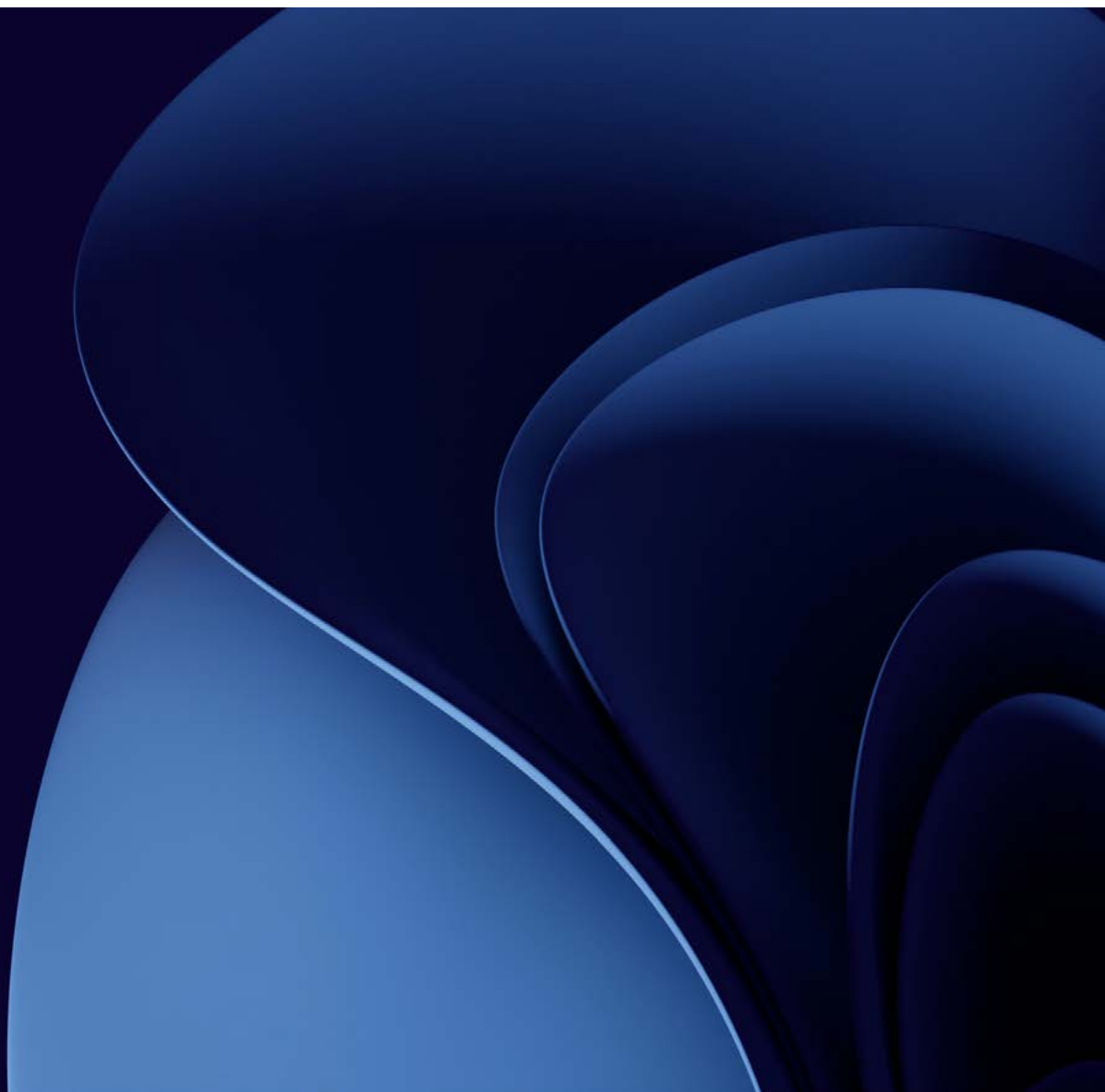
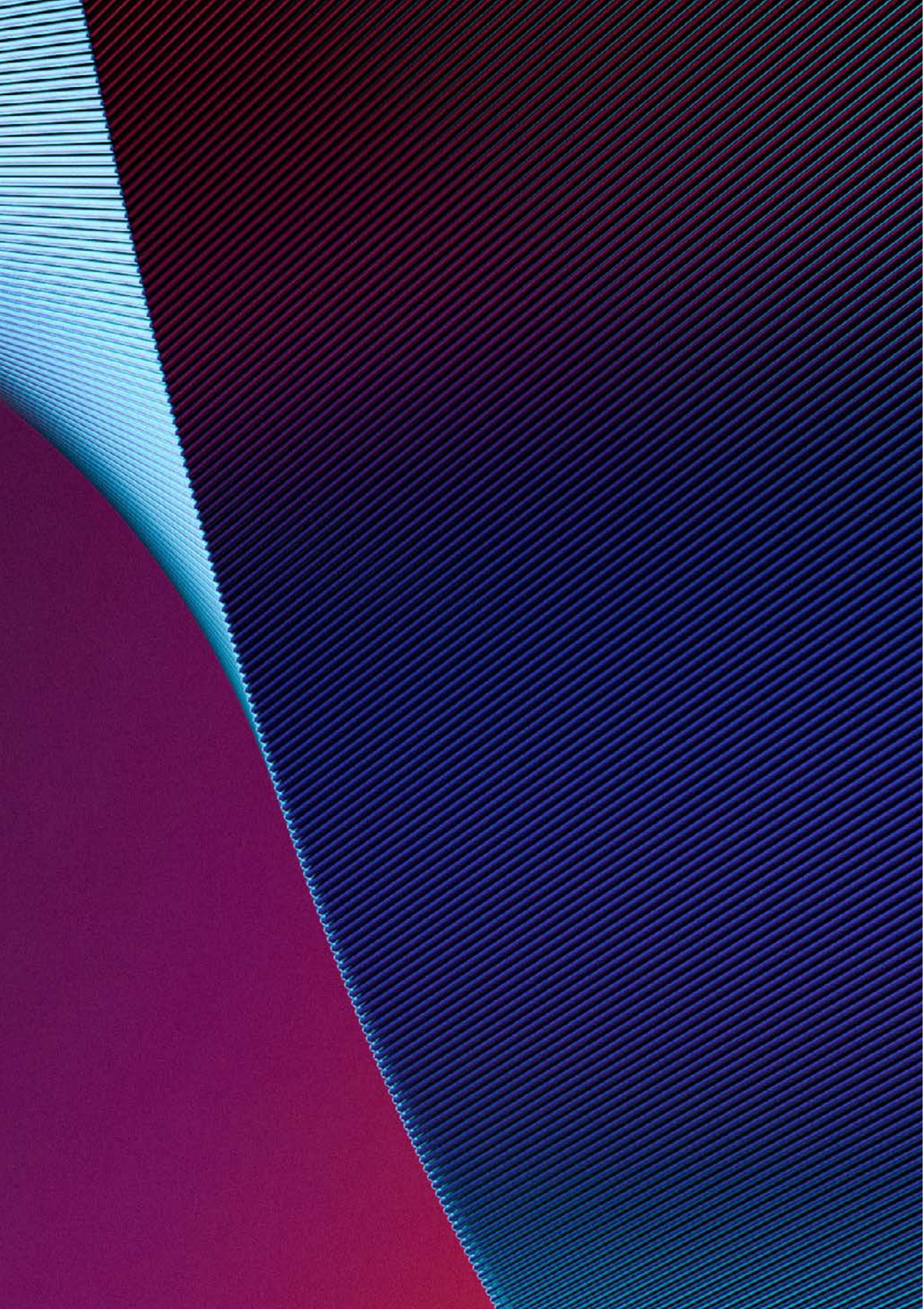


# 10 keys to venture capital transactions

January 2024









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# 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, 2022 and 2023, summarizing the characteristics of these transactions.

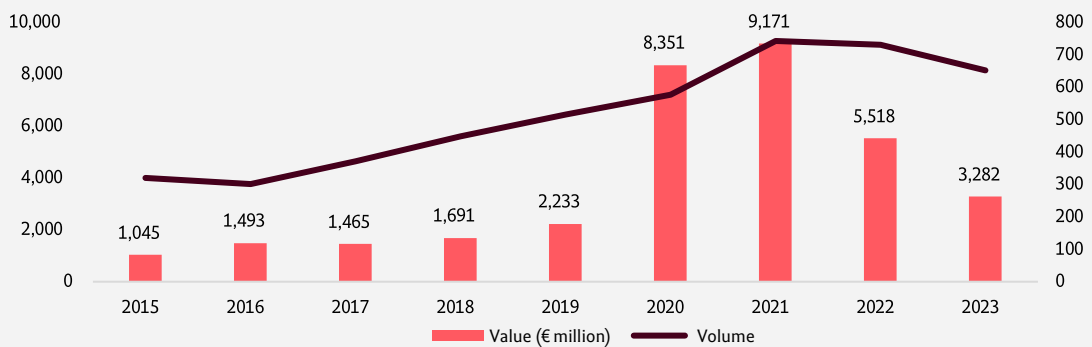
# General market overview

## Market evolution

The venture capital market, like the rest of the transactional spectrum, experienced a complex 2023. Transactions have continued to decline in volume and value, after reaching a record high in 2021. Despite this, the market size continues to exceed that of the years before COVID.

### 2015-2023 Spanish Venture Capital transactions

(Source: TTR)



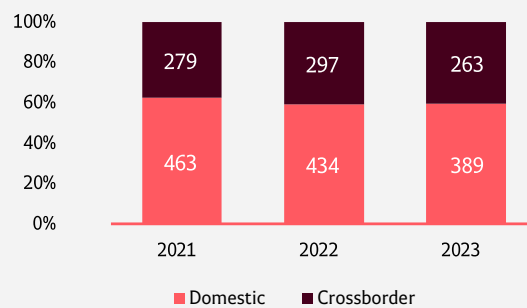
According to TTR, 652 transactions with an aggregate amount of €3.3 billion have been reported, meaning a decrease of 11% in the number of transactions and a decrease of 41% in the number of transactions on a year-on-year basis.

## Source of investment

The drop in activity stems from both domestic and international transactions. Although most transactions are domestic, international investors focus on transactions with greater value. However, we are seeing a trend where the weight of crossborder transactions is losing ground, from representing 95% of the total market value in 2021, to 77% in 2023.

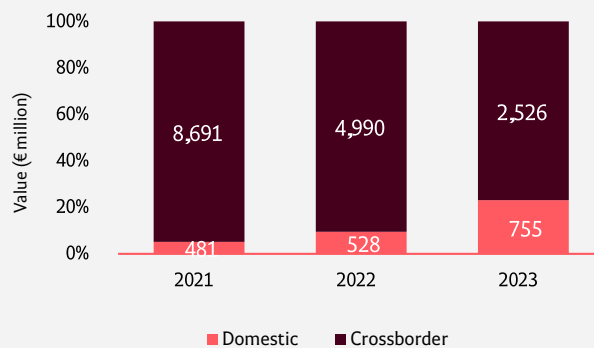
**Source of venture capital transactions in Spain  
(by volume) 2021 vs 2022 vs 2023**

(Source: TTR)



**Source of venture capital transactions in Spain  
(by value) 2021 vs 2022 vs 2023**

(Source: TTR)



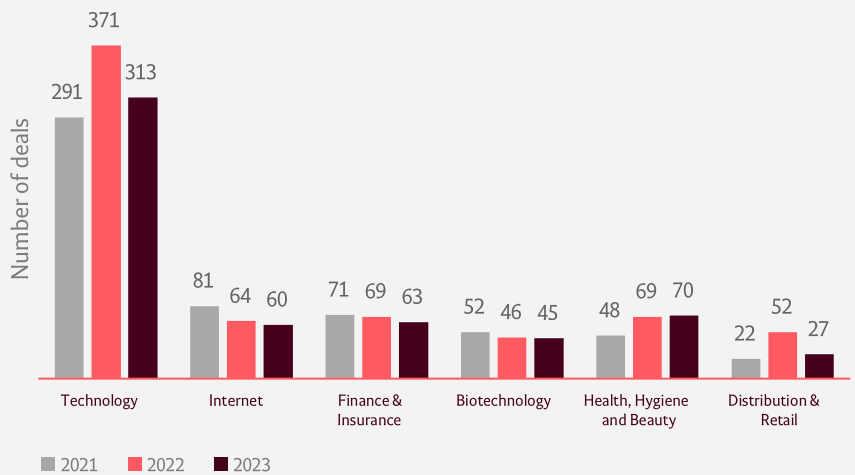
## Most active sectors

The market is clearly dominated by the technology and internet sectors, although these have suffered the most due to market slowdown, especially in terms of transaction value.

Health-related sectors have been the most resilient to the adverse environment over the past year.

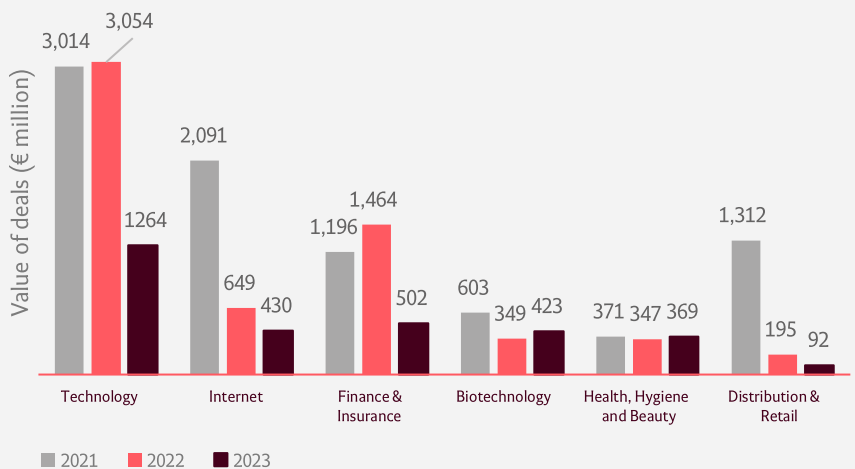
### Most relevant sectors (by volume)

(Source: TTR)



### Most relevant sectors (by value)

(Source: TTR)





# Our Venture Capital practice

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Team offering funds and investors a comprehensive and specialized service for venture capital transactions

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We regularly advise domestic and international venture capital 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 venture capital 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.

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## Chambers, 2023

*"Especially acclaimed for its venture capital work"*

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## Chambers, 2022

*"Cuatrecasas offers a wide-ranging practice advising on a variety of mandates in the funds sphere"*

**Large market share:** In 2023, we were involved in 23 venture capital transactions. We work with some of the most innovative national and international players in the startup ecosystem.

**Relevant experience:** We have participated in some of the largest and most complex transactions and rounds of investment in recent years.



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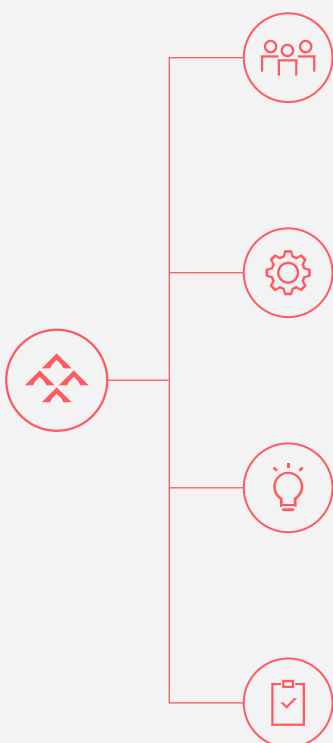
*Leading firm and top ranked lawyer  
(Band 1) in Venture Capital*

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# Cuatrecasas at a glance

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



## TALENT

A multidisciplinary and diverse team made up of over **1,300 lawyers and 29 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

LATINLAWYER  
250

THE  
LEGAL  
500

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

THE LAWYER

Law firm of the year in  
Europe and the Iberian  
Peninsula, 2022

LACCA

Fifth most popular  
international law firm in  
Latin America, 2021



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# 10 keys to negotiate venture capital transactions

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# 10 keys to negotiate venture capital transactions

## 1

### **Fast and complex transactions**

### **Transaction types**

These transactions are typically completed in short periods of time and with very tight schedules, which requires the parties and their advisors to have 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 of 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 certain specific aspects such as the negotiation exclusivity clause, the confidentiality obligation and the obligation to pay certain transaction-related expenses) and is usually signed by the founders, the company and the lead investor.





For the transaction, two main 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 and, if applicable, the contribution of credit claims arising from convertible loans granted by the investors to the company; and (ii) the shareholders agreement (“SHA”), which (a) sets out the terms and conditions of the relationships between the shareholders as shareholders of the company, and between the shareholders and the company; (b) regulates the share transfer conditions; and (c) establishes the operation, management and organizational structure of the company (including certain obligations specific to the founders and the consequences of breaching them). The company is a party to these agreements.

Their terms and conditions depend, among others, on the startup’s stage of development as well as 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, the individual bargaining power of non-investing shareholders—and even that of non-principal investing shareholders—is usually very limited 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 actively 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.



## 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 a cash capital increase (primary transactions).

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, depending on the company's evolution and cash needs. This financing is mostly made through investment or financing rounds.

### 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 (in principle, 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), owned by the investors.

### Upward trend in convertible loans

Investors can contribute funds to the startup through convertible loans. Subject to the fulfillment of one or more milestones or 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. Owing to their flexibility and quick turnaround, convertible loans have become increasingly popular and used in recent years, among other purposes, to facilitate financing to startups between the conclusion of each financing round.

Among other aspects, these agreements make it crucial to consider the rights of the parties during their term, 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 SHA and the IA in force at the time of the conversion (and, if applicable, the terms to be included in it).

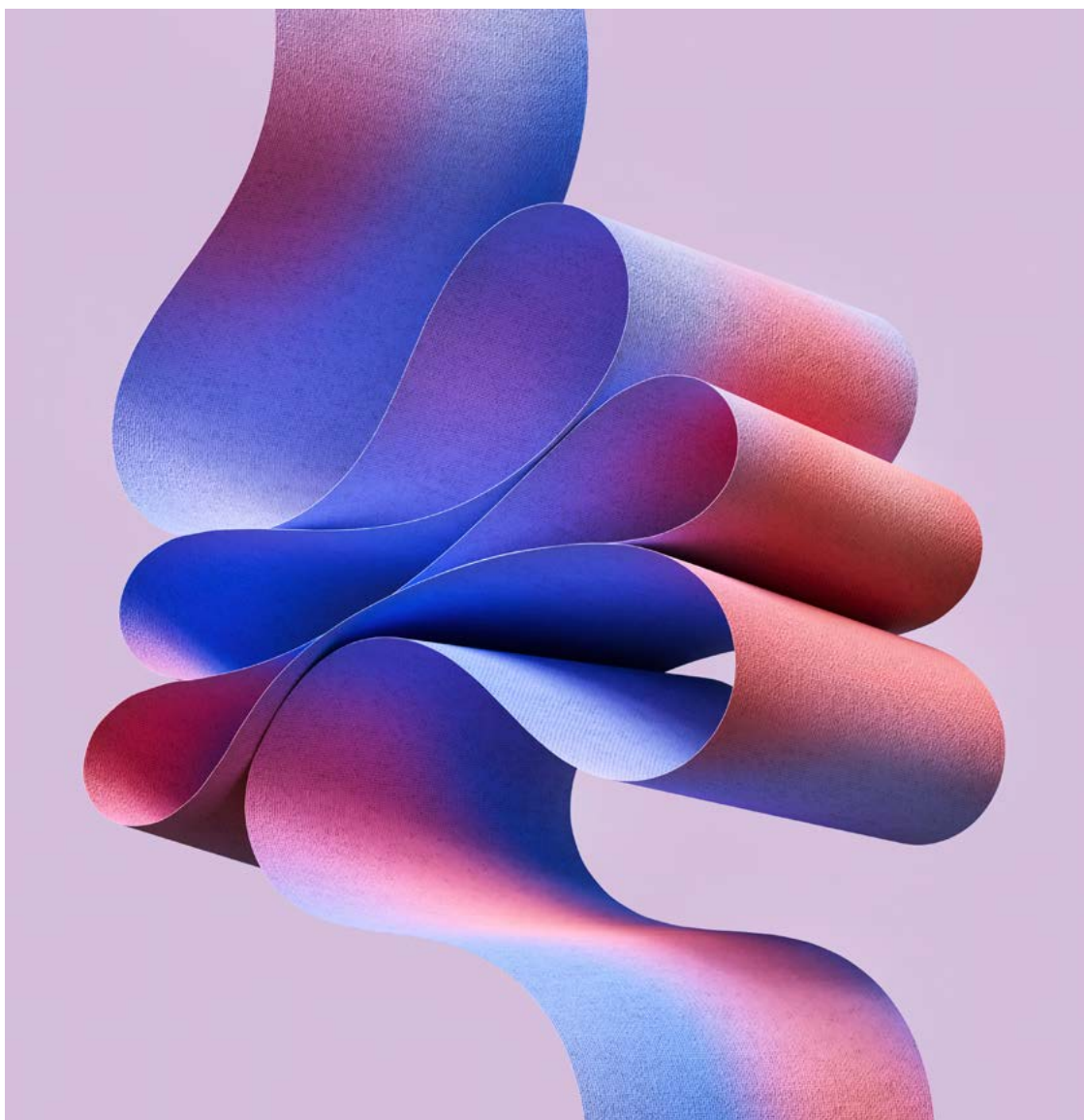
# 3

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

## Regulatory authorizations

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

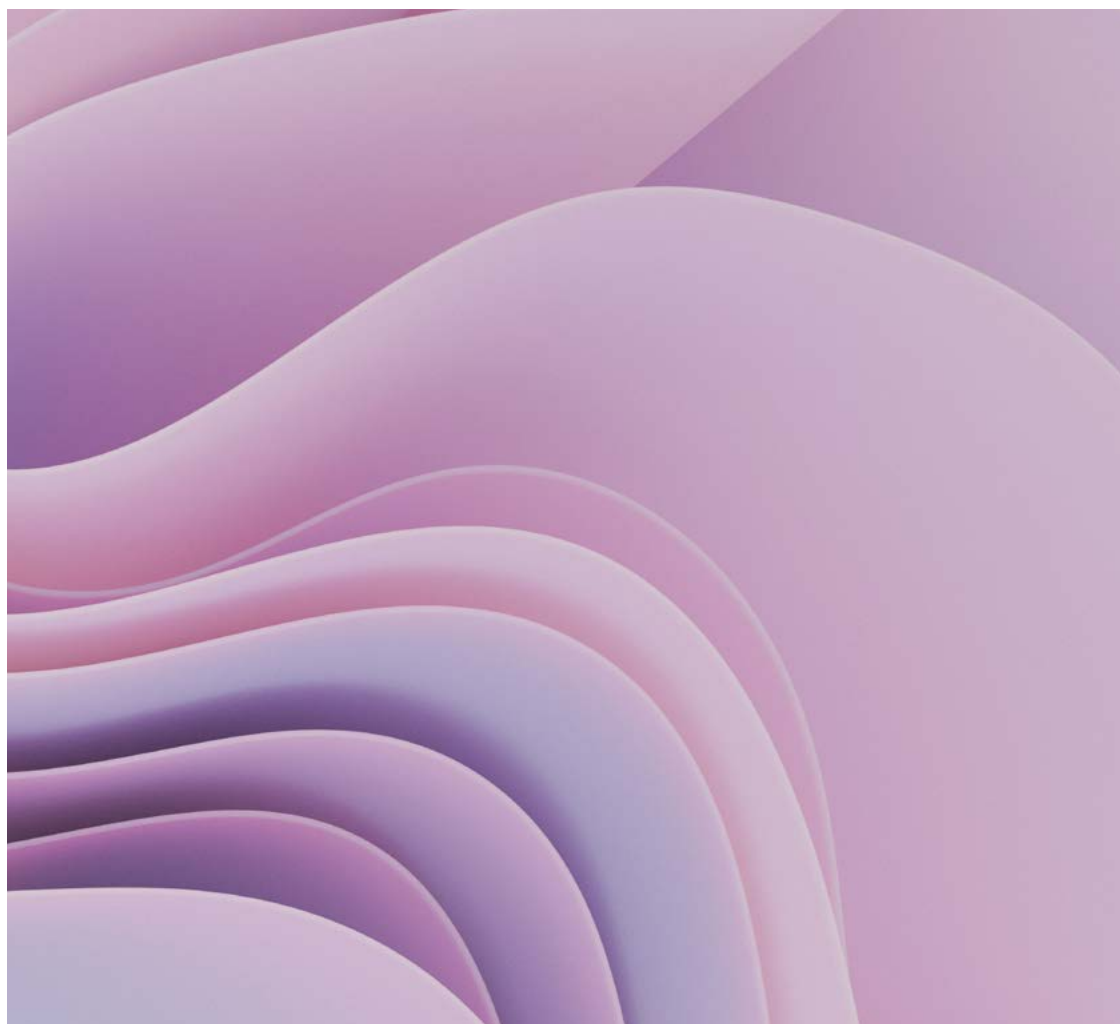
On carrying out VC transactions, depending on the startup's stage of development, the founders may not only seek funding, but also "smart money." Startups with a stronger negotiating position will demand investors, in addition to their monetary investment, to add value to the company (e.g., by acting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

### "For-equity" agreements

Media-for-equity agreements, a financing option whereby the investor provides advertising services to 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.





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## Founders' liability towards equity investors

### Business representations and warranties by the founders or the company

The IA sets out the liability regime in favor of investors. Unlike in other M&A transactions, business representations and warranties are not usually given by all the shareholders, but only by the founders (and/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 traditional 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.

One option is that the founders, as well as the other shareholders, limit their representations and warranties to their capacity and the title of their shares (so-called “fundamental warranties”), and that the company itself grants its business representations and warranties (so-called “business warranties”). In other cases, the “business warranties” are granted by the founders and the company.

In situations where the company assumes indemnity undertakings, they 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.

To preserve the founders' personal assets or, if applicable, to avoid cash outflows in the company, 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 and voluntary audits**

The lead investor of each round and other significant investors usually demand the inclusion in the SHA of additional information rights to those granted under the Spanish Companies Act, allowing them to monitor the business performance and the management team's main actions. It is also increasingly common for investors to demand that companies audit their annual accounts, even if they are not legally obliged to do so, to ensure uniform and objective accounting, and compliance with their internal policies.

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

As regards the adoption of resolutions, it is common to establish in the SHA and, if applicable, in the company's bylaws, matters subject to qualified majority. However, unlike private equity transactions, these matters are targeted and usually take share classes into account. Thus, veto rights of individual investors are uncommon except in the company's 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.

Typically, the company's CEO (as managing director or having broad powers of attorney) is a founder subject to the control of the board in a more active way.

The round's lead investor—and, if applicable, the majority of the class of preferred shares from the previous round—is often (but not always) entitled to propose the appointment of one of the directors. This will depend on the company's stage of development and each investor's percentage interest. Therefore, significant investors in VC transactions typically reserve the right to appoint an observer. Observers may attend board meetings and have access to the information the directors receive, but they do not have voting rights on the board. If the SHA establishes the right of any shareholder to appoint an observer, the rights and confidentiality obligations of that observer must be regulated in the agreement.

### **Independent directors**

It is increasingly common to establish the obligation to appoint independent directors.

# 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.

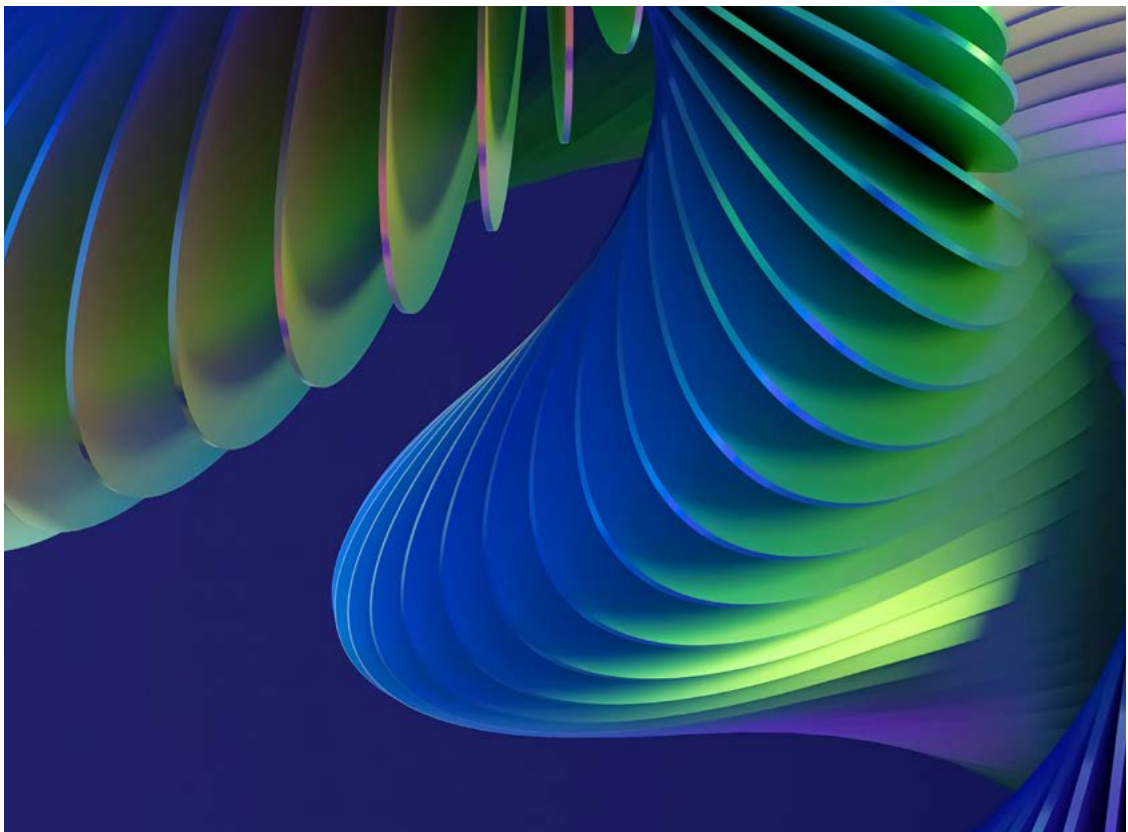
**Common covenants: founder lock-up provisions, free transfer between group members, preemptive rights and tags by class and drags**

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 situations involving permitted transfers between group companies (with a broader definition being agreed as to the concept of “group” to be applied to investment funds).
- Preemptive acquisition rights, often differentiated by type of share class.
- Tag-along rights differentiated between cases where the seller is a founder or an investor.
- Drag along rights.

**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 of their shares and capacity), or enforce non-compete or non-solicitation covenants.



## 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 subsequent 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 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 though round valuations may be 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 transfer of over 50% of the company's shares, the sale of the majority of its assets or its dissolution).

### Conversion rights

It is commonly agreed that investors are entitled, at any time, 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 to convert the preferred shares into ordinary shares, depending on the sale price of the liquidity event and the distribution calculation formula specified in the clause.

### 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 allowing shareholders to sell their interest with greater flexibility on 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 with the founders a put option in favor of the former, setting a symbolic sale price (e.g., €1). This enables the fund to dispose of its shares automatically if it considers advisable (e.g., to protect itself from reputational risk or avoid becoming involved in insolvency proceedings, or dissolution and wind-up proceedings affecting the startup).



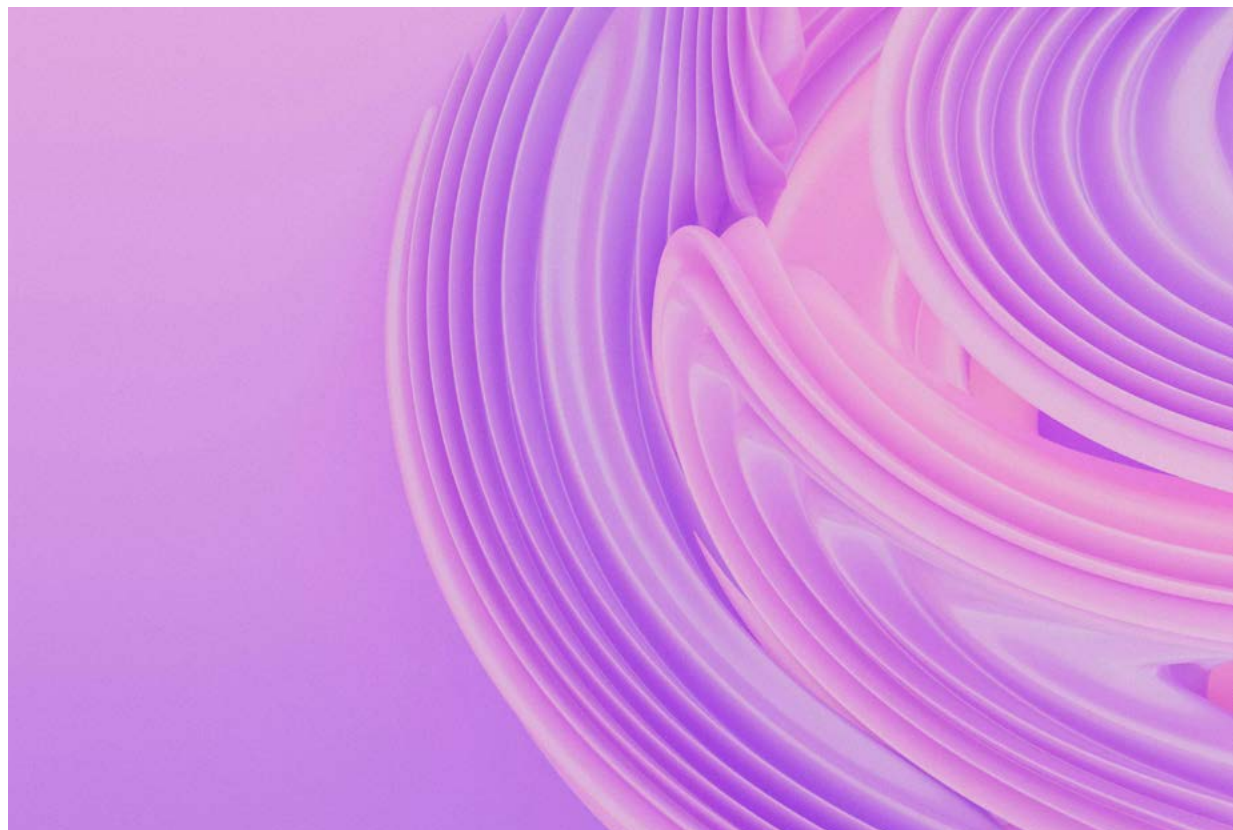
# 10

## 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 encourage them and ensure their commitment to the project, they are usually subject to permanence and exclusivity obligations in discharging their duties (in addition to lock-up period mentioned above in the case of shareholders), granting a call option on their shares in favor of the investors, the company (for redemption) and/or the rest of the founders in the event of non-compliance.

Typically, there is a reverse vesting period, i.e., if the call option is exercised due to the breach of one of the founder's specific obligations, the founder's obligation to sell a percentage of the share capital 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 and unfair dismissal.

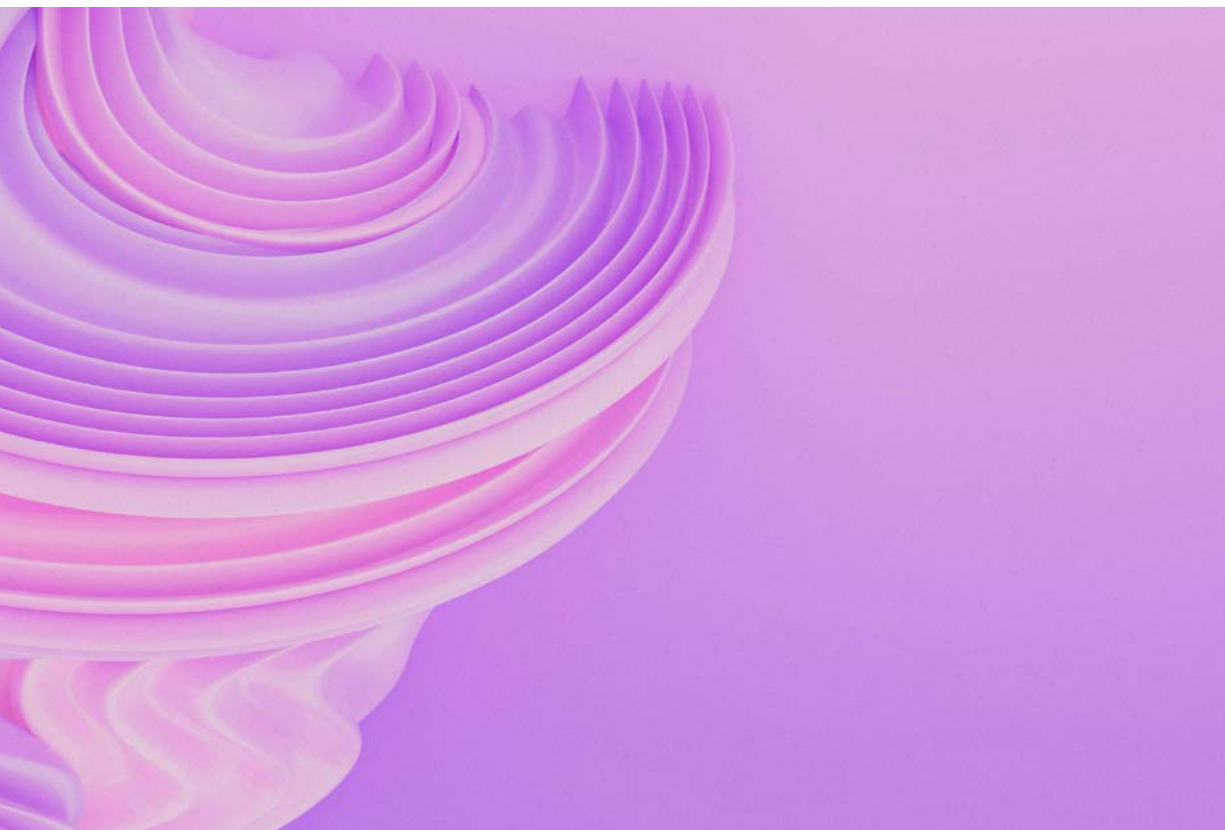


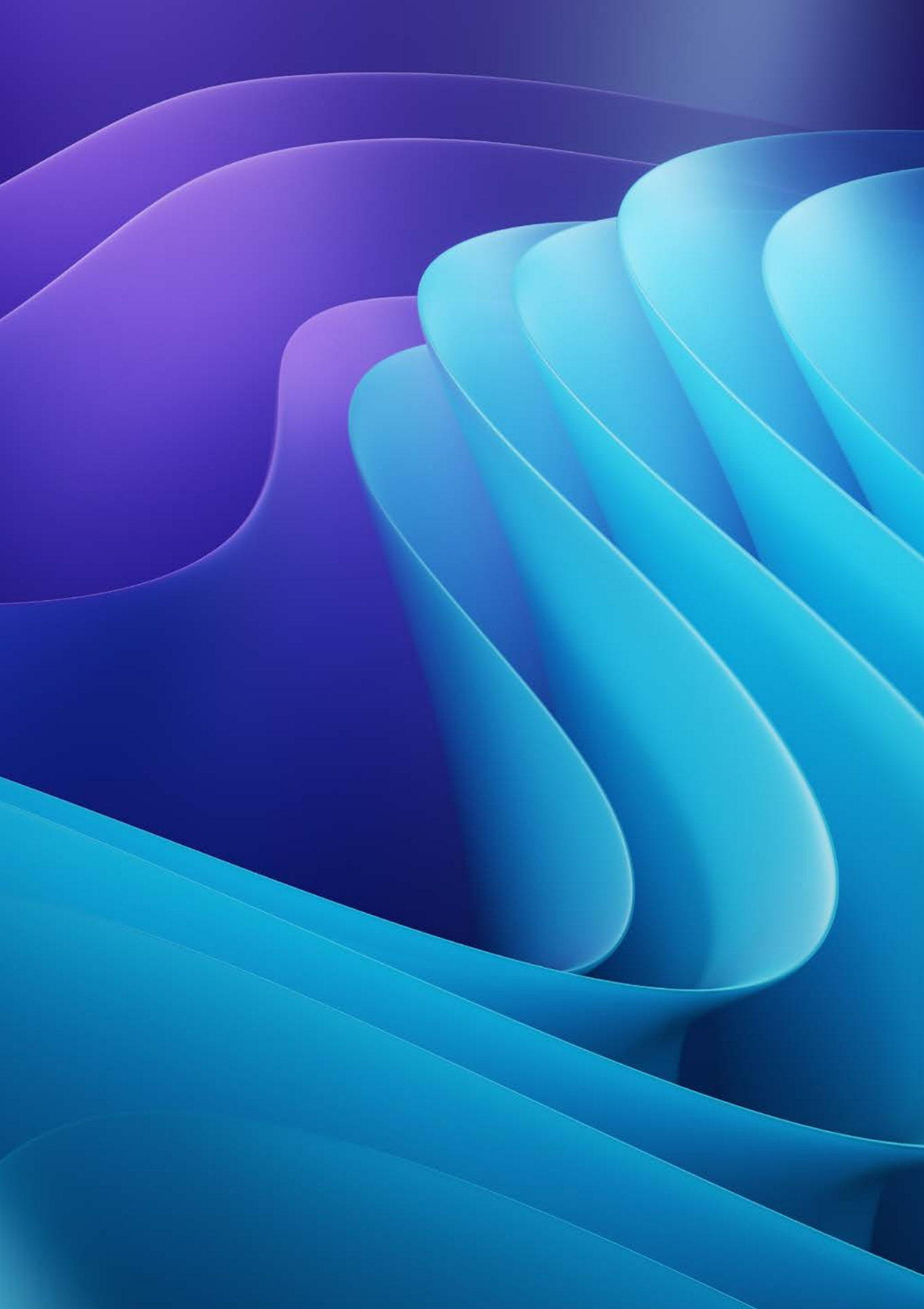
## Incentive schemes

To align the interests of the management team and investors, as well as to attract strategic talent, startups often 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. If a liquidity event occurs, it is agreed that beneficiaries will receive (i) an amount equivalent to the economic value of the real shares on the date a liquidity event occurs, 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 to consolidate the first package of phantom shares assigned (typically one year).







# Key contacts

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## Our venture capital specialized team

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