



UNDERSTANDING TERM SHEET

What is a 'Term Sheet'

A term sheet is a nonbinding agreement setting forth the basic terms and conditions under which an investment will be made. A term sheet serves as a template to develop more detailed legal documents. Once the parties involved reach an agreement on the details laid out in the term sheet, a binding agreement or contract that conforms to the term sheet details is then drawn up.

A term sheet lays the groundwork for ensuring that the parties involved in a business transaction agree on most major aspects of the deal, thereby precluding the possibility of a misunderstanding and lessening the likelihood of unnecessary disputes. It also ensures that expensive legal charges involved in drawing up a binding agreement or contract are not incurred prematurely.

Term sheets are not generally considered legally binding and are therefore seen as unenforceable in a legal sense. In that regard, a term sheet may seem similar to a letter of intent when the action is predominately one-sided, as in acquisitions, or a working document to serve as a jumping-off point for more intensive negotiations.

Term sheets, at times referred to as memorandums of understanding, serve as a summary of the terms being discussed or offered. Essentially all term sheets will contain certain elements, such as information pertaining to the identification of the parties involved. The basic information surrounding any involved assets will be outlined, as well as an initial purchase price, often accompanied by contingencies that may constitute a change in aforementioned, and the form of payment that will be supplied. Often, there is an acceptance period, providing a time frame for a response regarding the information set forth in the term sheets.

Term sheets generally cover the more important aspects of a deal without going into every minor detail and contingency covered by a binding contract. For example, a term sheet from a venture capital company that is investing in an early-stage company may contain such details as the amount of investment, the percentage stake sought, anti-dilutive provisions and the valuation.

A term sheet may also be used as part of a merger or attempted acquisition. The term sheet typically contains information regarding the initial purchase price offer and preferred payment method, as well as what assets are included in the deal. It may also contain information regarding what, if anything, is excluded from the deal or any items that may be considered requirements by one or both parties.