

When an investor hands you a term sheet, it often feels like a win. However, a "dirty term sheet" can contain predatory provisions that strip you of control or ensure you walk away with nothing during an exit.

Here is a red flag list of terms that are generally considered "off-market" or dangerous for founders.

The Term Sheet "Red Flag" List

1. Aggressive Liquidation Preferences (2x, 3x, or higher)

- **The Standard:** 1x non-participating preference.
- **The Red Flag:** Anything above 1x (e.g., 2x or 3x) means the investor must get double or triple their money back before you or your employees receive a cent.
- **The Trap:** In a modest exit, these multiples can eat the entire sale price, leaving the founding team with zero.

2. Participating Preferred Stock ("Double Dipping")

- **The Standard:** Non-participating preferred shares.
- **The Red Flag:** "Participating" status allows an investor to take their initial investment back *first* and then also take their percentage of the remaining proceeds alongside common shareholders.
- **The Trap:** This is effectively "double-dipping" and significantly reduces the payout for everyone else.

3. Full-Ratchet Anti-Dilution

- **The Standard:** Broad-based weighted average anti-dilution.
- **The Red Flag:** A "full-ratchet" clause protects the investor if you ever raise money at a lower valuation in the future.
- **The Trap:** If a "down round" occurs, the investor's ownership is reset to the new lower price as if they had invested at that price originally, leading to massive, unfair dilution of the founder.

4. Excessive Control & "Blocking" Rights

- **The Standard:** Veto rights over major "extraordinary" events like selling the company or filing for bankruptcy.

- **The Red Flag:** Veto rights over day-to-day operations, such as hiring/firing non-executive employees, setting minor budgets, or entering standard contracts.
- **The Trap:** These clauses allow investors to micromanage your business and can paralyze your ability to move quickly.

5. Redemption Rights

- **The Standard:** No redemption rights, or rights that only kick in after 5–7 years.
- **The Red Flag:** Short-term redemption rights (e.g., 2–3 years) that allow an investor to force the company to buy back their shares at any time.
- **The Trap:** This can force a healthy company into insolvency if it doesn't have the cash on hand to pay back the investor upon demand.

6. Broad "Bad Leaver" Triggers

- **The Standard:** You only lose unvested shares if you are fired for a legal "cause" (e.g., fraud or felony).
- **The Red Flag:** Vague definitions of "cause" such as "failure to perform duties satisfactorily" or "conduct detrimental to the company".
- **The Trap:** These subjective terms give investors leverage to fire you and claw back your vested equity without just cause.

Strategy: How to Push Back

When you see these terms, use your **capital efficiency** as leverage. Remind the investor that you have secured **non-dilutive debt** (like an SBA loan) for your operational needs, meaning the business is not desperate. This allows you to negotiate from a position of strength and insist on a "clean" term sheet.

These guides help founders identify and avoid "dirty" term sheets filled with predatory investor provisions: