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PAUL A. GOMPERS

edocs, Inc. (B-1): Kevin Laracey

Kevin Laracey knew that he and his partners, Jim Moran and Kris Canekeratne, had had a successful meeting. Charles River Ventures (CRV), one of the premier venture capital firms in the United States, wanted to finance their company. Their enthusiasm was so high that they had given the edocs team a term sheet on the spot. Laracey knew that the venture capital industry was moving quickly, but this seemed to exceed his wildest expectations.

On the flight back to California, he decided to make a list of issues that needed to be hammered out. He had spent most of the flight just trying to decipher the terms of the agreement. Laracey, Moran, and Canekeratne still felt that they needed to understand those terms better in order to negotiate from a position of understanding and strength. They tried to think of who might be able to provide a quick tutorial on venture capital terms and conditions.

The first question that Laracey pondered was whether CRV was offering a fair valuation of edocs. Laracey knew that prices were heating up in the venture capital industry as record amounts of capital began to flow into the sector. Many of his friends had been able to increase the valuation of their venture investments by creating a deal auction. Laracey wondered how he might capitalize on the increased competition for deals to extract concessions. This had to be balanced with the fact that other competitors were waiting in line to take money from CRV and others. First mover advantage was a key factor.

Management issues were also circling around in Laracey's mind. From the financing documents, it appeared that CRV wanted to bring in a new CEO. While he was amenable to that possibility, Laracey thought that he should be given the opportunity to run edocs until it outgrew his capabilities. Yes, he was young, but he had prepared himself to run his own company and felt that he should be given that opportunity. Similarly, he felt that his partner, Canekeratne, should have a place on the board of directors. Canekeratne and his family had been instrumental in the formative stages of the firm's development and Laracey thought that it was only fair that they have a say in the direction of the company. In addition, Moran brought a considerable amount of operating experience as a former SVP and GM at CheckFree Corporation and lent credibility to the team.

The vesting schedule also appeared onerous. Laracey had built the company and developed the software before any venture money had come into the deal. Why should he suddenly accept vesting of his shares over the next several years? Laracey and his partners were not going anywhere, so why should the venture capitalists try to tie their hands? Was this any way for a partnership to begin?

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Other issues were a bit fuzzier to understand. What were the antidilution provision and right of first refusal doing in the agreement? It appeared that CRV was trying to maintain leverage over future financing rounds. Laracey felt that he wanted to maintain maximum flexibility as it related to future investors. The current term sheet seemed to lock edocs into CRV. Was that such a good idea?

Finally, Guerster's letter stating that CRV intended to bring in a co-investor for the additional $2 million seemed problematic. If CRV failed to find a syndicate partner, CRV would not only get the additional 2 million shares of convertible preferred, but they would get cheap warrants. That too seemed to be one-sided. Why should Laracey, Moran, and Canekeratne bear the cost of CRV's inability to find a syndicate partner? That was their job anyway. Laracey felt that CRV should guarantee the entire $4 million of financing without any additional warrants or equity being handed out.

All of this was set in the backdrop of an attractive alternative. Sitting back in California was an offer to purchase edocs for $15 million, Laracey and Canekeratne could make a quick flip and have a nice payday without any of the hassles of negotiating with CRV or their counterparts at other venture firms. This seemed attractive, but Laracey was not certain it was the right path to follow. How could he decide which direction to go? Suddenly, the pilot announced that their plane would be diverted because of bad weather in the Los Angeles area. Laracey had promised to be home in time to take his wife out to dinner, and now it seemed like he would miss that opportunity. Laracey quickly picked up the phone from his seat and dialed his wife's office number, hoping to reach her before she left for the restaurant. He certainly hoped that this was not an omen about what lay down the road that he was about to travel with CRV.