA Documents that respond to market forces and changes in the law are extremely helpful and venture capital investors and attorneys need to make sure they are always working from the current releases of these documents.

Should you have any questions about this topic, please contact Robert H. Laird Jr., Hunter Threet, Chris Sloan, or any member of Baker Donelson's Business and Corporate Group.