



Lowenstein Sandler's Emerging Companies, Venture Capital Podcast: The Founder's Hour

Episode 3

[Laura Cicirelli](#), [Eric Weiner](#), [Raquel Smith](#)

MAY 2026

-
- Eric Weiner:** Hi, everybody. Welcome to *The Founder's Hour*, from Idea to Exit, Happy Hour Conversations on Forming, Growing, and Selling a Business, a Lowenstein Sandler podcast series. I am Eric Weiner.
- Laura Cicirelli:** And I'm Laura Cicirelli.
- Eric Weiner:** We're partners in Lowenstein's Emerging Companies and Venture Capital Group. Whether you're forming your first company, negotiating your first term sheet, or preparing for an exit, decisions you make early can shape your company's future.
- Laura Cicirelli:** Each month, we bring the conversations happening at our New York office to the broader founder and investor community, sharing practical, legal, and business insights to help you navigate every stage of your company's growth.
- All right. Welcome back, everyone. Thank you for joining us today. We're really excited. We have a special guest with us. But before we go and introduce her, we just want to talk about where we are right now in the podcast series.
- Laura Cicirelli:** So, we formed the company and last episode we talked about ways to get cash into the company quickly through SAFEs and convertible notes. Convertible notes, we talked about being a form of debt, and today we're going to be talking all about debt, but a very different type of debt. So, we're going to talk about different venture debt facilities. And we're joined today by our partner Raquel Smith. So welcome Raquel.
- Raquel Smith:** Thank you, thank you, thank you for having me. I'm happy to be here and talk about all things debt, in particular, venture debt. I think today it'd be great if we could chat about what is venture debt, how is it different from some of these other types of funding sources that

companies consider, some of the key terms of these types of facilities. How is it different from equity? What types of terms make it helpful or hurtful? When companies are thinking about capitalizing their businesses, some of these covenants, economics, and then maybe some pitfalls and things to think about for companies who are considering taking on venture debt. Or maybe you're an investor considering how to advise your companies when they're considering these types of facilities.

Eric Weiner: Thanks for that, Raquel. I'm so happy to have you on the podcast. Maybe we can start by talking about the two main types of venture debt facilities that you often see.

Raquel Smith: Absolutely. So maybe I'll just start with, you know, what is venture debt. And I think the thing about this that's slightly different from other types of debt facilities is that it's debt being given to venture-backed companies. And while that may seem very simple for a lender, that can be kind of tricky to figure out how to capitalize or put leverage into a company that may not be cash flow positive, may not have any assets that are considered valuable collateral. So it's a little bit—

Eric Weiner: You mean like an early-stage startup company?

Raquel Smith: Exactly.

Laura Cicirelli: It's also, I mean, when we talk to investors, when we represent investors, when they're going to go and put their money into these companies, we tell them, you know, it's very risky. It's you're not guaranteed to get anything back. And a lot of times you lose your money. So, I guess it's very similar for lenders in this space in the conversations that you have with lenders too.

Raquel Smith: Absolutely. So, I think the interesting thing about lenders that's different from equity investors is that lenders are really trying to optimize the way that they get their money back. Like, they are genuinely expecting to get their money back, and they are structuring their transactions in a way that allows them to be able to do that.

Eric Weiner: And it's not like venture capitalists aren't looking to make money or get money back if they need to. But I think the sensibility between a venture investor and a bank are materially different because when you're taking venture debt, you're dealing with a bank.

Raquel Smith: Exactly.

Raquel Smith: And so when you asked Eric about, you know, what's the difference, like the two different types of facilities, the two primary kind of groups would be term loans, which, is similar to a mortgage, which you get a big chunk of money on day one and you're paying it back over time. And then there's the other type, which is a revolving loan, which is similar to a line of credit, similar to a credit card. So you get a line, you pay it down, you borrow some money, then you pay it down, you borrow some money, you pay it down over time. And those are the two big kind of groups of types of facilities that we see in this space.

Laura Cicirelli: So, Raquel, before we even move on. Question for you, timing for these type of facilities, when do you see a lot of startup companies go out and seek venture debt? Is it something that they get prior to investors on the cap table, after, concurrently? What do you see the most?

Raquel Smith: Yeah, that's a great question. And often something that we are talking to our clients about when they're trying to optimize their strategy. And one thing that I think is important to know is that for most venture lenders, they're not looking to provide bridge financing, like they're not necessarily trying to give you short term cash to get you to your next equity raise. That's not usually what they're trying to do. So what's usually the best timing is concurrently with or right after doing a large priced, maybe not a large one, but a price financing round would be usually about the time that a company would consider tacking on venture debt that they may or may not actually intend to use, but it's a good time to kind of see what's your best options in the market.

Eric Weiner: Yeah, we often do see that almost concurrently with or just after. A lot of VCs will come in and say, "Okay, now it's time to get the venture debt deal done." And it's what, a there's not a better time to do it when you've just had an investor validate—

Laura Cicirelli: I was just going to say, for a lender, that's a good point. It gives them the comfort.

Raquel Smith: Yeah. It's not you know, it's somewhat a requirement right because what lenders or these particular lenders are looking for is to ensure that you have folks on your cap table, particularly what they would love to see, or some institutional investors on your cap table that have

some skin in the game and are able to confirm that they will be supportive of the company as we go through the different ups and downs early stage companies face. So they just want to make sure that there's that support in the background for the company.

Eric Weiner: And now you have the support. You know you found the lender, you get a term sheet. What do those term sheets look like? And what should founders, and by the way founders please don't negotiate those term sheets without talking to a lawyer who does this like Raquel every day, but what should they be looking for, Raquel.

Raquel Smith: Yes. If there's anything else that you take away from listening to this episode, if you are considering this process, you know, at some point when you're at the term sheet stage and you're ready to sign, you're feeling really good about it, just pass it along to your lawyers. Just send.

Laura Cicirelli: A second set of eyes, right?

Raquel Smith: A second set of eyes. And, you know, there are just a few things that we can chat about that are kind of red flags, but for the most part, you'll see pretty standard terms. And what founders and companies and their advisors are most focused on will be the economics. So, they're focused on how much, the interest rate, how long do they have to pay it back, and all of that. That's great. And those types of terms are best negotiated against different lenders. So as many term sheets as you can get is your ideal situation in order to see really what you can get in the market and when they're all kind of coming in about the same and that's—

Eric Weiner: As a general matter, like when, when Laura and I are working on a venture financing, you know, there's a market out there generally, you know, you see terms, okay, this this is market, give or take. I imagine it's the same when you're looking at these types of deals.

Raquel Smith: Absolutely. And there will be a market for venture debt lenders that are banks and there are venture debt lenders that are non-banks, like funds, and they might have different terms. Banks oftentimes are able to do a little bit better on the economics, maybe interest rates might be a little bit lower, things like that. But they're looking for something a little different. So they're looking for treasury, they are looking to make sure that when you agree to doing these facilities, you are keeping

your cash in their accounts. That's a big part of it. So they're able to kind of, you know, finesse a little bit on that side.

However, the non-bank lenders have a little bit, they're not focused as much on Treasury, but there might be other terms that they're very focused on like warrants. And we'll talk a little bit about that later. But there's different criteria, I would say, that we would think about when we're thinking about what's market, but it's really about what type of business this company is running, what type of assets that they're looking to use as collateral. Like, do you have a warehouse where you're actually have inventory? Are you looking for an asset-based loan or is it all of your value in IP? Are you a tech company or platform or a fintech that's only IP, whatever the case may be. So, it's really just thinking about where your company is right now, what your business is, and what value the lenders can ascribe.

Eric Weiner: So, with respect to the account control. If a bank is lending the money versus a fund, the bank is going to make the company enter into an account control agreement of some sort, which basically says you're either keeping the money here or if it's somewhere else, it's only going to be moved based upon how the bank is permitting you to do that. Is that the case?

Raquel Smith: That's right. But even the non-bank lenders, they also want you to have the account control agreements, right? So, the expectation is no matter what really, if you're doing a secured loan, meaning you're putting up collateral for the loan, and for the most part, most venture debt, they will all be secured. They're very rarely not, very, very rarely.

There are other types of lending that you can get that won't be secured, but venture debt, for the most part, will be all secured, which means that the banks are very focused on making sure that you either keep your money with them, meaning if things happen to go wrong and they needed to have access to it, they can—

Eric Weiner: Sweep it?

Raquel Smith: Sweep and they can go directly to the accounts that you have and you maintain with them. The non-bank lenders are far more focused on those control agreements because they need to know—they're not a bank; they don't have direct access to your accounts—but they need

to know that if you have an account at JPM or SVB, they need to know that they are able to have access if something did go wrong.

So, there's always, these are the types of things that we like to point out to our clients and make sure that they understand. These are definitely customary and market terms, but they need to understand that that's what that means. And I think oftentimes, especially if a company is taking on debt for the very first time, these are the things that we just like to make sure that they fully understand, fully understand what these different fees mean. There might be an exit fee and a prepayment fee and a commitment fee, like all these different fees. And it's important to understand when do those get paid. Like how much you know, what is the fee being calculated based on. Is it based on the entire commitment? Is it based on how much you actually draw down on the facility? Do you only pay when you draw down? Those types of things are all terms that you can negotiate, but you have to know that you can negotiate it, And that's where, you know?

Eric Weiner: We do. I feel like we do run into that a lot where the company grows up a little bit. It's looking to refinance or to maybe get a different facility, a larger facility, and it has to pay its existing lender a prepayment fee in order to do that and I think sometimes you do see a little bit of surprise about how expensive or challenging that process could be with the existing bank.

Laura Cicirelli: I think so far some of the terms people can relate to their existing mortgage, right? A prepayment penalty and interest rates. So those are all kind of economic terms that we can relate to. A lot of these facilities have covenants in them which we don't usually experience with our mortgages. So, what are some of those affirmative and negative covenants and how does that—I mean, I think a theme that we've talked about a couple of times now on the podcast is the idea of a dollar is not always the same. You need to think about what comes with that dollar. So, the economic terms are great, but what are some of the things we need to think about that are coming along for the ride with this money that just operationally you got to think of?

Raquel Smith: Yeah, I think that's a great question because that's probably another item that we want to flag in terms of how is taking on debt or venture debt different from equity, right. You know, there's usually covenants

when it comes to your investor documents, your shareholder paperwork. And there are things in there that you need to focus on and make sure you're maintaining and handling on a go forward basis. But I think oftentimes when companies and founders are taking on debt and they're reviewing the loan documents for the first time, they're a little bit overwhelmed by all of the covenants and requirements. And again, these are all completely standard and customary and what is to be expected.

Laura Cicirelli: That's why it's helpful to have an attorney tell you that what is customary to give you that comfort.

Raquel Smith: But they are always pretty shocked about how much that they're going to need to do. They're always concerned like am I going to remember to do this. And they have to kind of put in protocols, internal protocols, to make sure that they're handling this. They have their finance teams preparing certain items. So just as an overview, they're usually batched, I'll say in three different batches.

One is affirmative covenants, two is negative covenants, and then the third one would be financial covenants. So your affirmative covenants are all the things that you need to be doing on a go forward basis. All the things you need to deliver and make sure you're not forgetting to do right. So, you are delivering monthly financials and/or quarterly financials, yearly financials, maybe those are audited annual financials. You're delivering maybe KPIs, you're making sure that you're maintaining your insurance on a regular basis, like those types of things that they're just kind of like a list of things that you need to make sure that you're doing and handling on a go forward basis while the debt is in place.

And then comes the negative covenants. And those are, I think, where things get a little, we start to get dicey. Because these are the things that you absolutely cannot do while you have this debt in place without getting your lender's permission and that's something that I think some founders have a hard time getting used to.

Laura Cicirelli: Giving up control a bit, too.

Raquel Smith: Because they're just like, "I'm running a business here. We're moving quickly. We're pivoting. We have different opportunities on the line, and we need to be able to move fast." And that's definitely something

to think about and when our clients are asking us to weigh in on how is it working with this lender versus that lender, that's always something that comes up, like how quickly are and how nimble can they be in terms of getting consents for different transactions or items or amendments?

Eric Weiner: I think that's a really important point in that venture capital investors generally, well, they do get negative controls, certain types of negative controls, they have affirmative covenants too. Not to say that they don't enforce them, they do but there is a flexibility. And they can be nimble and there's a process by which you don't have to worry about the company having to shut down if you know you can't get something done. And not to say that banks or other lenders can't be similarly nimble at times, but it's a different process.

Raquel Smith: Especially because, you know, especially if we're dealing with like a bank bank. There's usually like back office operational requirements.

Eric Weiner: Right, you're not calling your person at the bank and it's going to get done. They have a department that they have to deal with.

Raquel Smith: Exactly. Yeah, you can call your person, but they're going to say, "Well, let me call my person and let you know." And sometimes that can be super quick and there are certain lenders that are so used to being in this space and they know the types of borrowers that they're dealing with, and they just have a well-oiled machine in terms of getting this done. Others, maybe not. Maybe they're dipping their toe into doing venture types of transactions. In the last few years, there have been quite a few, like large banks, that are now starting to get into these types of these types of transactions, and they're just a little less used to how quickly things need to go and how often these conversations need to be had.

So, I think, you know, for negative covenants, that's often something to think about. And as an example of some of those negative covenants like you're not going to be permitted to incur additional debt, you're not going to be permitted to make dividends and distributions. And, you know, those are considered restricted payments, investments, meaning you loaning money to other parties or doing joint ventures like those types of things. You can obviously negotiate all of that stuff when you're in the process of working through your loan documents with your lenders, but unless you have

an idea of the things that you want to do at that time, you're not going to be able to solve for everything.

Eric Weiner: And we had talked about last time about SAFEs and convertible notes and, Raquel, you had mentioned on this podcast that this type of debt is not bridge financing, but the company still may need bridge financing after it takes its venture debt. It's not to say we never see companies raise convertible notes or convertible debt when they have a facility in place, but that's going to require subordination, you're going to have to get the bank involved. This is not something you can just do just because. Now SAFEs, however, are not debt. So you may not have to deal with that type of subordination, but you will be limited in the things you can do without getting consent of the bank that traditionally you probably be able to do without it.

Laura Cicirelli: And quickly, a subordination agreement is an agreement that the bank, the term loan lender, will require each of the note holders to sign on to that says, "in the case of a liquidation event, if we need to go through the waterfall, the term loan gets paid out first before the note holders receive anything."

Eric Weiner: If you have 10 lenders, 10 convertible note holders, you're going to have to get 10 people to agree to subordinate and sign the subordination agreement.

Raquel Smith: Honestly, I would say that we see that all the time. That's something we're doing very regularly. It's just a part of the process, which is a company, they've took out venture debt at some point. That's their senior debt in the background, they are preparing to do their next financing, maybe the next few months, next few quarters. They need some bridge financing right now. Maybe those convertible notes are also backed by collateral, maybe they're not. But you definitely are going to need to get your senior lender's consent, you get all this documentation. We do it regularly.

Laura Cicirelli: We do it all the time. But the negative covenants are something in place that you need to just take a pause and see what am I restricted from doing and what are the steps to get the waivers. And I think two important takeaways from the negative covenant conversation is one, this is very important during the term sheet stage to talk with your counsel. If you know there is something coming up that you need this money for, and normally it would be something that a bank would say,

“No, you cannot do.” There can be carve outs. If you know that you need to go and make this, you know you need the loan to get this acquisition that you really need to run and operate the business, have that be carved out and have that be added to the term sheet.

So, I think that's super important to just think through before signing anything. And second is VCs, investors who are going to be on your cap table are so important for these purposes of getting the waivers, having the conversations with banks. We said a lot of times you contact the bank, they have to contact another person, but how great to have an investor in your boardroom who says, “Wait, I have my contact at that bank. In 15 of my portfolio companies, I have dealt with them through term loan facilities.” And really, they are customers of the bank because they want to be on great terms with these investors so that they go to the next portfolio company and say, “you should really use this bank because of XYZ reason. They're great to work with.” So, use those resources that you have.

Eric Weiner: And that's a broader point: not every investor is the same. So not every million-dollar check is the same. And we really have seen, particularly where companies are at the end, and they are struggling to fulfill these covenants or pay the bank. Relationships that someone on their board of venture capital on the board has with the bank has really helped and really, in some cases, saved the company's life because the bank really does want to work with the institutional investors that they have good relationships with.

Laura Cicirelli: And not just for negative covenants, but I think we'll even go into events of default. If there's something where—

Raquel Smith: And right before that, I'll just talk about financial covenants because I think that's where this comes up the most. So oftentimes in the term sheet, a bank or the lender might say, “Here are these financial covenants that we want you to maintain. So maybe certain are annual recurring revenue requirements on an ongoing basis or certain EBITDA requirements or certain leverage tests, like certain things that you might need to just be, based on your projections that they're expecting you to maintain on a kind of go forward basis. So maybe on a monthly or quarterly or annual, they're looking to see certain metrics and financials. So, I think oftentimes in our experience, companies can be a bit ambitious about what they agreed to in the term sheets because

usually the amount that they're able to receive in the debt will be tied to those financial covenants. So, they see big numbers. They want to grab the big numbers. The financial covenants might be a little ambitious. They didn't build it enough cushion. They didn't model it in the way that they probably should have. And those types of things are, I think, probably one of the earliest ways that we see companies, you know, they've had a facility in place for maybe a few months, and now they're realizing, "Okay, we're having a tough time. We think we're coming up on some challenges. We may not meet the projections that we had provided the bank."

Eric Weiner: You mean startup companies don't meet their projections?

Raquel Smith: Shocker, right?

Oftentimes they are pretty surprised. And they come to us and say, "Hey, what should we do? Like this is coming up, this is coming down the pike. We need to strategize as to how to handle it." We also represent a ton of lenders as well. And I think for them, transparency is often exactly what they're looking for because they will work with you.

Laura Cicirelli: Same with investors.

Raquel Smith: Especially in the beginning. It's not like we've been in some real muddy waters for a long time and things are looking dire for the most part. They're going to rework some things. You are going to be seeking waivers or amendments. You may have to scale back on some things that you receive, but also that's where you definitely want to leverage who is on your cap table.

Laura Cicirelli: Those relationships.

Raquel Smith: That is key because that will really help to really navigate against these tough times.

Eric Weiner: It really is an interesting point, I think, just as a general matter. In running a company, raising money from third parties, taking on debt, anything, it's about relationships. If you treat the people around the table, whatever that table is, with respect and reasonable transparency, they're more likely to work with you. And startup companies are going to enter into these facilities. We have these conversations about potential violations of these covenants all the

time. And the ones that survive it are the ones that have treated the parties around the table with respect.

Raquel Smith: Absolutely. And treating them as partners. And then going back to the point that we made before was just getting references. Maybe you're a founder and you have other friends that are founders, maybe they've taken on debt figuring out like, okay, so who did you work with? How were they? Did you ever have any difficult times? How were they to work with? How quickly are they with amendments and things like that? I think that's always very helpful for companies to do that diligence upfront to understand who they are working with. There are certain lenders that we work with all the time that we have glowing reviews of because they're so easy to work with. Obviously it's all a relationship and figuring out who can be a partner as you go on a years-long journey with is important. There are other lenders that may be tougher to work with or may have very difficult documentation that we're going to have to fight through the entire time, things like that. So it's good to get feedback, asking your board members and others on your cap table what are good experiences, what context do you have.

Eric Weiner: And counsel too. Here you get perspective on, okay, we've signed this term sheet, what's this deal going to look like. But to the point you made about diligence, Raquel, which I think is a good one, this is in the venture context too. If you're a founder of a company, the investors or the lenders are going to do a lot of diligence on you. You are allowed to do diligence on them as well to understand who the right partner is going to be.

Raquel Smith: I think that that's a good way to transition back into events of default. I think we had mentioned that before. And that's a key part of these documents as well. And that that's just a list of items that if a company violates this or breaches these requirements, then that gives the lender the right to start kind of taking action or exercising their remedies or doing whatever they need to do under the law and under the documents that allows them to try to recover the money that they put in. So that's something to definitely be aware of and that that list of stuff, it's usually a high, high bar. It's things like “you didn't pay me when you said that you were going to pay me” or “you took out other debt that you shouldn't have” or “you have other debt and you're in default over there.” This lender is now like able to say, “I'm concerned about your ability to pay me because you're not paying

them,” “you're going into bankruptcy.” There's just a list of stuff and it usually includes violating these covenants that we just discussed. So for the financial covenants, those are usually immediate events of default. If you don't hit the targets that you said you were going to hit and there's no ability to cure or resolve that by way of that is set out in the document.

Laura Cicirelli: Or a waiver like we talked about from the bank because you had those conversations.

Raquel Smith: And that's why it's important to have those conversations early. You don't want to wait until you're already in default to now try to ask for some type of consent.

Eric Weiner: Are there cure periods on financial covenants?

Raquel Smith: There are. I would say they're a lot more rare in venture debt facilities. In other commercial debt transactions, those are very common. But here, sometimes we are able to negotiate those. It's not as common, but it just depends on what type of facility it is, how much leverage the company has, who's on their board. Those types of things really help to build that in.

But what the idea is that if you have a financial covenant that you don't meet, you have some investors that are able to come in and put in more equity to cure what those defaults are and be able to resolve those issues for you. And they'll usually set a limit like, you know, no more than X number of times a year or during the life of this loan or things like that. They're a bit more rare, I would say, for venture debt, but it is something that you might be able to see.

Eric Weiner: How often have you seen a lender foreclose based upon violation of these?

Laura Cicirelli: I have not, so I'm curious to see. I'm sure you're take is maybe a little different.

Raquel Smith: That's a very important question, right? Because as I mentioned, most of these facilities are backed by collateral. And the whole point of collateral is that if things go south and you don't pay the lender back. Because for the most part, if you violate these covenants and if the lender is maybe they're at their wits end, they're done with this facility and they're just like, “We don't we don't want to stay in this anymore.

We want you to just pay us back.” That'll be their first and primary remedy, which is pay us our money back. Let's all go our separate ways.

Eric Weiner: Because they don't want to operate your business.

Raquel Smith: They don't want to operate your business. Most of these lenders are in the business of lending. They're not in the business of running venture-backed companies. They just want their money back and if you give them their money back then everybody parts ways and everyone's happy. Oftentimes the reason why we are having all of these issues is because the company does not have the money to pay them back. So now we're in a we're in a different world.

Laura Cicirelli: Look to the collateral. What do we got?

Raquel Smith: That's why that collateral is so important. It's so important for them to understand the value of it up front, and later on, and throughout the life of the facility, and definitely at this time. They want to know what's valuable and what can I take. Or under the law, there are a lot of restrictions as to how they do that. But, they are able to go— and it's the same thing, we were talking about mortgages. You have a house, you are not paying your mortgage payments. They are allowed to take that house back. That's their collateral. They know that if something goes wrong, they can sell that house and use that money to pay themselves back.

Laura Cicirelli: But I imagine putting a house on the market or at an auction is a lot easier than taking a bunch of startup assets and trying to sell those off piece by piece, or even in batches, but also not what a lender wants to be doing, I'd assume.

Raquel Smith: And that is actually a very key part of this. So when we're doing, and we'll talk about pitfalls later, but when we are doing these venture backed or venture debt facilities, one of the key big risks that the lender is taking on when they do these types of loans is that because you are a venture backed company, they're not getting a pledge of the equity, meaning they won't be able to come in and just own the company. They can't. Those shares are owned by your shareholders and your investors, so the only thing they can really have is everything that the company owns, meaning all of the assets of the company, so the IP or the inventory or the software, whatever it is, they can have

that and they can take that and try to use that to pay themselves back. But is there a market to sell this thing? And that's what makes it very tricky and risky for these types of lenders to go into these deals because it's a pain. It's a pain to try to take this.

Eric Weiner: And presumably if the company was able to sell itself, it would sell itself. I mean, sometimes we do see I have seen it happen very, very rarely. The bank comes in and it takes the assets and it tries to negotiate some asset deal or something. But it's been very rare in the 20 years I've been practicing.

Raquel Smith: Absolutely. Because for them, and usually when we get to the point where things have been going south for a while and the lender are really trying to get out of this and they've tried to get their money back. They can't get their money back. Maybe some of the investors are abandoning ship, maybe things have gotten tough. The lenders' first line of defense and they're going to really focus on getting this business sold. So, they're going to be working with you to try to get this business sold.

Eric Weiner: 100 percent.

Raquel Smith: They're going to be trying to bring you potential buyers. They want to be very involved in the process because it's a lot easier for them to help you facilitate getting a sale than to have to come take it. Now it's a lot more aggressive operators are gone, maybe employees are going. Like what do they have; it's just difficult. So, the question was really, how often do we see lenders really go fully into foreclosure. And it's very, very rare because there's usually not a lot that they can gain from this. I will say the only caveat there are the non-bank lenders that may not be like lender-*lender* lenders and they may have a strategic reason why they do want that thing. Maybe they do want that IP that you have, maybe they do have a third party that they might want to sell it to. They might have connections and depending on what kind of business they're in and if they're a bespoke lender that does interesting different types of deals. Again, this is all extremely rare and not something that most companies will encounter. For the most part lenders don't want to foreclose. They want their money back.

Eric Weiner: But I think that's important context for the beginning stages of the deal when you're at the LOI. So, who is the lender, what's their strategy, why are they giving you this money. It's important to understand it, I

think, we should probably move on to—and by the way, I do want to come back to the risk of an equity pledge when Raquel talks about pitfalls—but maybe, Laura, we could talk a little bit about warrant coverage.

Laura Cicirelli: Well, it's funny that you mentioned risk. So, I was going to say how many times have we said risk during this podcast. But again, this is a very risky lending situation. And to kind of hedge that risk, a lot of times we see these lenders in the term sheet talk about warrant coverage, and they want to get a piece of the pie a bit to kind of give them that upside. So, in case things go wrong with the debt facility or to compensate me for taking on this huge amount of risk, I want a little extra from the company.

What are warrants? So, we talked a lot of times about how these lenders are different than investors because they're not getting equity in the company, but with warrants, they essentially are getting something and getting a piece of the pie. So a lot of times we see warrant coverage, very small amounts, I'd say usually between ten basis points to 25—so that's like .1 percent to 0.25 percent of the fully diluted capitalization of the company—and it's done through a warrant, which is essentially very similar to what you would give your service providers, in that it's not equity as of day one. It is the ability for them to purchase equity at a future date. So, it's usually, we see preferred stock, I see, I think, more frequently it is as common stock.

Eric Weiner: Every now and again you see preferred stock. But I would agree. Generally, it's common.

Laura Cicirelli: Yeah. And it's going to be at the most recent 409A price, which is the exercised price, so whatever the most recent fair market valuation you have for your common stock is, they have the right to exercise. There's usually sometimes vesting schedules when you see like with tranche lending. If you achieve that second tranche, then 50 percent of this will vest and the other 50 percent is available to just be purchased right at the initial closing of the term loan. Sometimes it's time-based vesting. I mean, it really depends, I think. Raquel, I don't see anything as absolutely standard across the board with the vesting schedule, but it gives the lender the opportunity to purchase either a common or preferred stock of the company and get on that cap table.

Eric Weiner: Yeah, and the warrant should be relatively standard. But this is also something that you really want to talk to your counsel about because there are things on the edges that can come into play. Sometimes the banks get participation rights, they want pro rata rights. You know, you have to think about, we often talk in the equity context—and Laura and I will talk about this when we talk about priced rounds—you know, how do you get a waiver of pro-rata and stuff like that. Banks are, we talked about it earlier, they're institutions. They're not always the easiest to get waivers from. Sometimes they ask for rights that we would say are very nonstandard. Sometimes warrants are just payable on a sale of the company. You don't have to pay the exercise price, the dollar value of that warrant. Not every warrant has that. And if we see one that does, maybe we'll negotiate with the bank a little bit there. So, it's something that you want to see at the term sheet phase as well.

Laura Cicirelli: Yeah. And make sure that there's language in that warrant that once they exercise, they become a shareholder. If there are shareholder agreements in place, which oftentimes there will be, because we said they get these facilities concurrently or after a venture round, they sign on to those shareholder agreements in the same way the other common holders or preferred holders are signing on to them as well.

Eric Weiner: And that language is not going to be in the bank's form. But they'll, I think in our experience they typically—

Laura Cicirelli: I haven't seen them push back. That's fair. And so now this kind of leads us to the end. We always like to wrap up with some things to just be wary of. And what are some things that if you see this in a term sheet, absolutely red flag, we should be talking about it.

Raquel Smith: Yes. So, we'll start with the one that we already mentioned, which was the equity pledge concept. As we mentioned, in these companies, all the equity is owned by individual shareholders, investors. Your cap table can be extremely long. So, when a lender comes in and you see on a term sheet that it says they're looking for a pledge of the equity of the borrower, that is an issue.

Laura Cicirelli: Red flag.

Raquel Smith: It's a red flag. It's again, this is also a very customary common concept that we use in other types of debt, but not for venture backed

companies. Of course, when we have PE backed companies, that's easy. You're owned 100 percent by one, you know they can easily throw in—

Laura Cicirelli: Get one person to pledge the equity not 55—

Raquel Smith: They can easily slot in an extra entity in there that can just be a hold co entity and it'll just go ahead and pledge 100 percent. Easy peasy. Not a problem. When we've had some situations where lender is like, “no, we absolutely need it,” we absolutely need to get a pledge of all the equity.

Raquel Smith: So that can be done in two ways, really. One—

Eric Weiner: None of them are not painful.

Raquel Smith: Exactly. They're both horrible.

Eric Weiner: And very, very expensive.

Raquel Smith: That's why they're horrible. It's a lot of work. But you're putting a lot of money into legal costs that, I don't think, most founders want to do.

Laura Cicirelli: And what lender wants the money that they're putting into the company to go pay our legal fees?

Eric Weiner: It's an exponential increase, you have to rework your equity documents, you have to get consent from your stockholders. You might have 100 of them. And you know, it's a lot to have to explain. It puts parties that wouldn't even be thinking of having leverage in the leverage position. It's just not anything you want to do. I don't want to go too much further into equity pledges other than to say, if you are a venture backed business and you see an equity pledge in that LOI, even if you do not use a lawyer for that LOI, cross it out.

Raquel Smith: That's great. And the other one that I feel just as strongly about would be personal guarantees. And similarly, if you see it in the term sheet, that's a red flag because for most of these companies, and it just depends, for most of these companies, there's no expectation you're going to take on \$5 million or whatever the size of the facility is from some lender. And you are putting it into your company. If they're saying “you, your individual self as the founder need to also sign a document saying if this company does not pay back this \$5 million. I as a lender can come after you personally, individually.”

Laura Cicirelli: Personal accounts, your house, your everything.

Eric Weiner: What's our legal term to fight this NFW.

Raquel Smith: I mean, there are certain limited situations where it makes sense to agree to it depending on how your business is structured. Oftentimes if it's a company that's like 100 percent owned by one person and they're kind of already bankrolling it, it really doesn't make a difference. But it's just very rare. And you what I often need to have like a clear conversation with that, whoever it is, we've seen certain term sheets that have asked officers to give personal guarantees, like they don't even own this company, and they are giving a personal guarantee that if this money does not get paid back, that they—it's bizarre. But we need to have clear conversations with you to make sure you understand what that means. And nine out of ten times, maybe even higher than that, when we have that conversation, they're like, whoa, they absolutely had no idea what that meant.

Eric Weiner: Well, I think that this is an important point, just generally. LOIs, whether it's an equity deal or a debt deal, I mean, there are words in these term sheets that look very clearly understandable, and they seem innocuous, but every word in a legal document, for the most part, has a meaning. And it's very important to make sure you really understand what you are agreeing to.

Laura Cicirelli: But I think, yeah, going off of every single word, especially in a term sheet, like you said, it has a meaning. Bringing in legal counsel as soon as you get that LOI, not only to review the terms, but we have such a good feel of the market to discuss what we've seen, make suggestions who to go to, who to reach out to, who to avoid. I think this is all just really helpful conversations to be had.

Raquel Smith: Yeah. And we also connect different companies to lenders. We do this every day. We have so many connections with lenders in the space. If you tell us what you're looking for, we're happy to make some recommendations as to who might be a good fit for you. We can help to be those types of partners and advisors as they're thinking about these types of transactions.

Eric Weiner: I think I just close out by saying, if you get an LOI from a venture lender, it means you probably close a venture round. It means there's some type of a lender that's willing to give you money. These are really

good things, and it means that the company is progressing really nicely. So even though we've talked about some scary things with respect to what you might see in the term sheet or in the documents themselves, this is a really good thing if you're having to have these discussions. So, we will end with that. And hopefully, some of you out there are dealing with a venture debt term sheet right now. And if so, you know Raquel's here.

Laura Cicirelli: Thank you, Raquel, so much for joining us.

Raquel Smith: Thank you both for having me.

Eric Weiner: Thank you so much for joining us for *The Founder's Hour*. If you enjoyed this episode, be sure to subscribe on Apple Podcasts, Spotify, YouTube, or wherever you listen so you don't miss future conversations. If you would like to join *The Founder's Hour* events live in our New York office, you can contact TheFoundersHour@Lowenstein.com for details. You can also contact Laura or me.

Laura Cicirelli: Join us for the next episode of *The Founder's Hour*, where we talk about venture math, including pre money and post money valuations and all the calculations in between.

Eric Weiner: Until then, thanks so much for joining us.