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Ten 'Public Company' Issues

Venture Capitalists Should Understand

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While venture capitalists generally have a good grasp of legal issues relevant in the private company context—tag along and drag along rights, rights of first refusal and the like—venture capitalists are often not as familiar with the legal issues relevant in a public company context. Indeed, venture capitalists' confidence in their understanding of private company legal issues may breed a sense of complacency about legal issues that can lead to problems in the public company context.

Venture capitalists have not traditionally made direct investments in public companies, although that has begun to happen as public company valuations recently have fallen. Most VC funds' experience with public companies has arisen as a result of a successful IPO of their private portfolio companies. As the champagne corks are popping and the high fives are flying, a new set of legal issues comes into play.

This outline discusses briefly ten issues most likely to be relevant in the context of ownership of public company securities by VC funds. Communicating a basic understanding of these legal issues to VC funds—enough to ask questions when in doubt—will go a long way toward heading off serious legal problems down the road.

1. SEC Beneficial Ownership Filings

· Section 16 (Forms 3, 4 and 5) officers, directors, 10% owners

Section 16 of the Securities Exchange Act of 1934 requires public disclosure of stock ownership—including initial ownership and changes in ownership—by officers, directors and 10% stockholder of public company issuers. The initial Form 3 filing must be filed prior to effectiveness of the IPO registration statement (or thereafter within 10 days of a new officer or director taking office or a VC fund's ownership exceeding 10%). A Form 4 must be filed to report most changes in stock ownership. Form 4s are due by the 10th day of the month following the month in which the change occurred. Form 5 filings are required for a handful of transactions not required to be filed on a Form 4—such as option grants and gifts—and for transactions that should have been reported on a Form 4 but were not. Form 5s are due within 45 days of the issuer's fiscal year end (*e.g.,* by February 14 for issuers on a calendar year end). However, Form 5 filings can be avoided completely by voluntarily including Form 5 transactions on a Form 4 filed before the Form 5 deadline. One or more entities or individuals can make a joint filing, which can ease the filing logistics when a number of entities or individuals may be deemed to beneficially own the same shares (*see* the discussion of beneficial ownership below).

Forms 3, 4 and 5 may be filed electronically using the SEC's EDGAR system or in hard copy. Electronic filings generally have the advantage of effectively extending the filing deadline by a day or two. The SEC will also accept hard copies of faxed filings, opening up the possibility of faxing the filing at the last minute to a DC location and having the filing messengered to the SEC. Both electronic and hard copy filings become quickly available to the public, although EDGAR filings may be somewhat easier to locate, particularly for older filings. See, for example, Yahoo's 'Insider' links under the public company profile links to information provided by First Call/ Thompson Financial, which carries a summary of all Form 4 filings by issuer.

The biggest challenge for most VC funds is to establish a system to report transactions in public company securities to someone responsible for ensuring that Section 16 filings are promptly made. While this sounds simple enough in concept, VC funds find it difficult in practice because the fund employees responsible for making buy-sell decisions are often not the employees, or outside legal counsel, charged with SEC filings. Keep in mind that only 10 days at the beginning of each month are permitted to make Form 4 filings.

A number of public companies file Form 4s for their officers and directors, and these companies may require the officer or director to fill out a form to report transactions. Some companies require a monthly form even if no transactions have occurred. Few public companies, however, will file the required reports for the VC funds that hold their shares, so most VC funds are on their own for these filings.

As a practical matter, there is little penalty for failing to make timely Section 16 filings. The SEC has regulatory authority and can bring enforcement action. However, the SEC acts only in particularly egregious cases, and often only when other legal violations have occurred. The only other likely penalty for an untimely filing is a mention of the late filing in the issuer's proxy statement. The SEC's view is that a little public embarrassment is its best assistant for achieving compliance with the Section 16 filing requirements.

Section 16 filings can be surprisingly complex. Only one suggestion here—follow Peter Romeo and Alan Dye's *Section 16 Forms and Filings Handbook*, which at last count included 167 sample filings illustrating the suggested treatment for filings in different factual circumstances.

· Regulation 13D/G—5% owners

In addition to Section 16 filings, 5% owners have filing requirements under Section 13(d) of the Securities Exchange Act of 1934. The SEC has adopted a short form 'chedule 13G' filing and a long form 'Schedule 13D' filing, which requires much more extensive information than Schedule 13G. Filers fall into four basic categories:

- *'Grandfathered' 13G filers.* Most funds will find themselves here. Essentially, any 5% owner who owns stock prior to the IPO and does not acquire beneficial ownership of more than 2% of the issuer's stock in a 12-month period qualifies to file a Schedule 13G.
- *'Institutional' 13G filers.* Banks, brokerage firms, insurance companies and other institutions also qualify for 13G status, unless they are a party to any arrangements affecting control of the issuer.
- *'Passive' 13G filers.* Holders who own less than 20% of an issuer's stock and are not party to any arrangements affecting control of the issuer also qualify to file a Schedule 13G.
- *13D filers.* If a 5% stockholder does not fit within one of the three categories above, a Schedule 13D is required.

A number of differences between Schedule 13G and Schedule 13D exist. A Schedule 13G is essentially a snapshot taken, generally, at the end of the year. A Schedule 13D, on the other hand, is more like a movie, with amendments to the filing required at any point if a material change occurs. As indicated above, the information required for a Schedule 13D is much more extensive, and the information is required for a number of individuals and entities associated with the VF fund, including disclosure for any officers and directors (or general partners).

One of the most difficult issues for VC funds in connection with Schedule 13D filings and Schedule 13G filings is the SEC's broad definition of 'beneficial ownership.' Beneficial ownership is attributed to anyone who controls the fund's shares—so typically all general partners, and possibly other control entities such a bank holding companies or other parent companies. This broad attribution of beneficial ownership can create significant challenges in the VC fund context. A Schedule 13D for a venture capital fund that operates as a subsidiary of a much larger organization—bank VC funds, for example—can be quite time consuming to compile.

Finally, even if a VC fund holds less than 5% of the public company's securities, the fund may have Schedule 13D or Schedule 13G filing obligations if it is part of a 'group' (discussed below).

The SEC has enforcement authority over violations of the Section 13 filing obligations, and has brought enforcement proceedings against VC funds for failing to make Schedule 13D filings. In addition, private rights of action may also exist.

Additional information on the nuts and bolts of Section 13(d) filings can be found in my book, *Beneficial Ownership Reporting: Schedules 13D and 13G*, part of BNA's Corporate Practice Series.

· Form 13F—$100 million institutional investors

Any manager of accounts with more than $100 million in securities of public companies incurs a different legal obligation—that of making quarterly 13F filings showing all positions held.

2. Insider trading issues

Prior to an IPO, VC funds pay little attention to the pitfalls of inside information. But as holders of public company securities, VC funds often have exactly the type of access to insiders that can create problematic situations.

· Material inside information

Generally, information is material if a reasonable investor would consider it significant in making an investment decision. As mentioned earlier, VC funds often have the type of access to insiders that creates a risk of the fund obtaining inside information. Indeed, from the fund manager's point of view, keeping on top of information about a portfolio company is part of the manager's job. So, unless the VC fund completely changes its approach after an IPO, the VC fund is likely to have material inside information concerning its portfolio companies at any number of relevant points.

· Tipping issues

Of course, possession of inside information is not necessarily a problem. Trading on the information or tipping the information to third parties is a problem. In particular, VC funds need to take particular care with respect to their own limited partners. Large pension funds, in particular, may well have investments in VC portfolio companies aside from their interest in the VC fund, and an inadvertent insider trading violation may occur based on a VC fund manager 'tipping' information to a limited partner.

· Internal VC fund policies

VC funds should implement their own insider trading policies, particularly with respect to their own employees and partners. While all information about portfolio companies is typically considered as confidential by VC funds, consideration should be given to further restricting information about public portfolio companies on a 'need to know' basis, based on the simple fact that such information can give rise to insider trading issues. As organizations as diverse as large law firms and financial printers have painfully discovered, inside information can be misused by virtually any staff member. An insider trading policy can help familiarize the VC fund's employees with respect to insider trading issues, and may help head off embarrassing situations. And, if all else fails, a policy at least provides something of a defense if an insider trading violation occurs.

· Portfolio company policies

VC fund managers who continue to serve as directors of a public portfolio company following the IPO will be subject to whatever insider trading policy the company adopts. Indeed, VC funds may wish to push for similar policies among their portfolio companies in order to provide for a certain consistency in policies.

A more problematic issue is whether the VC fund should voluntarily abide by the policies adopted by its portfolio companies. On one hand, the VC fund may be criticized for selling shares when the company's own policy may have forbidden the transaction. On the other hand, it is unlikely a VC fund will have much interest in effectively relinquishing its ability to sell portfolio securities. A middle ground is to make sure the VC fund is aware of the portfolio company's guidelines and that any decision to go outside the guidelines is not inadvertent.

· Regulation FD

Under the SEC's regulation FD, public companies have been subjected to a new system of regulation designed to ensure that material information is disclosed publicly at the same time it is disclosed outside the company. Dealing with Wall Street and stock analysts has generated most of the attention since the new rule was adopted. However, VC funds are also considered 'market participants' under the new rules. As a result, VC funds are treated no differently than Wall Street analysts, and disclosure of material information to a VC fund may trigger an obligation of public disclosure by the public company. Likewise, statements by a VC fund manager who serves on the board of a public portfolio company may also trigger public disclosure obligations.

· *Disposition Plans*

Rule 10b5-1, newly adopted by the SEC, received relatively little attention in view of the focus on Regulation FD, but the rule offers a viable strategy for VC funds struggling to liquidate public company portfolio securities in the context of concerns about trading while in possession of inside information. Consider a public company with an active acquisition strategy and a VC fund with either a director or close relationships with the company's management. The VC fund may effectively never have a trading window without at least some question of inside information. However, under the new rule, dispositions pursuant to a pre-existing plan are able to claim a safe harbor from inside trading issues. The downside, of course, is that fund loses some ability to time the market and take advantage of ups and downs in stock prices, although the plan may include provisions with respect to amount, price and timing of trades.

3. Sales & Distributions—Legal Issues

· Valuation issues

Valuation of public company securities distributed in kind can have a significant impact on a VC fund's stated returns—and consequently on future fund raising. VC partnership agreements generally have valuation provisions, and these provisions, often overlooked in the past, are more frequently becoming items of negotiation with limited partners.

· Rule 144 restrictions

Rule 144 permits VC funds to sell in the public markets restricted securities and affiliate securities. Restricted securities, in a VC context, will generally be securities that were acquired prior to the IPO. Affiliate securities are securities of issuers controlled by the VC fund. Officers and directors of the issuer, by practice, are also deemed to hold affiliate securities.

Effectively, Rule 144 requires a one year holding period during which no public trades can occur, followed by a one year period during which securities can be sold in public markets subject to volume limits. After two years, no volume limits apply to sales of restricted securities, but the volume limits continue to apply to sales of affiliate securities. The volume limits permit at least 1% of the outstanding shares to be sold every three months. However, sales by related parties must be aggregated to determine if the 1% threshold has been met. Significantly, in the context of VC funds, sales by limited partners of securities distributed by the fund must be aggregated with any sales by the fund. In addition to the holding period and volume limits, Rule 144 has several other requirements that are not normally at issue—specifically, that the issuer be current in its SEC filings, that sales be conducted in broker transactions, and that a Form 144 be filed.

· Form 144

Rule 144 requires that a Form 144 be filed prior to or on the date of any sale of restricted or affiliate securities in public markets (other than sales of restricted securities held for two years). All major brokerage firms have special 144 desks where trades subject to Rule 144 are routed, and the brokerage firm will almost always file the Form 144 in connection with executing trades.

· Secondary offerings and block trades

Piggyback and demand registration rights are almost always sought and received by VC funds when making portfolio company investments. However, these rights are often not used, for a variety of reasons. Seldom will an underwriter accept secondary shares in an IPO, although in the burst of Internet and tech IPOs in 1999 and early 2000, some IPOs included secondary shares. After the IPO, secondary offerings may be a viable option for a fund to liquidate large holdings, but carry significant downsides reflected in the time and effort required for a successful secondary offering and the costs.

Another alternative, which is rarely used, is a block trade arranged by a large brokerage firm. Essentially, like an underwritten offering, the broker acquires a block of securities and then places the securities with selected institutional clients (and, indeed, may have effectively presold a number of the securities prior to the block trade). No prospectus or offering document is used. Brokers engage in very few large block trades as the traditional underwritten offering is an easier and less risky pathway.

4. Sales & Distributions—Market Issues

· Lockups

VC funds will be asked to agree to a typical 180 day lockup at the time of the IPO (and may indeed have already agreed to some sort of lockup in the initial registration rights agreement entered into at the time of the VC fund's investment). The expiration of the 180-day lockup has often been greeted with short selling by arbs confident they will be able to cover their short positions as securities come into the market following the expiration of the lockup. The result is often a decline in the public company's stock price in the week or two prior to the lockup expiration, and a less than stable trading market.

Recognizing these market dynamics, underwriters have been willing to grant early releases from lockups so as to smooth out the shares coming into the market. VC funds may want to look into this possibility and may even want to discuss release priorities with the underwriters prior to the IPO.

· Float

Perhaps the most telling issue for sales and distributions by VC funds is the amount of public float or trading volume. If the float is reasonably large, in kind distributions may be an effective way to liquidate the fund's position (recognizing that VC fund limited partners will typically sell the distributed securities shortly after receiving them). On the other hand, if float is small, the VC fund may decide that an in kind distribution will not offer an effective means to liquidate its position, and the fund may opt to sell the securities itself, taking into account market conditions along the way.

· Hedging transactions

The public markets open up the possibility of a VC fund engaging in some hedging transactions—effectively offsetting puts and calls—which reduce the VC fund's risk of holding portfolio securities. These, of course, must be reviewed carefully for compliance with any applicable provisions, such as the short swing profit provisions of Section 16(b).

5. Purchases

VC funds are seldom buyers of public company securities, but purchases may arise in at least two distinct circumstances—when market prices are low enough so that investing in a public company suddenly offers an attractive investment alternative, and when VC funds must step in to try to rescue an ailing company.

· Antitakeover provisions

Antitakeover provisions come from two basic sources—state laws that are designed to restrict and deter takeovers (for example, control share statutes adopted in a number of states, or business combination restrictions like Section 203 of the Delaware General Corporation Law), and provisions adopted by public companies (such as poison pills and advance notice bylaw provisions). VC funds are not generally fans of antitakeover provisions, and some funds routinely insist that portfolio companies not adopt or opt into any antitakeover provisions. Nevertheless, before any acquisition is made of public company securities, VC funds should run the traps on antitakeover provisions, particularly as these are provisions the VC funds seldom encounter.

· Short swing profit issues

Section 16(b) of the Securities Exchange Act of 1934 imposes a so-called 'hort swing profit' liability on all trades made by officers, directors and 10% stockholders of public companies. While the rules are objective, they are also strict and inflexible, and often catch company insiders by surprise. Essentially, sales or purchases within a six-month period can be matched, and any profit deemed to exist must be paid to the issuer. Needless to say, as long as the VC fund is only disposing of its holdings, the rule is not implicated. But outright purchases of securities, as well as exchanges of securities, acquisitions of options and other transactions that

might be considered purchases of the issuer's underlying stock, should be carefully reviewed before the transaction is completed.

A sophisticated plaintiff's bar effectively acts as the enforcement arm for Section 16(b), monitoring Form 4 and 5 filings and public disclosures of trades. To the extent a short swing issue is clear, anyone violating the rule is best advised to pay up and avoid liability for legal fees in a contested case. The plaintiff's attorney identifying the case will collect a percentage of the issuer's recovery, and happily go back to identifying other violators.

While the short swing profit rule is simple enough, the basic concepts have a number of intricate legal nuances. What constitutes a 'purchase' or 'sale' can be a complicated issue, particularly in the context of attributed beneficial ownership and groups as discussed above. As in the case of filing Forms 3, 4 and 5 under Section 16 (a) of the Securities Exchange Act of 1934, the recognized authority is Peter Romeo and Alan Dye.

· Hart Scott Rodino

As Hart Scott Rodino issues are not limited to public company acquisitions, VC funds should have a general familiarity with the possibility of HSR filings, filing fees and even waiting periods or more comprehensive antitrust reviews. However, acquisitions of public company securities might inadvertently push a VC fund over a filing threshold and, as a result, VC funds should determine whether HSR is applicable before proceeding with any purchase. In particular, VC funds should recognize that the HSR filing thresholds (a minimum of $50 million as of February 1, 2001) are determined on the basis of market prices, so a VC fund with a very low cost basis may find that the market price of its investment exceeds the $50 million threshold.

· *Shareholder Approval*

In the private company context, shareholder approval of a potential investment can be obtained quickly. However, if shareholder approval is required in the public company context, the process may well take two to three months to complete. NYSE and Nasdaq rules require approval of new stock issuances that exceed 20% of the outstanding shares. Generally, a proxy statement must be prepared by the issuer and submitted to the SEC for comment. Once the proxy statement is finalized, printed and mailed, a period of 30 days is generally required before the vote can be taken.

6. Group issues

A group for securities purposes is deemed to exist whenever two stockholders act in concert in connection with the issuer's securities. Of course, in the private company context, VC funds seldom do anything but act in concert with others—perhaps other funds or perhaps company management. So, to the extent these arrangements do not disappear at the time of the IPO (or to the extent they reappear as a result of some concerted activity by the VC fund and others after an IPO), the VC fund will be deemed to be part of a group, with a number of potentially un pleasant legal implications.

First, as indicated above, all members of a group have filing obligations for a Schedule 13D or a Schedule 13G if the group holds over 5% of an issuer's securities. For an example, see the particularly complex Schedule 13D filed on September 1, 1998 by virtually all of the stockholders of Crown Castle International Corp. as a result of a voting agreement entered into at the time of the company's IPO.

Second, group members may find themselves subject to filing Forms 3, 4 and 5 and to short swing profit liability under Section 16(b) of the Securities Exchange Act of 1934. Under the SEC's interpretations of its rules, all shares held by a group are attributed to each member of the group in order to determine whether the group member is a 10% stockholder or not. While short swing profit liability only attaches to those shares in which the group member has a 'pecuniary interest,' the formation of the group may create Section 16(b) liability when none existed before.

Third, group activity may have unpleasant effects under antitakeover provisions. Most poison pills and antitakeover statutes have very broad definitions of beneficial ownership that may inadvertently implicate activity by VC funds.

7. Board membership

· Options and board compensation

A number of VC fund agreements provide that at least some, if not all, compensation paid to a VC fund manager for serving as a board member is considered compensation to the VC fund, or at least serves as an offset to management fees. These provisions raise issues with respect to payment of taxes on any such compensation (an issue for private portfolio companies as well as public portfolio companies) and transferability of any options or stock received as compensation. Generally, for tax as well as securities laws, the fund representative on the portfolio company board will continue to hold any options until exercised, although it may be advisable for any public disclosures (Form 3, 4 or 5 filings, Schedule 13D or 13G filings, and the issuer's prospectus or proxy statement reports on beneficial ownership) to acknowledge the VC fund's interest in any such options.

· Fiduciary duties

As a member of the Board, directors owe fiduciary duties to the company's stockholders. Ordinarily, this presents no particularly troublesome issues for a representative of a VC fund holding stock in the issuer—indeed, it is generally considered a good idea for directors to be stockholders. However, VC fund representatives should be sensitive to the problems that may arise when fiduciary duties owed to a portfolio company's stockholders conflict with those owed to the VC fund's investors.

· Taking an active role when management stumbles

A difficult situation for VC fund representatives on a public board arises when management stumbles. Obviously, these situations are hardly unknown to VC funds' private investments. However, in the context of a public company, an added layer of complexity exists. First, information about management shakeups is likely to be considered material, implicating insider trading and public disclosure issues, and requiring a review of any trading activity by the company and by the VC fund. Second, VC fund representatives may be unaccustomed to —and none too happy about—public inquiries from stockholders, analysts or the press—and perhaps private inquiries from the SEC, the New York Stock Exchange, Nasdaq, or law enforcement. Third, to the extent action by the VC fund itself is required, the VC fund's activities may implicate the group issues discussed above. Successfully maneuvering through the minefield of possible issues and pitfalls requires care and experienced

counsel.

· When to call it quits

In troubled companies, it is not always clear to whom fiduciary duties are owed—indeed, those duties may be owed to creditors rather than stockholders. Circumstances may also exist where the obligations of VC fund representatives to all stockholders conflict with their obligations to the VC fund. In any of these situations, it is probably advisable for the VC fund representative to resign as a director. Generally speaking, no liability attaches to a resignation as a director.

8. Director and Officer Liability

· Shareholder lawsuits

Shareholder lawsuits are simply a fact of life for public companies. Any public company with a reasonably large following or market capitalization can virtually be assured of a shareholder lawsuit within hours of announcing unexpected bad news—such as an earnings disappointment. Indeed, plaintiffs' lawyers appear to look for lawsuits merely by watching for sudden stock price drops. Mergers and acquisitions is also a ripe area for shareholder lawsuits.

High tech and VC-backed companies have been active in attempting to stem the tide of shareholder lawsuits, with little success. In economic terms, fighting a shareholder lawsuit, even one that is clearly without merit, is often a losing proposition. Three factors conspire to make settlement of many lawsuits a virtual certainty. First, the management of public companies often faces the specter of extensive time and effort required to defend a lawsuit. Second, insurance coverage frequently covers a substantial portion of the settlement (often 80% plus or minus), but little of the maximum potential liability, making settlement difficult to resist on cost-benefit terms. Third, cases can often be settled prior to trial for out-of-pocket amounts that are not far different from the costs the company will bear from the trial itself, even assuming a complete victory for the company. So until this dynamic changes, or until the role of shareholder lawsuits in our legal system—essentially to police management abuses—changes, expect shareholder lawsuits to be a very real threat for public companies and the VC fund representatives that serve as directors of public companies.

· D&O policies

The risk of shareholder lawsuits, no matter how remote, means that D&O insurance coverage is a standard cost of being a public company. VC funds should consider whether to permit fund partners to serve as directors on public companies without adequate D&O coverage. Coverage is generally available at (somewhat) reasonable premiums, and is likely to be critical in attracting qualified independent directors as well.

· Indemnification agreements

In addition to D&O coverage, VC funds may want to insist that portfolio companies enter into indemnification agreements with any fund partner serving as a director. Indemnification agreements generally do not expand the scope of permitted indemnification coverage, but they should grant the director the right to certain otherwise optional indemnification protections, such as advancing expenses in litigation.

9. Public Conflict of Interest/ Related Party Transaction Disclosures

Both the SEC's Regulation S-X (Rule 404) as well as the accounting rules require disclosure of transactions between public companies and officers and directors or significant shareholders. This issue will first surface in reviewing the IPO prospectus, but continues to show up in footnotes to annual financial statements and in proxy statements.

10. Selling a Public Company

Even the prospect of selling a public portfolio company carries a different panoply of problems from those encountered when a private portfolio company is involved. Several issues that must be considered:

· *Public Disclosure*

At some point during the negotiations, the question of whether applicable SEC rules might require a public portfolio company to publicly announce a potential or pending transaction will be raised. Needless to say, those negotiating the transaction seldom favor moving the negotiations into a fishbowl.

· *Fiduciary Duties and Shareholder Lawsuits*

As indicated above, fiduciary duties come into sharp focus during the sale process for a public company. In addition, no public company merger can avoid the potential risk of shareholder lawsuits, which may take several years to resolve even after a transaction is completed.

PubCo Rescue Project

PubCo has run into trouble. VC Funds, which still hold a significant portion of their original investment and a significant percentage of PubCo's stock, decide to make a new investment in order help PubCo get back on track. The investment has standard VC terms:

- New series of preferred stock, convertible into common stock
- Registration rights
- Shareholders agreement, providing for additional director seat
- Warrants

The rescue project has a number of nuances now that PubCo is public and not private:

- PubCo's problems and the proposed solutions may be material inside information until disclosure is made to the public. PubCo files a Form 8-K to announce the transaction when a term sheet is signed. VC Funds should take care in keeping this information confidential until disclosed by PubCo.
- The transaction will implicate PubCo's related party disclosure requirements because, among other reasons, the VC funds have existing representation on the board. As a result, the transaction will be mentioned in PubCo's financial statements and proxy statement.

- If the preferred stock is convertible into more than 20% of PubCo's outstanding stock, stockholder approval is required under NYSE/ Nasdaq rules before the transaction can be effected. This requires preparation of a proxy statement and SEC review of the proxy statement before mailing.
- State antitakeover laws must be reviewed for applicability.
- VC Fund's representatives on the PubCo board may consider abstaining in view of their conflict of interest in the transaction. If the rescue project affects control of the issuer, a heightened focus on fiduciary duties, involving special board committees and independent advisors, may occur.
- VC Funds have formed a 'group' for SEC purposes at some point during the negotiation process, at least by the point in which the term sheet is signed.
  - Each VC Fund is now deemed to be a 10% stockholder, requiring that a Form 3 be filed within 10 days, or a Form 4 (by the 10th day of the following month) if a Form 3 has already been filed. By virtue of the group creation, each member of the group is deemed to have acquired beneficial ownership of shares held by other group members.
  - Section 16(b) short swing profit liabilities are created by virtue of being deemed to be 10% stockholders.
  - VC Funds also have Schedule 13D filing requirements, most likely within 10 days of the signing of the term sheet. The funds lose their 13G exemptions by virtue of acquiring more than 2% of PubCo's stock (either by virtue of the formation of the group or by virtue of the conversion feature of the new preferred stock) and by acting in a manner that influences control of PubCo (*e.g.*, by acquiring rights to an additional board seat).