

## INSIDE A TERM SHEET: SEVEN CLAUSES FOUNDERS SHOULD NEVER IGNORE



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## ABSTRACT

The term sheet, conventionally deemed "non-binding," is in reality the foundational legal and commercial blueprint of venture financing. For Nigerian founders - negotiating in a rapidly evolving but structurally asymmetric ecosystem - missteps in term sheet provisions can mean irreversible dilution, loss of control, and downward exits. Anchored in Nigeria's legal framework under the Companies and Allied Matters Act 2020 ("CAMA 2020") and the evolving corporate governance landscape, and informed by comparative insights from the UK, Singapore, and South Africa, this article provides a comprehensive analysis of the most critical legal and commercial provisions. By exploring the legal nuances of CAMA 2020, financial modeling, tax implications, and dispute resolution, it empowers founders to secure funding without compromising their long-term equity, influence, or strategic trajectory.

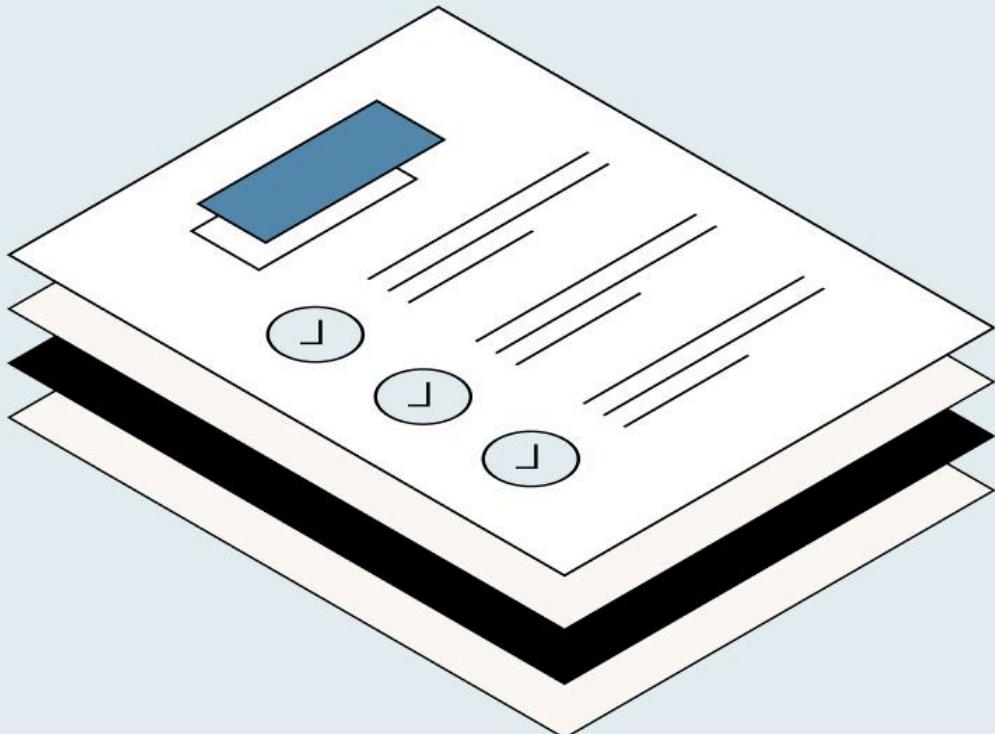
# INTRODUCTION: THE TERM SHEET AS A STARTUP'S CONSTITUTION



In the dynamic landscape of venture financing, particularly within rapidly evolving ecosystems like Nigeria, the term sheet is far more than a preliminary document. It is the foundational legal and commercial blueprint of a startup's future, shaping everything from equity ownership to strategic control. While often perceived as a formality preceding "real documents," missteps at this stage can lead to irreversible dilution, loss of control, and sub-optimal exits for founders.

In 2024, despite an overall contraction in African venture financing, Nigeria maintained its leadership position, accounting for 16% of Africa's total US \$3.6 billion VC investments<sup>[1]</sup>. Yet, for many founders, the term sheet is approached as a precursor to "getting to the real documents," rather than as the blueprint in substance and leverage it truly is. This article bridges that gap by grounding its analysis in Nigerian corporate law, particularly CAMA 2020, and drawing on common-law comparators in mature venture ecosystems like the UK, Singapore, and South Africa.

# LEGAL AND REGULATORY FOUNDATIONS IN NIGERIA



## A. BINDING EFFECT OF TERM SHEET CLAUSES

Under Nigerian contract law, the enforceability of term sheets hinges on the intention to create legal relations and the certainty of terms[2]. While social or preparatory provisions like confidentiality and exclusivity are generally binding, courts may enforce other provisions if they amount to clear, specific commitments on which parties have relied, creating risks of promissory estoppel[3]. This underscores the need for precision in drafting to explicitly delineate binding and non-binding clauses.

## B. DEEPER DIVE INTO CAMA 2020 AND CORPORATE CAPITAL STRUCTURE

The Companies and Allied Matters Act 2020 ("CAMA 2020") modernized Nigerian company law, enabling private companies to incorporate with a single shareholder and director[4]. This flexibility, however, is balanced by strict regulation of share capital.

**Classes of Shares:** CAMA permits different classes of shares with varying rights[5]. This is the legal basis for the "Preferred" shares issued to investors, which carry specific rights (e.g., liquidation preference, anti-dilution) that are distinct from the "Common" shares typically held by founders. The company's Articles of Association must authorize the issuance of these different classes.

**Pre-emption Rights:** Section 142 of CAMA grants existing shareholders a right of first refusal (pre-emption right) to subscribe to any new shares issued by the company. This is a critical statutory protection against dilution. While it can be waived by a special resolution of the company, the process is formal and must be followed to avoid invalid share issuances.

**Procedural Requirements:** The issuance of new shares, alteration of share capital, and changes to the Articles of Association must all follow specific procedural steps under CAMA, including board resolutions and, in many cases, shareholder resolutions. Failure to comply can render the issuance void.

## C. CROSS-JURISDICTIONAL ENFORCEABILITY NORMS

**United Kingdom:** UK law regards term sheets as presumptively non-binding unless the document expressly states "binding clauses"[6].

**Singapore:** Singapore courts prioritize certainty and hold term sheets non-binding if essential terms, such as price or value mechanisms are undefined, even with significant reliance[7].

**South Africa:** Commercial term sheets are often enforced where they demonstrate a clear intention to bind, particularly when parties proceed to negotiate definitive agreements in good faith[8].

These comparators highlight the importance of clarity in Nigerian term sheets to avoid unintended enforceability or litigation.



# CLAUSE-BY-CLAUSE ANALYSIS



## 1. VALUATION AND CAP TABLE INTEGRITY

Valuation defines the economic foundation of equity ownership and dilution. Nigerian companies must comply with CAMA provisions on share allotments and capital increases, requiring proper board and shareholder approvals[9]. The creation of an option pool (shares reserved for future employees) is a critical point.

### DEEPER ANALYSIS OF OPTION POOL IMPACT:

**Pre-money option pool:** When an investor demands a pre-money option pool of 15%, for example, they are essentially saying, "before I put my money in, let's create a pool of shares that dilutes the existing shareholders (you, the founders) first." The investor then buys their stake based on the new, reduced ownership percentage of the founders. This is a common but detrimental practice for founders.

**Post-money option pool:** A founder-friendly term sheet would propose that any increase in the option pool comes from the company's post-money capital, diluting all shareholders, including the new investor, proportionally.

**Global Best Practice & Cure:** In the UK, option pools are commonly expanded post-money to protect founders. Singaporean SAFE instruments often include valuation caps. South African deals may escrow option pool increases pending milestones to align incentives.

**Negotiation Tips:** Insist option pools be created post-money. Demand fully diluted cap tables. Negotiate carve-outs to exclude option pools from triggering anti-dilution rights.

## 2. LIQUIDATION PREFERENCE

This clause governs how proceeds from a sale or wind-up are allocated. Nigerian company law does not explicitly regulate liquidation preferences, leaving contractual terms paramount. A 1x non-participating preference is generally founder-friendly, as it entitles investors to recover their original investment without "double dipping" in the remaining proceeds[10].

### DEEPER ANALYSIS OF ECONOMIC IMPACT:

A 1x participating preference allows investors to get their money back first and then participate pro rata in the remaining proceeds. For a founder, this is a major value leak, as it allows the investor to "double dip" and significantly reduces the founder's share of the exit.

A capped participating preference offers a compromise, allowing participation up to a certain multiple (e.g., 2x or 3x) before the shares convert to non-participating.

**Global Best Practice & Cure:** The US market often sees participating preferred, but UK and South African deals generally favor non-participating preferences.

**Negotiation Tips:** Always aim for non-participating preferences. Limit liquidation multiples to 1x.

### 3. ANTI-DILUTION PROTECTION

Anti-dilution clauses protect investors if new shares are issued at a lower valuation. Weighted average anti-dilution is more balanced than full ratchet protection, which is highly detrimental to founders.

**Deeper Analysis of Weighted Average:** Weighted average anti-dilution adjusts the investor's conversion price proportionally to the new, lower valuation, taking into account both the price and the number of new shares issued. It is the industry standard and considered a fair compromise. Full ratchet, by contrast, resets the investor's conversion price to the lowest price of the new shares, significantly increasing their ownership.

**Global Best Practice & Cure:** Delaware courts have extensively refined anti-dilution doctrines. UK and South African deals also commonly incorporate weighted average protection[11].

**Negotiation Tips:** Strongly prefer weighted average over full ratchet. Negotiate carve-outs for shares issued to employees or strategic partners. Limit the duration or scope of anti-dilution rights.

### 4. BOARD COMPOSITION AND CONTROL

Board control is critical for strategic influence and governance. Under CAMA, directors owe fiduciary duties to the company and its shareholders[12]. Investor-appointed directors are standard, but the balance of power is key. Reserved matters and veto rights are typically documented in a separate Shareholders' Agreement, requiring investor consent for fundamental corporate actions.

**Negotiation Tips:** Define clear thresholds for appointment/removal rights. Protect founder veto rights on fundamental decisions like a sale of the company. Consider including independent directors.

### 5. FOUNDER VESTING AND REVERSE VESTING

Vesting aligns founder incentives with long-term company growth. A four-year vesting schedule with a one-year cliff is standard. Acceleration clauses are crucial for founders in the event of an exit. A double-trigger acceleration (change of control and founder termination) is the most balanced and founder-friendly provision. Nigerian law recognizes contractual share restrictions, but case law on vesting enforceability is limited, making clear drafting and integration with employment contracts advisable[13].

**Negotiation Tips:** Negotiate vesting schedules that are realistic for your company's lifecycle. Clarify acceleration triggers.

### 6. DRAG-ALONG AND TAG-ALONG RIGHTS

Drag-along rights empower majority shareholders to compel minority shareholders to join in the sale of the company, thereby preventing minority holdouts that could frustrate a transaction. Conversely, tag-along rights protect minority shareholders by granting them the option to participate in a sale initiated by majority shareholders on the same terms and conditions. While these rights are not explicitly regulated under the Companies and Allied Matters Act 2020 ("CAMA 2020"), their enforceability arises from carefully drafted contractual provisions in shareholders' agreements or investment agreements, which operate within the broader statutory framework governing share transfers under CAMA (notably Section 142 on pre-emption rights). Consequently, clear and precise contractual drafting is essential to ensure these rights are upheld by Nigerian courts. Comparative jurisdictions such as the UK and South Africa similarly treat drag-along and tag-along rights as contractual protections rather than statutory

entitlements, reinforcing the primacy of bespoke shareholder agreements in governing minority protections.

**Negotiation Tips:** Set clear thresholds and procedures for drag-along. Protect minority valuation rights. Include robust dispute resolution mechanisms.

## 7. RIGHT OF FIRST REFUSAL (ROFR) AND PRO RATA RIGHTS

CAMA mandates pre-emption rights for existing shareholders. Contractual pro rata rights allow investors to participate in new funding rounds to maintain their ownership. Right of First Refusal grants investors the right to purchase a founder's shares before they can be offered to a third party.

**Negotiation Tips:** Confirm the precise scope and duration of these rights. Negotiate clear waiver mechanisms for efficiency.

## TAX AND REGULATORY IMPLICATIONS

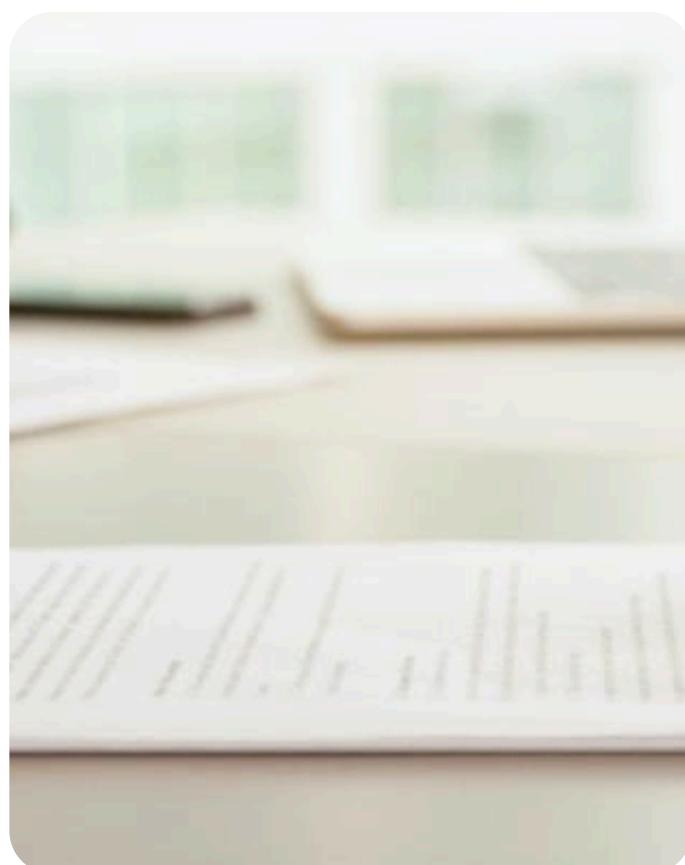


Term sheets must be drafted with an understanding of their tax consequences in Nigeria.

**Capital Gains Tax (CGT):** The Capital Gains Tax Act levies a 10% tax on gains from the disposal of chargeable assets, including shares[14]. Founders should understand how this will be applied to their proceeds upon exit.

**Withholding Tax (WHT):** WHT is a tax deducted at source. For foreign investors, dividends or interest payments may be subject to WHT, which can impact the net return on their investment.

**Foreign Currency and CBN Regulations:** The Central Bank of Nigeria (CBN) regulates foreign currency transactions. Repatriation of capital and profits by foreign investors is subject to these regulations. The term sheet should be structured to facilitate compliance and reduce friction.



## DISPUTE RESOLUTION AND ENFORCEMENT

A comprehensive term sheet must anticipate and provide a mechanism for resolving disputes.

**Arbitration vs. Litigation:** A top-tier term sheet will typically favor arbitration over litigation. Arbitration is often faster, more confidential, and can be conducted by arbitrators with industry-specific expertise[15]. It also bypasses the slow and sometimes unpredictable nature of the Nigerian court system.

**Enforcement of Foreign Judgments:** For deals with foreign investors, the enforceability of foreign judgments and arbitral awards in Nigeria is critical. The Arbitration and Mediation Act in Nigeria provides a framework for the enforcement of foreign arbitral awards, which is a significant comfort to international investors[16].

**Governing Law and Forum:** While the choice of law might be Nigeria, the choice of forum for dispute resolution could be a neutral venue like London or Geneva, which is a common compromise for international deals.

## CONCLUSION AND RECOMMENDATIONS

Term sheets represent the “constitutional moments” of a startup. Approaching them with the utmost diligence and strategic foresight is non-negotiable for Nigerian founders. The provisions on valuation, liquidation preference, and control are not legal boilerplate; they are tools for shaping a company’s future.

To further strengthen the Nigerian venture ecosystem and empower founders, we advocate for:

- Standardizing market documents via Nigerian venture associations to align expectations and reduce disputes.
- Enhanced founder education on term sheet mechanics and legal implications.
- Seeking regulatory clarity from the SEC on hybrid instruments like SAFEs and convertible notes to reduce legal uncertainty.

By mastering the critical clauses outlined in this article and employing sound negotiation strategies, Nigerian founders can secure the vital funding needed for growth without sacrificing equity, influence, or strategic options, positioning their startups for sustained success and impactful exits.



# REFERENCES

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