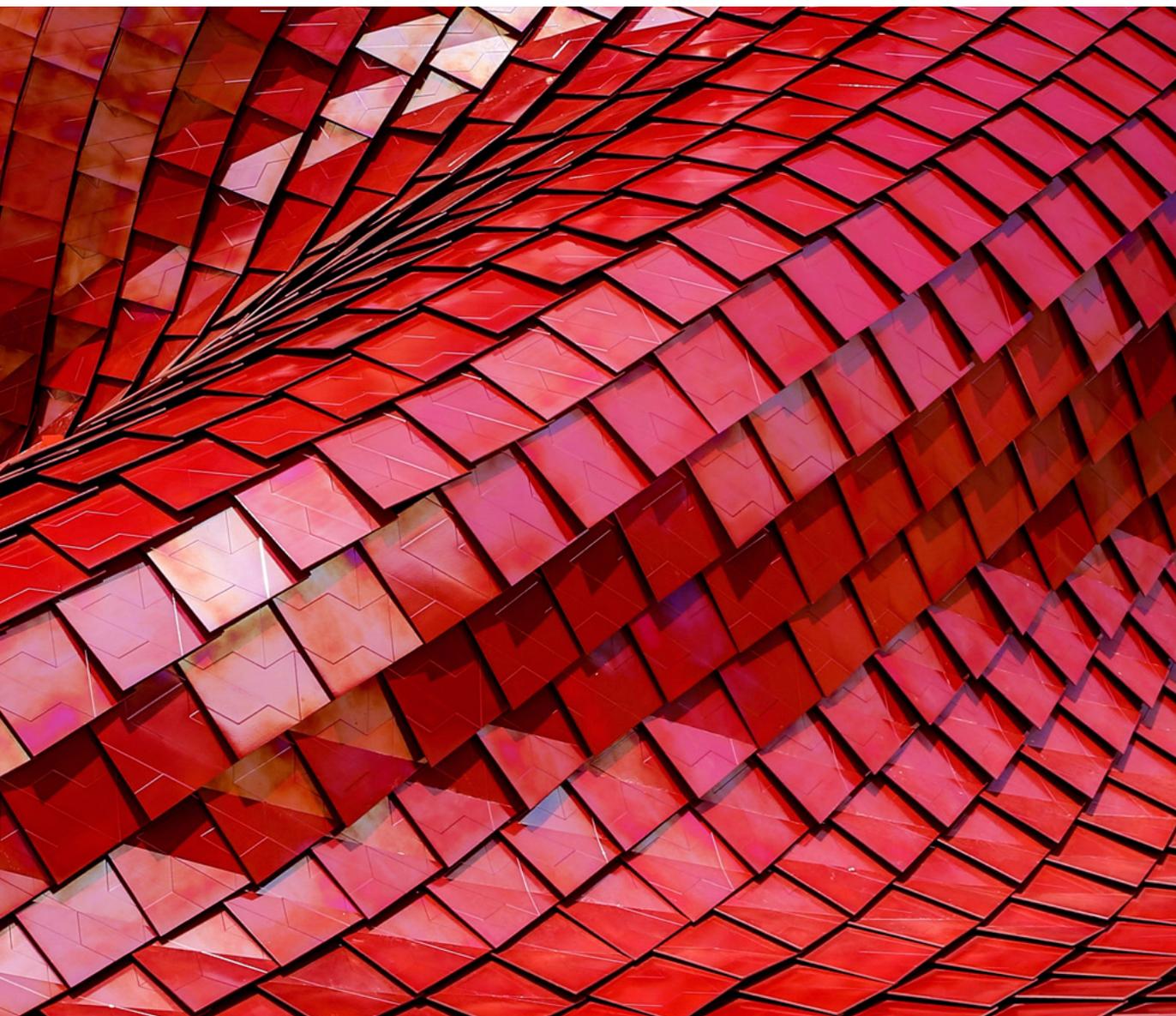


10 keys to venture capital transactions

December 2022





Index

Introduction	5
General market overview	
Market evolution	6
Source of investment	7
Most active sectors	7
Our venture capital practice	9
Cuatrecasas: What do we offer	10
10 keys to negotiate venture capital transactions	
1. Transaction types	12
2. Structure of the transactions	13
3. Regulatory authorizations	14
4. Allocation and use of proceeds	15
5. Founders' liability towards equity investors	16
6. Shareholders' voting and other rights	17
7. Restrictions on share transfers	18
8. Investors' anti-dilution rights in down rounds	19
9. Shareholders' economic rights	20
10. Founders' and key personnel's commitments and rights	21
Key contacts	23





Introduction

Venture capital (“VC”) investments in startups (emerging companies operating in the technology sector or with high levels of innovation and potential) have grown significantly in Spain in recent years. VC financing has proven to be essential for the growth and expansion of startups.

Investments in startups are mainly executed through funding rounds, once the company is already in operation, although some funds and other investors support entrepreneurs at the incorporation stage. The investor profile varies in each round (friends, family and fools; incubators; accelerators; business angels; VC funds, and corporate ventures), depending on the startup’s stage of development (seed or growth).

VC investment transactions have some distinguishing features from private equity. In short, while private equity provides funding to established companies to acquire, in most cases, a majority stake, VC diversifies its investment by acquiring minority stakes in companies in the early stages of their development.

VC investment requires specialized legal advice with extensive knowledge of market practices, given the tight deadlines and multiple risks and interests involved.

This document analyzes the Spanish VC market in 2021 and 2022, summarizing the characteristics of these transactions.

General market overview

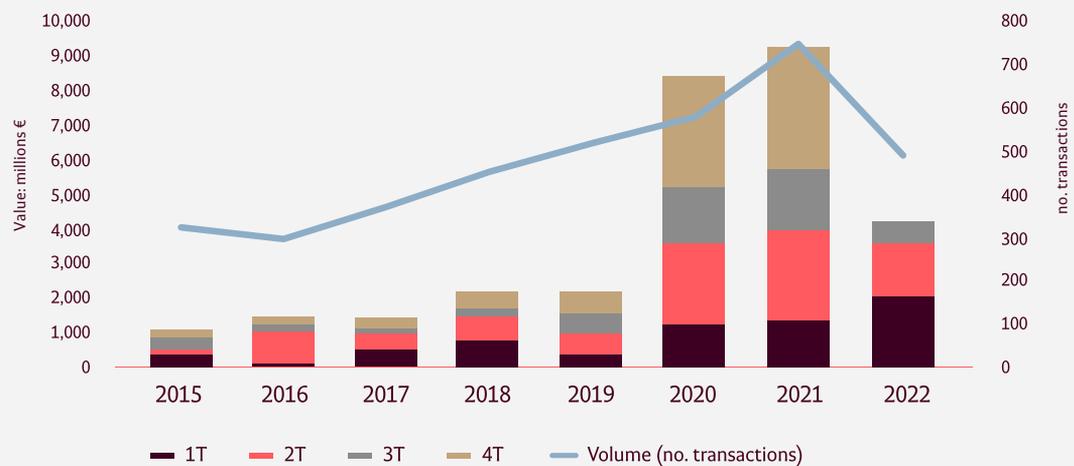
Market evolution

After its boom in 2020, the Spanish VC market hit a new all-time high in 2021 in both the value and number of transactions, both of which exceeded the figures reached in previous years.

According to figures reported by TTR in Spain, the VC market registered 744 transactions in 2021 - totaling €9.251 billion - a 29% year-on-year growth in the number of transactions and their value.

Venture capital transactions in Spain 2019-3Q2022 (quarterly)

(Source: TTR)



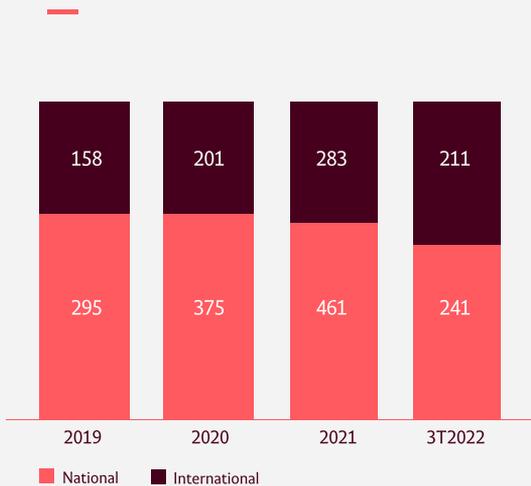
Other entities such as SPAINCAP confirm this milestone with similar figures: in 2021, VC reached a new historical high, both in the value (+139%) and number of transactions (+15%). The trend slowed down in 2022, with a decline in both activity and transaction value, especially from the second quarter onwards, when the effects of the macroeconomic situation began to be felt. However, and thanks to the intense activity in the first quarter built on the momentum from the previous year, Q3 2022 had already exceeded the figures reached in the full years prior to 2020.

Source of investment

With regard to the source of investment, even though most transactions were domestic (although with a decreasing share), international investors focused on higher value transactions, accounting for 95% of the Spanish total market value

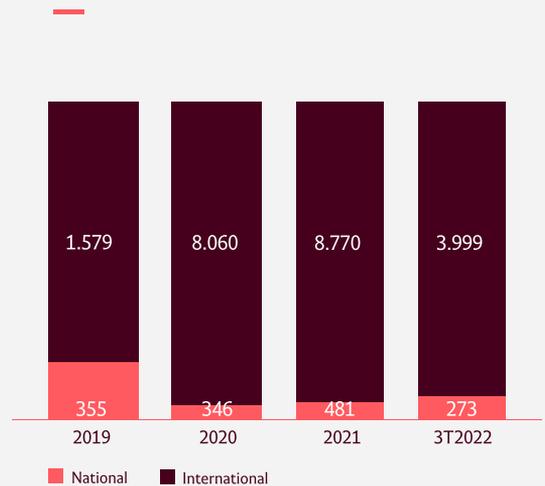
Source of VC transactions in Spain (by volume)
2019 vs 2020 vs 2021 vs 3Q2022

(Source: TTR)



Source of VC transactions in Spain (by value)
2019 vs 2020 vs 2021 vs 3Q2022

(Source: TTR)



SPAINCAP also confirms this trend in 2021, where the market record had chiefly to do with VC from international sources.

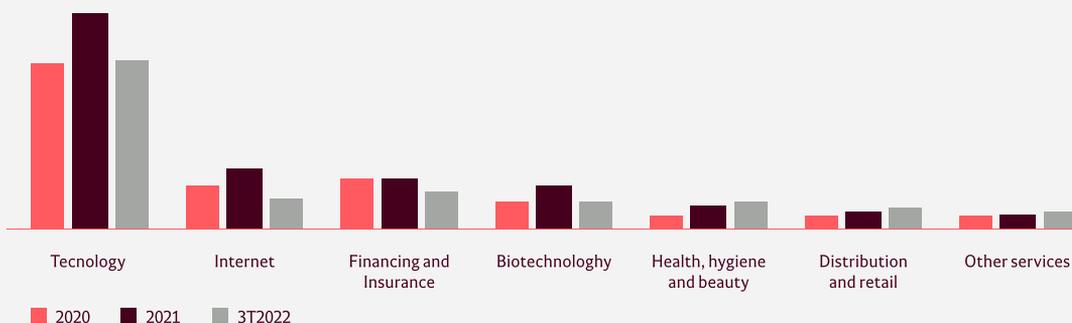


Most active sectors

The market was clearly dominated by the technology and internet sectors, with both areas showing an increase in value and volume of transactions in 2021.

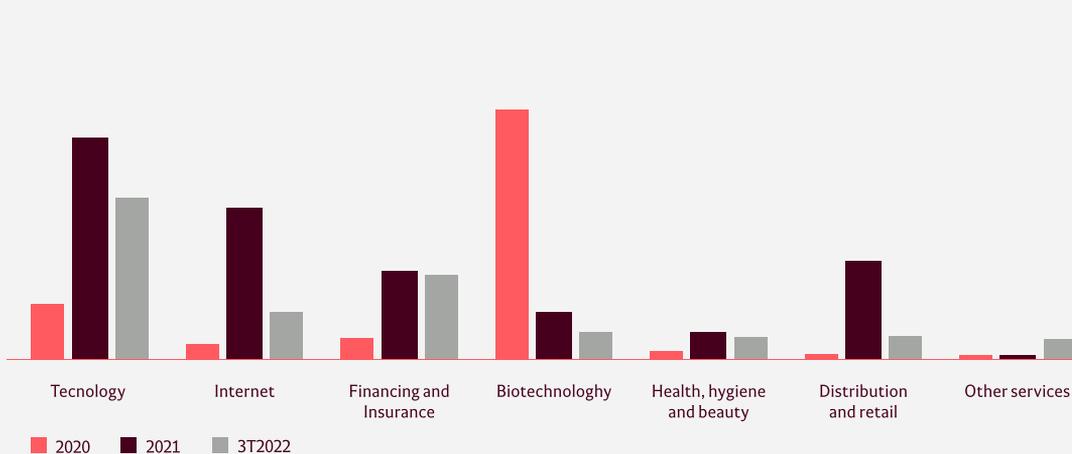
Most relevant sectors (by volume)

(Source: TTR)



Most relevant sectors (by value)

(Fuente: TTR)



The distribution and retail sector also stood out; although there were fewer transactions, they were high value and included Delivery Hero's acquisition of a 39.4% stake in Glovo, the largest transaction of 2021 (closed in 2022).

Our Venture Capital practice

The Cuatrecasas team offers funds and investors a comprehensive and specialized service for VC transactions.

We regularly advise national and international VC funds and investors, including corporate ventures, on all aspects of their activity: ranging from their early development stages incorporating the fund or vehicle, regulatory compliance, participation in financing rounds in startups and companies in all stages, to sales processes and exits.

Our team regularly advises on recapitalization transactions and divestments. We focus on designing and implementing innovative strategies and structures that are optimum and efficient from a tax and commercial perspective.

Through our VC team, made up of lawyers from all specialties (including corporate and commercial, intellectual and industrial property, data protection, labor and tax), we offer a wide range of services in the entrepreneurial ecosystem, understanding entrepreneurs' day-to-day challenges and sharing their business vision.

Chambers, 2022

"Well equipped to assist clients with venture capital financing rounds."

Chambers, 2022

"They have built strong programmes with venture capital and private equity and are very focused on transactions."

Large market share: In 2021, we were involved in over 70 VC and private equity transactions. We work closely with the most innovative national and international players in the startup ecosystem.

Relevant experience: We have participated in many of the largest and most complex transactions and financing rounds in recent years.

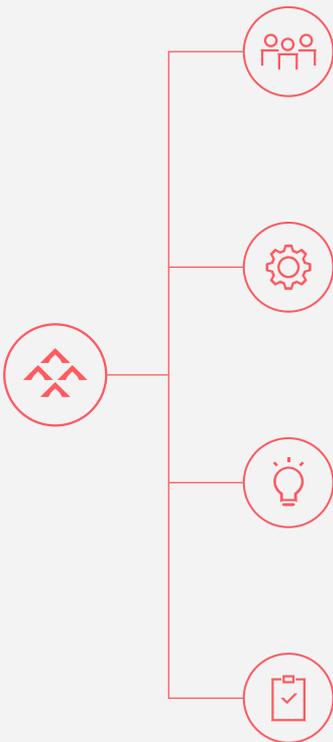
Chambers
AND PARTNERS

Recommended firm in Venture Capital

Cuatrecasas: What we offer



Through our highly specialized legal teams with extensive knowledge and experience, we advise on all areas of business law. We help our clients with the most demanding matters wherever they are based.



TALENT

A multidisciplinary and diverse team made up of over **1,200 lawyers and 26 nationalities**. Our people are our strength and we are committed to being inclusive and egalitarian.

EXPERIENCE

We have a **sectoral approach** and focus on all types of business. With extensive knowledge and experience, we offer our clients the **most sophisticated advice**, covering ongoing and transactional matters.

INNOVATION

We promote an innovation culture applied to the legal activity, which combines training, procedures and technological resources to enhance efficiency.

SPECIALIZATION

We offer optimal value thanks to our highly specialized teams, which apply a cross-sectoral approach to our clients' business to offer efficient solutions.

Chambers AND PARTNERS IFLR1000
LATIN LAWYER 250 THE LEGAL 500

Recommended firm in the main areas of law in Europe and Latin America

THE LAWYER

Iberian Firm of the Year, 2022 and 2020

LACCA Latin American Corporate Counsel Association

Fifth most popular international law firm in Latin America, 2021



10 keys to negotiate venture capital transactions

1

Transaction types

Fast and complex transactions

These transactions are typically completed in short periods of time and with very tight schedules, which requires specific knowledge of market standards and negotiation readiness. They are technically highly complex, as it is necessary to align the interests of fragmented shareholders with significant differences in investment value (both in the total amount and in the valuation in the Company in which they invested). This poses continuing legal challenges and the need to come up with innovative solutions.

Main agreements: investment agreement and shareholders agreement (or, in a single document, “ISHA”)

Non-disclosure agreements (NDAs), common in M&A, are rare in VC. This is due to the speed of these transactions and the high number of opportunities analyzed by investors. Investors, whether VC funds or corporate ventures, undertake confidentiality commitments under the term sheet or directly on executing the transaction agreements.

It is customary to sign a term sheet outlining the main terms and conditions of the transaction. The term sheet is not binding (except, if applicable, for some specific sections such as the negotiation exclusivity clause) and is usually signed by the founders and the lead investor.

Two separate contracts are usually signed: (i) the investment agreement (“IA”), which sets out the terms and conditions of the investment, generally by means of cash capital increases or, if applicable, by setting off convertible loans granted by the investors to the company; and (ii) the shareholders agreement (“SHA”), which (i) sets out the terms and conditions of the relationships between the shareholders as shareholders of the company, and between the shareholders and the company; and (ii) establishes the operation, management and organizational structure of the company. Typically, the company is a party to these agreements.

Their terms and conditions depend on the startup’s stage of development and the fully diluted cap table showing the percentage ownership at any given time. For companies at a more advanced stage, SHAs tend to be more complex - being subject to the extensive regulation of share classes and associated rights.

Lead investor: the investor who leads the negotiation on behalf of the investors of the round with the founders and the company

In a startup, investors have individually limited bargaining power, given the large number of shareholders and the primary need to close the financing round quickly and efficiently. Therefore, except for the round’s lead investor and, if applicable, the lead investor(s) of previous rounds, the rest of the shareholders seldom participate in the negotiation and simply sign the new contracts already negotiated.

Therefore, the lead investor negotiates each round’s terms with the founders and the company.



2

Structure of the transactions

Minority investments in limited companies via capital increase

In Spain, startups mainly take the form of private limited companies (*sociedades de responsabilidad limitada*), i.e., closed capital companies subject to legal and bylaw restrictions on the entry of third parties. VC investors normally acquire a minority stake in the startup's share capital by assuming newly issued shares from (i) a cash capital increase, or (ii) a capital increase setting off credits arising from loans granted to the company.

This differs from private equity transactions, where funds generally acquire 100% or a majority stake in well consolidated companies directly through the purchase of shares.

Financing rounds through cash capital increases or convertible loans

Startup financing does not take place all at once, but in different stages (called investment or financing rounds), depending on the company's evolution and cash needs.

Startups are typically financed through the issue of new shares from a capital increase (primary transactions) or through convertible loans granted by investors.

Ordinary shares (founders and initial investors) and preferred shares (other investors)

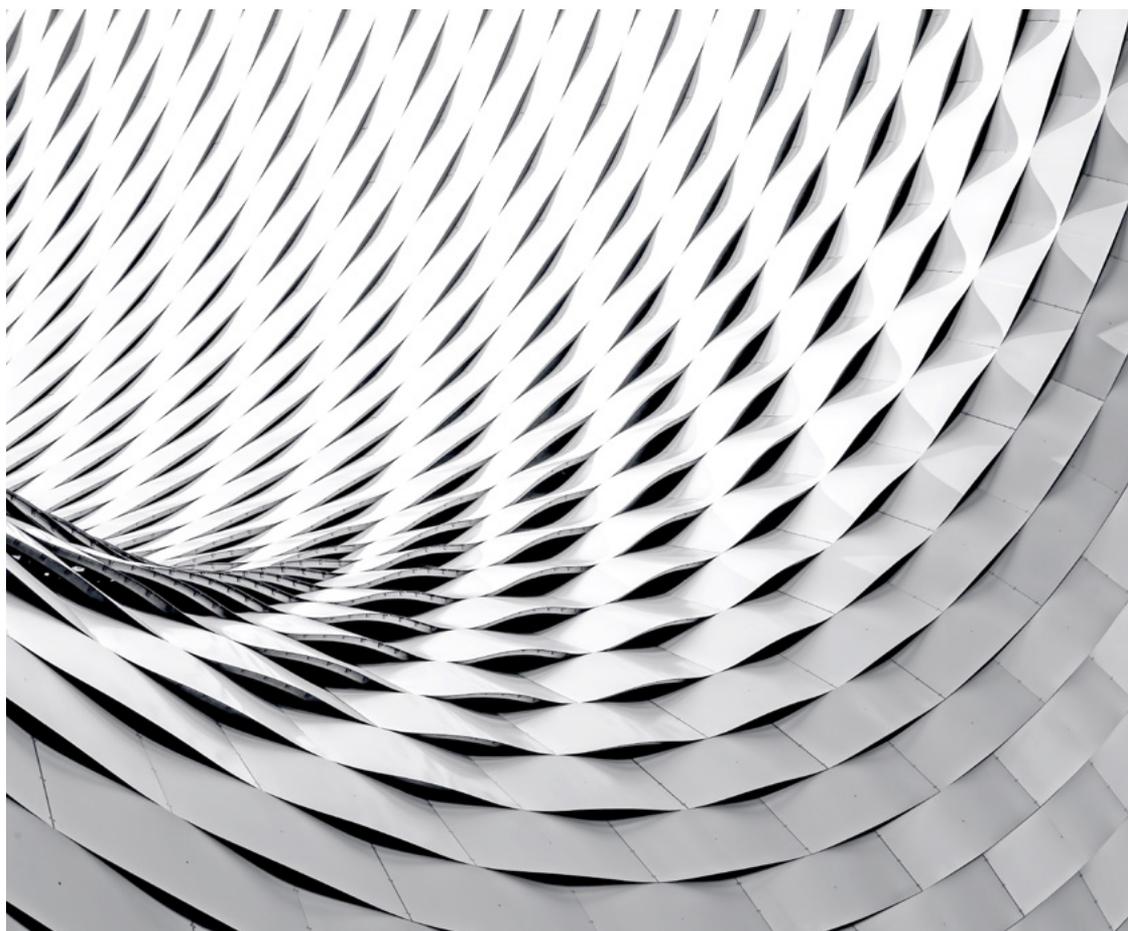
As the company's business develops and successive investment rounds are carried out, different classes of shares are issued (usually at a higher nominal value and with more beneficial rights than the previous ones).

A distinction is made between (i) ordinary shares held by the founders and, as the case may be, by early investors close to the founders, such as "friends and family;" and (ii) preferred shares of different classes, depending on the round (e.g., A, B, C), held by the investors.

Upward trend in convertible loans

Investors can contribute funds to the startup through convertible loans. Subject to the fulfillment of certain milestones and events (usually by the time of the next financing round), these investors are allowed to capitalize their credit claims by acquiring shares in the company through debt-to-equity conversion. Convertible loans have become increasingly popular and used in recent years.

Among other aspects, it is crucial to consider the rights of the parties during the term of these agreements, the causes for early termination, the conversion events, and their fit with the project. Likewise, it is important to set out the investors' obligation to enter into to the IA and the SHA in force at the time of the conversion (or, if applicable, the terms to be included in it).



3

Regulatory authorities

Merger control and foreign direct investment (“FDI”) analysis is necessary

Even if the parties prefer quicker transactions involving simultaneous signing and closing, it is sometimes necessary to conduct a merger control assessment (antitrust) and, more often, FDI control to verify whether the transaction is subject to prior administrative clearance.

The analysis of FDI control is particularly important when the investor comes from (or has a beneficial owner in) a country that is not a member of the European Union or the European Free Trade Association and the target company is a tech or data-intensive investee company, which is not uncommon in VC investments focused on innovative companies.





4

Allocation and use of proceeds

Smart money

On carrying out VC transactions, depending on the startup's stage of development and shareholding structure, the founders may not only seek funding, but also "smart money." Startups with a stronger negotiating position will demand investors to add value to the company (e.g., by acting as mentors to the founders or by providing reputation or contacts with potential future investors).

"For-equity" agreements

Media-for-equity agreements, under which investors indirectly contribute publicity for the startup, are common in some sectors. The investor and the startup enter into an advertising agreement, and the investor acquires the company's shares by setting off its credit in a capital increase. There are other "for-equity" arrangements, such as legal services for equity.

Use of the investment proceeds

Given that the founders will continue to manage the company (subject to greater or lesser control by the investors depending on the terms of the SHA), investors often demand that their funds be used for a specific purpose (through "use of proceeds" clauses), normally linked to the business plan in force.

5

Founders' liability towards equity investors

Business representations and warranties by the founders or the company

The IA sets out the liability of existing shareholders on the incorporation of new ones. Unlike in other M&A transactions, business representations and warranties are not usually given by all the shareholders, but only by the founders (or, as we will see in the next point, by the company itself), since they are in charge of managing the company, know it in depth and have developed its business plan.

Alternative solutions to traditional liability for breach of business representations and warranties

As the founders are individuals who invest their personal wealth in the startup and usually work exclusively for the company, they are often reluctant to undertake indemnity obligations similar to those customary in M&A transactions in the event that the business representations and warranties turn out to be incorrect or incomplete. Alternative solutions require a case-by-case legal analysis.

A first possibility is that the founders, as well as the other shareholders, limit their representations and warranties to capacity and title (so-called “fundamental warranties”), and that the company itself grants its business representations and warranties. The particular arrangements should be analyzed on a case-specific basis in the light of the prohibition of financial assistance under the Spanish Companies Act (*Ley de Sociedades de Capital*), which prevents companies from providing guarantees or any type of financial assistance for the acquisition of their own shares by third parties.

Another common alternative is that the indemnity for breach of representations and warranties be paid in kind through company shares. In this case, it is necessary to consider the restrictions on transferability both under the SHA and the bylaws.



6

Shareholders' voting and other rights

Voting proxies granted to founders

VC investments often target companies with a large number of minority shareholders. Therefore, to speed up decision-making, it is common for shareholders meetings to grant voting proxies to the founders or, less frequently, to the lead investor of the last round.

Enhanced information rights for lead investors

The lead investor of each round and other significant investors usually demand the inclusion in the SHA of additional information rights to those under applicable law, allowing them to monitor the business performance and the management team's actions.

Greater limitations on qualified majorities at the shareholders meeting and preclusion of individual veto rights

As regards the adoption of resolutions, fewer matters are subject to qualified majority than in private equity transactions, and they are usually linked to share classes. Thus, veto rights of individual investors are uncommon except in the early stages.

The board as the most common management body and investors' right to appoint observers

When professional investors join the company, the management body usually takes the form of a board.

However, unlike in M&A and private equity transactions, VC investors do not have a vested interest in managing the business. In fact, the founders and key personnel are in charge of management under the investors' supervision. Typically, the CEO is a founder subject to the control of the board in a more active way.

The round's lead investor is often (but not always) the only one entitled to propose the appointment of one of the directors (depending on the company's stage of development and the investor's percentage interest). Therefore, significant investors in VC transactions typically reserve the right to appoint observers. Observers may attend board meetings and have access to the information the directors receive, but they do not have voting rights on the board. The SHA should specify the rights and confidentiality obligations of the observers, if any.

Independent directors and voluntary audits

It is increasingly common to establish the obligation to appoint independent directors. Also, investors usually demand voluntary audits of these companies to ensure uniform and objective accounting.

7

Restrictions on share transfers

Secondary transactions: alternative to dividends to obtain a return

Startups do not usually distribute dividends during the first years. Therefore, the way for shareholders (investors or founders) to obtain a return is through the sale of their shares (secondary transactions). This requires a detailed analysis and negotiation of the restrictions on transferability in each round.

Common covenants: founder lock-up provisions, free transfer between group members, preemptive rights by class, and tags and drags in favor of the investor pool

Detailed covenants on share transferability are included. They often differentiate between classes of shares. The following are the most common, although they may vary depending on the stage of development of the startup:

- Lock-up periods for founders.
- Conditions on permitted transfers between group companies and, in particular, to investment fund members (in a broad sense).
- Preemptive rights, often differentiated by type of share class.
- Tag-along rights differentiated between founders and investors. The more advanced the round, the lower the percentage that triggers the tag-along (in any case, always lower than in traditional M&A transactions).
- Drag along rights in favor of a significant investor group.

Investors do not grant business warranties or non-compete or non-solicitation covenants

As regards investors' liability in sale transactions on divestment, it is usually agreed that they will not grant representations and warranties (except for title and capacity), or enforce non-compete or non-solicitation covenants.





8

Investors' anti-dilution rights in down rounds

Anti-dilution clauses

Among the standard protections investors demand are anti-dilution rights aimed at protecting the value of their investment in future financing rounds on the issue of new shares at a lower price (down rounds).

Pre-emptive rights under the Spanish Companies Act or the bylaws protect investors against potential dilution, but require additional disbursements.

Investors seek to cover dilution risk in financial and economic terms, thus avoiding losing the theoretical value of their investment and obtaining compensation for new down rounds.

Anti-dilution mechanisms: full ratchet and weighted average

There are basically two anti-dilution mechanisms in VC transactions:

- **Full ratchet:** This involves compensating the total economic dilution an investor suffers as a result of the new round, so that the company agrees to deliver a number of shares representing the loss in value of the investor's initial investment.
- **Weighted average:** The current market trend is to use this mechanism, which neutralizes the negative impact of the economic dilution. A weighted average is made between the value of the investment in the company before and after the round. There are two variants: (a) narrow-based weighted average, which only takes into account the legal capital ("non-fully diluted"); and (b) broad-based weighted average, which takes into account all present and future capital ("fully diluted"), such as stock options or any other conversion right.



9

Shareholders' economic rights

Preferential conditions in liquidity events

Startups do not usually distribute dividends to the shareholders during the first years since any profits (usually not immediate even if round valuations are high) are usually reinvested in the company itself. Therefore, return on investment comes from other types of transactions (see point 7).

This is where preferential liquidation clauses come into play, guaranteeing a certain return to investors if a liquidity event occurs (basically, the sale of over 50% of the company's shares, the sale of the majority of its assets, dissolution or IPO).

Conversion rights

Investors are often given the right to convert their preferred shares into ordinary shares with immediate effect.

These types of clauses typically cover two scenarios: (i) IPOs; or (ii) preferential liquidation rights where it may be in the investors' interest, depending on the sale price of the liquidity event, to convert the preferred shares into ordinary shares.

Typical exit of investors is through a sale to third parties

Although IPOs are a potential divestment objective for all shareholders, thus increasing the financial value of the company and giving shareholders flexibility to sell their interest in an unrestricted secondary market, the most common exit for investors is to sell the startup to a third party.

Investors' put option at a symbolic price

Given the risk involved in VC transactions, funds often negotiate a put option at a symbolic sale price (e.g., €1). This enables them to sell their shares automatically if the company does not achieve the desired success. Thus, investors avoid becoming involved in lengthy dissolution and liquidation processes.



10

Founders' and key personnel's commitments and rights

Founders' permanence and exclusivity obligations

Founders, together with key personnel hired throughout the life of the startup, are crucial to its success. Therefore, to retain them and ensure their commitment to the project, they are usually subject to permanence and exclusivity obligations (in addition to lock-up periods), granting investors a call option on their shares in the event of non-compliance.

Typically, there is a vesting period, i.e., if the call option is exercised, the obligation to sell a percentage of the share capital to the investors decreases over time.

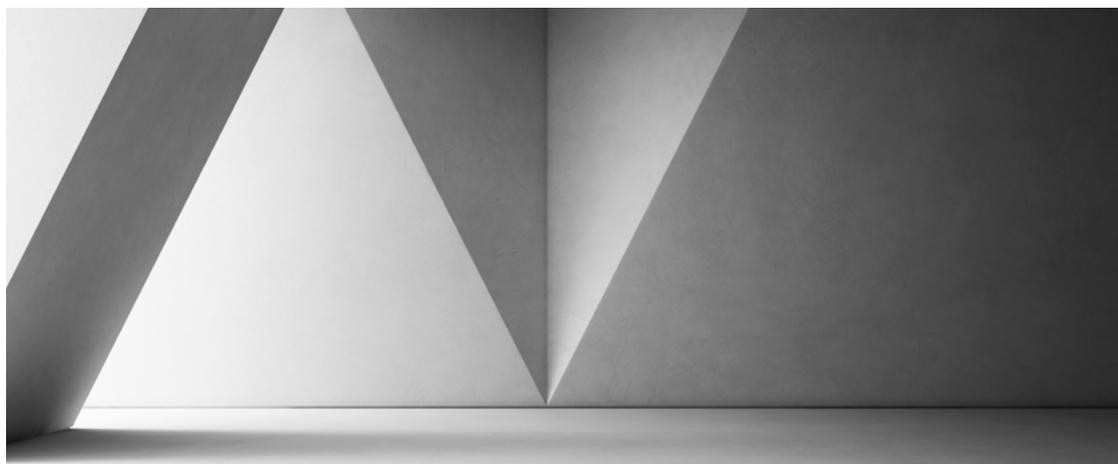
Consideration will depend on the scenario (bad leaver or good leaver). Typical examples of bad leaver scenarios are fair dismissal or voluntary termination before the end of the permanence period. Examples of good leaver scenarios are retirement, unfair dismissal or termination of the agreement for objective reasons in accordance with labor legislation.

Incentive schemes

To align the interests of the management team and investors, as well as to attract strategic talent, startups usually implement incentive schemes aimed at the founders and key personnel, most notably phantom share plans.

Phantom share plans are incentive schemes based on the appreciation of virtual stock that makes up the company's share capital (phantom shares). The company appoints phantom shares to the beneficiaries. The phantom shares' value mirrors that of the real underlying stock. At an agreed date, beneficiaries will receive (i) an amount equivalent to the economic value of the real shares on the date of the relevant milestone (usually a liquidity event), or (ii) an amount equal to the difference between the stock value at grant date and the stock value on the date of the milestone.

These rights to acquire phantom shares are subject to a vesting period, i.e., a period during which the beneficiary gradually acquires the phantom shares. Directly linked to this are cliff clauses, which establish a minimum initial vesting period (typically one year).





Key contacts

Our venture
capital
specialized team



Diana Rivera
Partner

Corporate & M&A
Venture capital
Madrid

diana.rivera
@cuatrecasas.com



Isabel Gandoy
Partner

Corporate & M&A
Venture capital
Barcelona

isabel.gandoy
@cuatrecasas.com



©2022 CUATRECASAS | All rights reserved.

This document is a compilation of legal information prepared by Cuatrecasas. The information and comments in it do not constitute legal advice.

Cuatrecasas owns the intellectual property rights over this document. Any reproduction, distribution, assignment, or any other full or partial use of this document is prohibited, unless with the consent of Cuatrecasas.

