Graceful Exit

Navigating the Complexities of Winding Down a Deep Tech Venture

Joshua March, PhD
Kasia Gora, PhD

October 2024

What's inside

About the authors 3

Most venture-backed startups fail, an introduction 4

Planning for failure 5

Does it ever make sense to hibernate? 6
- The risk and opportunity of venture debt 8

Useful strategies to preserve runway 8
- Buying more time with layoffs 8
  - Tips for carrying out layoffs in the best way possible 9
- Delay paying vendors 11

Overview of possible exits 12
- Acquisitions: using a banker vs DIY M&A 12
  - Checklist for running an M&A process 13
- Asset sales vs acquisitions 13
- Simple wind-down or ABC 14
  - Simple wind-down situations 14
- Bankruptcy or an ABC 14
  - An important note on ABC costs 15

Legal responsibility of company directors 15
- Prioritizing creditors if you're in the 'zone of insolvency' 15
- Paying your employees' salary and PTO 16
- Protecting company directors with D&O insurance 16

Strategies to maximize your IP's continued impact 16

Stakeholder management 17
- Board 17
- Investors 18
- Employees 18
- Press 19

Checklists 19
- Minus one year 19
- Minus six months 19
- Minus three months 20
- Minus one month 20
- Minus one week 20
- Minus zero 20

Funded by the Astera Institute—learn more at astera.org

About the authors

Joshua March is a serial entrepreneur with two exits to his name. He was the co-founder of Conversocial, a digital care platform for messaging that integrates with many of the world's leading brands, which was acquired by Verint (VRNT). He is also the author of Message Me, a book about the future of customer service in the era of social messaging and AI that has been featured on Bloomberg, CNBC, and NPR, amongst others. He was the co-founder and CEO of SCiFi Foods, a cultivated meat company that used high-throughput genetic engineering to develop high-performance animal cell lines.

Dr. Kasia Gora is a science leader with a PhD in Biology from MIT. She has spent over a decade working at start-ups that harness cutting-edge science to create more sustainable solutions for some of the world's most pressing needs. Kasia was an early employee at Zymergen, a company that pioneered synthetic biology to make biomanufacturing competitive with conventional petrochemical processes. She was Joshua's co-founder and CTO of SCiFi Foods, applying synbio magic to cultivated meat.

For five years, Joshua and Kasia built SCiFi Foods, raising $40m+ from top-tier investors, only to wind it down in 2024. They remain business partners and close friends, suggesting they must have done something right.

DISCLAIMER: This document reflects the personal opinions of two fellow founders and should not be considered legal advice. For all legal matters, please consult your legal counsel.

Most venture-backed startups fail, an introduction

Every entrepreneur and investor starts a new venture with the hope of building a successful company—a company that can generate 10x or even 1000x returns while making the world just a little bit (or a lot) better. This is particularly true for those of us who build businesses in deep tech, a capital-intensive and technically risky journey with an outsized opportunity for impact.

But while a small percentage of these startups go on to deliver against these promises, the vast majority don't. Failure lies on a continuum, from somewhat positive outcomes like an acquisition or "acquihire" that returns investor capital, to abject failure involving lawsuits with personal liability or, worse still, professional disgrace. Unfortunately, in 2024, we are currently at the precipice of mass (startup) extinction. Many companies raised large amounts of capital before VC funding significantly constricted in 2022 and are now near the end of their runway, and struggling to raise their next round (according to Carta, startup failures are up by 60% over the past year). If yours is one of those companies, this guide is for you.

Imagining your startup at the end of its runway is an unpleasant exercise. Still, it is important to be prepared for the possibility—or the likelihood, if you have less than six months of runway in the bank and no term sheet in hand. There are good and bad ways to handle this crisis. Good ways minimize legal exposure and leave a positive impression on your investors, creditors, and employees while contributing to the common good. Bad ways attract lawsuits, cause irrevocable reputational harm, traumatize employees, and waste everything your company managed to accomplish.

For a deep tech company, that last risk may feel unconscionable. You've invested too much time and effort to allow your hard-won advancements to disappear into obscurity. In the ideal case, getting your IP into the public domain may be possible. At a bare minimum, you can work to ensure it goes to worthy competitors. Without a proper plan, your intellectual property could go unused or shelved, and the advancements you've worked so hard to achieve may never reach their full impact.

We were the cofounders of SCiFi Foods, a cultivated meat company that raised over $40m from top-tier investors, including a16z. Despite hitting all of our technical milestones, we failed to raise a Series B, and with venture debt on the books, we ran out of time to close an M&A transaction, leading us to wind down the company through an ABC process. We learned a lot from the process, and knowing what we know now, there are several things we would have done differently. We hope

that this guide better prepares you to navigate the end of your epic startup journey. Our experience is specific to winding down a venture-backed deep tech company with IP, but no revenue, but many of the topics we cover are universally applicable.

Note, reader, that we have saved the best section for last, namely stakeholder management. If you only read one part of this document, we suggest you skip to the end; however, you will get the most value by reading all the way through. Fifteen minutes of reading now may save you infinite amounts of heartache in the future.

Planning for failure

> "The best time to plant a tree was 20 years ago. The second best time is now."

In an ideal world, you are ready to kick off fundraising with more than a year of runway in the bank. You've spent years nurturing relationships with potential investors and building partnerships with multiple other companies in your space that might pave the way for a merger or acquisition. But if you're reading this guide, that's probably not the case. If you're down to six months or less of runway with no term sheet, now is the time to start working on backup plans. For most companies, this will look like "Plan A: raise a round; Plan B: get acquired; and Plan C: wind down the company." While in the latter years of the last boom, getting some kind of Plan B "acquihire" was relatively easy, it has become much harder today. The unfortunate reality is that Plan C is the most likely outcome.

This can be a bitter pill to swallow for an entrepreneur who has, for years, put their blood, sweat, and tears into building their company while projecting nothing short of total confidence to investors, executives, and employees alike. However distasteful it may be, it is your fiduciary responsibility to put real effort against not only Plan A, but also Plan B and C to maximize upside and protect against downside risk. You must act now.

Six months out, action against Plan B means shifting conversations with potential acquirers from exploring partnership opportunities to running a formal M&A process. While it can seem challenging to position this confidently alongside a fundraise, you can put a positive spin on

the situation when speaking to investors by saying you have received inbound M&A interest (as long as you genuinely have interest). So while your main goal is to raise a round, you think it's prudent to run an M&A process alongside as a market check to see what kind of offers and valuations emerge. This is a more positive framing than saying you're preparing for fundraising failure.

Six months out, action against Plan C means developing a wind-down plan with an accurate budget. You still have enough time to evaluate different wind-down options and interview potential partners. This work is ideally done by your senior finance or operations leaders, leaving the CEO and others to focus on Plan A and Plan B. By the time you get to three months to cash out, you should have a comprehensive budget for closing down the business which includes everything from paying out employee PTO, to D&O tail insurance, and all professional services costs involved in executing the wind down (legal, accountancy, ABC advisory firms etc). This budget informs your drop dead cash balance, which is the amount of money in the bank you need to execute the wind-down process. This is critical information for the leadership team to know when they will run out of time to work on Plan A or B. At SCiFi, we almost got into trouble when it turned out our quote for the ABC process was only the fees for the advisory firm, and the full budget was more than twice the cost. Luckily we discovered this in time to adjust our budget and cover everything necessary, but if we'd found out just a week later, it could have been a huge problem—without the services of an experienced advisory firm, we would have been left as founders to spend many months of painful communications and admin work to be able to shut the company down without being sued by vendors.

Does it ever make sense to hibernate?

A now-famous NVIDIA story recounts an early time in the company's history when, almost running out of money, they had to lay off 75% of their workforce and launch a new chip without any of the industry's normal testing standards. It was a hair-raising moment, but they pushed through it, and the rest, as they say, is history—NVIDIA is now a trillion-dollar company. Many startups go through incredibly challenging periods, and persistence in the face of difficulty is a requirement for success.

But there's a difference between the persistence essential for success and stubbornness. Felix Dennis, the successful British entrepreneur and author, wrote eloquently about this:

“Stubbornness is not persistence. Stubbornness implies you intend to persist despite plentiful evidence that you should not. A stubborn person fears to be shown he or she is wrong. A persistent person is convinced that he or she has been right all along, and that the proof lies just around the corner. That with just a little further effort, the veil of failure will be torn away to reveal success.

Quitting is not dishonourable. Quitting when you believe you can still succeed is. You must keep the faith. Belief in yourself and faith in your project can move mountains. But not if you insist on trying to scale the mountain by an impossible route which has already failed.”

His takeaway is to never give in easily, but to go just one step further than is prudent. One tempting route to push further is to enact some form of hibernation strategy. You could cut costs down to the bone, firing most or even all of the employees to keep the company alive, albeit in suspended animation, at least long enough to wait out a market downturn and to rise again. While this can seem like an attractive route, it should be carefully considered against the opportunity cost of your own time as a founder and the actual probability of being able to revive the company in the future.

It is human nature to want to back a winner, and VCs are no exception. VCs want to back companies on an upward trajectory. There are plenty of examples where a company has trundled along for years below the radar, only to hit some kind of technological or revenue inflection point that gets VCs excited to support the company again. If a hibernation strategy will enable you to reach an inflection point that changes the company’s momentum, then it can be worth pursuing. However, if no inflection point will come until you’re able to raise more capital, trying to raise off the back of zero growth or momentum is incredibly hard, no matter what the overall market conditions are. In this case, a ‘hibernation strategy’ may be a waste of time and potentially money. So it’s really important to be honest with yourself—does hibernating enable you to reach a real inflection point, or is it just dragging out the inevitable?

Hibernation is generally incompatible with venture debt, as monthly loan repayments will create an impending deadline for cash-out. While it is sometimes possible to negotiate new interest-only periods or payment holidays with venture debt providers, it’s much easier when you have physical hard assets that give the debt provider confidence about the security of their loan, or if you have additional bridge funding coming from your investors. Either way, these deals are harder to negotiate in today’s environment, when venture debt providers are dealing with the imminent default of a significant part of their portfolio, and are generally more pessimistic of companies chances of eventually raising money if they’re not already being supported by their existing investors.

The risk and opportunity of venture debt

The standard startup advice warns about the perils of venture debt, and why you should never take it unless you're a revenue-generating company with the clear means to pay it off. While this is generally good advice—if you haven't raised by the time your interest-only period is complete, the principal payments can significantly increase your burn and decrease runway—sometimes taking venture debt is the only way to hit the milestones you think are necessary for your next fundraise. We went through this dilemma at SCiFi Foods, where taking on venture debt was the only way for us to fund our pilot plant, an essential step toward commercialization. We went through a decision-making framework and concluded that having this route to commercialization would be necessary for a successful Series B round, and took on the venture debt accordingly. Unfortunately, the pilot plant was necessary but not sufficient, and we weren't able to raise a series B (largely due to a collapse in funding for the entire cultivated meat industry). By the time we approached the end of our runway we were past our interest-only period on the venture debt, and the large principal and interest payment coming out every month reduced our options significantly, creating a count-down clock to cash out that no amount of belt-tightening could relieve. Nevertheless, it was still the right decision—doing otherwise would have meant giving up 18 months before we had no other choice. Then and now, we chose persistence, not stubbornness.

Useful strategies to preserve runway

Buying more time with layoffs

Circling back to the NVIDIA story, strategic layoffs are a tried and true strategy for runway extension. One of the biggest levers you have to extend runway is to reduce the size of your team—but only if you do it soon enough. Layoffs close to cash out generally have little impact on runway. Proactive layoffs can be really painful. It can be emotionally challenging to let go of employees you care about, potentially into a difficult job market; especially because, if you are being proactive, you can't be 100% sure it's necessary. It is also painful to reduce your ambitions and to proactively cut your team, which means you are reducing your capacity to execute against milestones—which could put key objectives for fundraising at risk. And yet, with salaries often comprising 50% of a startup budget, you have no choice but to consider layoffs as a serious option.

A year before the end of our runway at SCiFi, we decided it would be prudent to do a round of proactive layoffs. We assessed how different depths of cuts would impact our ability to hit near-term objectives and our ability to ramp up post-fundraise to hit future objectives. We decided to do a relatively small layoff (10-15% of staff), which retrospectively was a mistake. The sooner you make a deeper cut, the bigger the impact it will have. Six months later, when we chose to lay off 50% of our staff, we were genuinely shocked that the remaining team ended up being just as productive as the bigger team had been. It turned out that having a small team of great scientists spending most of their time in the lab was much more effective than having those same scientists spend most of their time managing a larger junior team. If we had the deeper cut sooner, we would have been just as productive while extending our runway by multiple extra months. We've heard the same thing multiple times from other founders.

Tips for carrying out layoffs in the best way possible

Talk to an employment lawyer first: Ensure you're doing things correctly to minimize liability, especially if any staff are in protected classes (over 40, minorities, etc.). As your company grows to more than 50 employees, additional regulations may apply. Make sure you fully understand any legal requirements before taking action.

Move quickly: Once you've decided to do layoffs, move as quickly as possible to decide who to lay off and then carry it out as soon as possible (ideally, less than a week). People will feel the mood shift. They may notice the management holding closed-door sessions and hushed conversations. Believe us, word will leak out somehow. As soon as it does, productivity will plummet, and people will start looking for other roles. The faster you move, the less likely this will happen. As soon as the layoffs happen, the affected people should be cut off from all systems and helped to leave the office / return computers, etc.

Make one deep-cut: After a layoff, remaining employees will want genuine reassurance that no more layoffs are imminent and their jobs are safe, or at least as secure as they can be at a start-up with six months of runway. If you plan on successive layoffs, you cannot reassure the remaining team, leaving staff to worry that they are next and killing all productivity. Therefore, you should make just one cut and a deep one for the sake of your company. To reiterate, no one ever cuts deep enough at this point, and anyone you don't cut (but should) will cost you more runway. So, cut deeper.

Communicate immediately to the rest of the team: Nature abhors a vacuum as much as companies abhor a communication vacuum. Under no circumstance should you wait and let people wonder what is going on. They will make up a story far worse than the truth, however dire the truth may be. Have an all-hands meeting immediately afterward and explain what happened and why you made the decision. Assure them

of the safety of their job—after all, you chose a layoff to extend the runway and protect the company. Some people like to do an all-hands meeting with everyone and THEN do the layoffs; we prefer to do the layoffs quickly in the morning and then do an all-hands meeting with the remaining team.

In an ideal world, no one would be genuinely surprised by this layoff. That's because you have communicated positive but realistic updates on the company's state to employees since day one. They should know how much runway is left, whether there are headwinds or tailwinds in the fundraising market or the general tone of conversations. If you haven't been communicating, start today. Your remaining employees have chosen to stay on the bus, and they deserve to know the challenges and obstacles you face on the road so they can rise to meet them.

Make layoffs a shared responsibility: Contrary to popular belief, involving your people managers in planning the layoff is empowering. Explain the budget constraints, how you've cut all other discretionary spending, and how you must bridge the remaining gap by cutting a certain number of positions to keep the company alive. Let your managers choose who to cut. These managers have the best knowledge of on-the-ground operations, which staff are essential for meeting goals, and who can be laid off to extend the runway. Being involved in the decision will give managers a sense of shared responsibility. They are unlikely to criticize the decision-making that went into the process because they made some decisions.

Be kind: Getting laid off sucks, there is no getting around it. However, you can minimize the negative impact by being honest about what is happening and why. Be clear this is a layoff, and they are not being fired for cause, meaning they are eligible for unemployment and COBRA (while the company remains solvent). You should have severance documents ready and offer reasonable severance (usually 2 weeks) in return for a waiver. At SCiFi, we hired our recruiters to help outplace laid-off employees and reached out to our VCs—some of which have talent networks that help those affected have a leg up in finding a new job.

An important note on health insurance and COBRA: As SCiFi entered the ABC process, we held the (mistaken) belief that our employees were eligible for COBRA. As it turned out, the reality was different. Even though our HR software allowed terminated employees to sign up and pay for COBRA, we discovered (after many hours on the phone) that with COBRA, the former employee's payment is just deposited into your company bank account to keep paying the health insurer; once the company stops paying for health insurance, it also stops any COBRA payments. This situation was stressful, and neither payroll nor health insurance platforms could handle it effectively. Keep this in mind if you're doing a layoff immediately before wind down, and ensure employees know to get health insurance separately.

Encourage an alumni network: Everyone at a startup, from the founders to the most junior employees, plays their part in the company's success. Some people have the privilege of playing those roles longer than others, but that does not diminish everyone's contribution. At SCiFi, we promoted communication and collaboration between current and former employees. We held group events for those laid off a week or so after the event to allow everyone to process the event together. Employees who remain employed can help their laid-off colleagues find jobs, and those laid off can wish those who remain the best of luck on the continuing journey. A good outcome is a strong alumni network that can serve all your employees throughout their careers.

Delay paying vendors

You cannot stop paying employees; that is illegal. However, it may be possible to stop paying some vendors for a few months without too much trouble. How many months depends on the vendor, how much you owe them, etc.

Once you're down to your final 3-6 months of runway, you should start with a list of vendors whose services are essential for the continued operation of your company. Keep paying those vendors, but stop paying everyone else to give yourself as much runway as possible to secure new capital or an exit. For small vendors, it's possible to delay payment without explanation. However, we strongly recommend you proactively communicate the situation to any large unsecured creditors and your landlord. Tell them what is happening and how you are resolving the issue. Your creditors (including your lawyers) or landlord might volunteer ways to support (or at least do no harm to) your company through the situation. After all, it is in everyone's best interest to get you back on your feet so you can pay your bills or rent and send vendors even more business in the future. This is a moment where years of excellent corporate good citizenship can pay off.

Block recurring payments: The last few months and weeks of runway can be hectic, and it is hard to account for 100% of recurring payments. When every dollar begins to matter, it can make sense to put a hold on your business accounts and manually authorize every payment. This prevents an unexpected ACH transfer from blowing your wind-down budget and causing existential harm. If you decide not to put a hold on your business accounts, monitor account activity every single day. Working with your financial institution to reverse a transfer is possible if you act quickly.

Do pay health insurance: Be careful about stopping payment on employee health insurance plans. While some insurers, like Kaiser, will continue to cover individual employees for 90 days after a company stops paying its bills, others can backdate the cancellation of coverage

to when a company stops paying its bills without informing employees. Make sure you include paying your insurance premiums in your wind-down budget.

Overview of possible exits

Assuming an IPO or major acquisition is off the table, the next best thing is generally to get any kind of acquisition to happen (hopefully for at least 1x invested capital). The standard wisdom is that companies are bought, not sold. But this doesn't mean that start-ups are powerless in the process. A third party can only buy a startup they know exists, and many great acquisitions started with a partnership between the companies. Therefore, it is prudent for founders to maintain relationships with potential acquirers' CEOs or corporate development teams and, when relevant, invest time in partnership development that could lead to future M&A. However, this takes time, and if you're down to 6 months of runway, you don't have that luxury.

Six months of runway means that your company must be sold, not bought—and in the current financial climate, that generally means a fire sale. An acquirer is unlikely to pay a premium, but (especially if you've raised less than $50m) you may be able to sell for 1x funds raised, enabling you to return cash to your investors. However, you may have to accept less cash than this or an all-stock deal.

Acquisitions: using a banker vs DIY M&A

If there's a real chance of selling your company for a significant sum (say $50 million or more), then it can make sense to use a banker who is an expert in M&A deals and knows your industry (and thus all the potential acquirers) well. But bankers don't come cheap, with their percentage increasing for smaller deals and generally $1m+ minimum remuneration for any successful deal. However, bankers can help introduce you to a bigger pool of acquirers and manage an effective M&A process end to end. I used a banker to sell one of my previous venture-backed startups, and they introduced us to a public company that ended up acquiring us for cash. However, the process took 12+ months, and I am not confident we would have closed had we only had six months of runway.

At SCiFi Foods, we had been building partnerships with large food corporations for more than a year leading up to the end of our runway. However, it became clear that these partnerships couldn't lead to M&A on our required timeline. Given the immaturity of the cultivated meat sector, we believed the only likely acquirers were other startups in the same industry, and conversations with a couple of friendly bankers

confirmed this. So, we decided to run our own M&A process, given that we knew all the likely players and had relationships with their CEOs.

In retrospect, while foregoing a banker was the right decision, we should have started the M&A process earlier. We only had four months to run our process, which was insufficient. That is because we waited until we were sure that fundraising was likely to fail before formally kicking off the process. Ideally, we would have run a dual fundraising and M&A process, which would have been harder to pull off regarding investor communication, but it could have yielded a better outcome.

Checklist for running an M&A process

- ☐ **Create a data room**, similar to what you'd need for fundraising, with all your legal docs in order.
- ☐ **Include a non-NDA overview presentation:** This is similar to an investor deck. It should be 10 slides or less and designed to generate interest.
- ☐ **Detailed M&A presentation:** This is a confidential deck that includes the details on all of your assets, including IP, and team members
- ☐ **Set a clear timeframe for the process:** Schedule phases for initial meetings, diligence, and a final offer date and time. Ensure enough time for legal diligence post the final offer date.
- ☐ **Communicate your timelines to potential acquirers:** Everyone will want more time than you have, so enforcing deadlines in your process is essential.

Asset sales vs acquisitions

A successful M&A will result in the straight acquisition of the entire company, the proceeds of which can be distributed directly to shareholders, less any amount held in escrow. Furthermore, the acquiring company will take full responsibility for all administration, allowing the founders to move on to their next venture unless they are retained as part of the deal.

An alternative to acquisition is an asset purchase, where the acquirer purchases IP and other assets for cash or stock, potentially re-hiring some employees as part of the deal. From the acquirer's point of view, an asset purchase does not carry the same legal risk as a straight acquisition, namely taking on unknown legal liabilities of the acquired company. Therefore asset purchases require less rigorous legal diligence and are often preferred, especially in the case of small deals. In some ways, these deals are relatively fast and simple, but mean that you will be left with a shell company to wind down yourself. If they paid you in cash, this can be relatively straightforward—you can distribute the cash to shareholders as part of the wind-down process. If they paid you in stock, however, it's a more complex situation, and you may need to maintain a

holding company for the stock until a future date when the stock can be liquidated for cash. Talk to a lawyer with experience in M&A transactions to make sure you understand the implications of any one kind of deal structure.

Simple wind-down or ABC

Simple wind-down situations

If you have enough cash in the bank to pay off your creditors and no IP or assets (because you've sold them already or you have none), you can simply wind down the company. Many law firms will do this for you, but there are also several startups, like SimpleClosure, that will handle this process, including investor distributions, for a relatively small fee.

Bankruptcy or an ABC

However, suppose you have insufficient cash to pay off your liabilities. In that case, you have entered the "zone of insolvency", and it is crucial to determine the most effective way to liquidate your remaining assets and resolve any outstanding debts. While bankruptcy is a widely recognized method for business liquidation, small start-ups may have better choices. An alternative to federal bankruptcy is the Assignment for the Benefit of Creditors (ABC), a state law procedure that provides small businesses several advantages over bankruptcy. In an ABC process, you appoint an advisory firm with relevant expertise to handle the sale of your IP and assets and distribution to creditors and shareholders, giving you more control over the process. In contrast, federal bankruptcy involves a court-appointed fiduciary (and can be even more expensive), so an ABC is often the preferred legal process for liquidating a start-up.

While the choice of advisory firms is yours, be advised that you will hand over all legal control to the ABC firm. Often, the firm will re-hire founders and some key employees on an hourly basis to consult in the process, but you do not have control beyond choosing the firm you wish to work with. Therefore it may be useful to interview several advisory firms to help you make an informed decision on whom to trust to run the process.

At SCiFi, we entered an ABC process when we reached a critical cash balance with just enough funds to meet our legal obligations to employees and retain the ABC firm. We chose to work with Sherwood Partners, one of the top ABC consultants in Silicon Valley. They ran a formal auction process to sell our IP and worked with our equipment finance vendor to auction all our equipment and other miscellaneous assets. Sherwood Partners was able to manage our creditors and handle all the legal issues related to the sale and wind down.

An important note on ABC costs

ABCs are not inexpensive—at SCiFi, the total cost came in at around $200k. Approximately half of the cost was Sherwood's fee for managing the process; the rest was the budget for the legal, accounting, and consulting fees to execute the process. As you prepare for this contingency, it is critical to get a final quote for the total budget, not just the fees for the advisory firm, both of which will vary depending on the specifics of your company and the complexity of your IP. This will require you to go through a light diligence process, during which the potential partner reviews your balance sheets and assets to develop the final budget. At SCiFi, we mistakenly assumed the quote from our initial meeting with the advisory firm was the total price, which later caught us off guard.

Short of raising a round or being acquired, an ABC process will likely yield the best return for creditors and shareholders while minimizing your own time and hassle. Make sure you have enough money in the bank to pay for it before cash out!

Note: Whether you qualify for an ABC depends on your local state laws, so check with legal counsel. For a primer on other forms of bankruptcy, see Cooley here*.*

Legal responsibility of company directors

Please note: This document is not legal advice. Be sure to consult your corporate counsel!

Prioritizing creditors if you're in the 'zone of insolvency'

It is important to know that when your liabilities exceed your (likely) ability to pay them, you enter the "zone of insolvency." At this point, your responsibility as a company director shifts away from your shareholders to your creditors, which has many potential implications for selling or winding down the company. For instance, your responsibility to your creditors (even unsecured ones) may require you to take a cash deal that pays back creditors over a stock deal that shareholders may prefer. Discussing the implications with legal counsel and your board of directors is critical.

Paying your employees' salary and PTO

Paying employees for time worked and accrued PTO during a wind-down is a legal and ethical obligation. It ensures fair treatment, helps avoid legal disputes, and maintains the company's reputation, reflecting respect for employees' contributions and preserving trust for future endeavors. **As a company director, you are personally liable for unpaid wages, so pay your employees and do not mess this up.**

Protecting company directors with D&O insurance

Regardless of your runway, ensuring you have D&O insurance in place is always good practice. Directors and Officers insurance is a type of liability insurance that provides coverage for the personal assets of directors and officers of a company if they are sued for alleged wrongful acts as company leaders. This insurance typically covers legal defense costs, settlements, and judgments arising from lawsuits related to decisions or actions taken by directors and officers. Many VCs will require D&O insurance when they join the board. In the case of a wind-down, purchasing three years of D&O tail insurance is standard and should be adequate to cover any potential legal issues arising from the process.

As a cautionary note, at SCiFi, we discovered that our D&O insurance policy had only a one-year tail. We tried in vain to increase this to three years and eventually gave up and purchased a separate D&O tail policy from another reputable insurer with mere moments to spare. With three months to cash out, ensure you have the right D&O insurance policy or do the work to find another option for a three-year tail. Pro-tip, tell insurance brokers to write the policy for an ABC process (even if you are not 100% sure that will be the outcome) otherwise, you will be stuck in a catch-22 that prevents you from getting a quote and a new policy in place.

Strategies to maximize your IP's continued impact

How much control you have over the fate of your IP depends on many factors, including the governance of your company and the rights of any secured creditors. As a director of your company, you must always act in the best interest of shareholders, or creditors in the case of insolvency. This means getting the greatest monetary value for your company in

case of a sale or wind-down. However, this fiduciary responsibility can be independent of the moral imperative of ensuring your IP contributes to the common good. For instance, the best use of your IP may be to sell to a competitor in your industry so they can continue building on the work. Another option is for your IP to be acquired by a non-profit or academic institution to make it open access for other companies in the future. This requires the non-profit to make a competitive offer, which could be nominal if demand is low. While it can be hard to square this circle of maximizing monetary value and public impact, it is worth the effort. Proactively reach out to non-profits, including universities in your sector, and help them discover the opportunity to buy your IP. You can try to connect non-profits with high-net-worth individuals in your network to raise capital for the purchase. As SCiFi was nearing an end, and through the ABC process, we worked hard to forge connections who could make this kind of deal happen, and we were able to arrange for a non-profit to acquire our primary IP (in our case cell lines) in order to make them open access for future startups. Given the huge amount of investment and time we spent developing these cell lines, it will be transformative for future startups to start their companies with them!

Competitive sale dynamics aside, some things are within your control when maximizing your IP's continued impact. First and foremost, proper documentation and assembling effective marketing materials highlight the value to potential acquirers. Work with your legal counsel to get comprehensive lists and descriptions of your IP assets. Similarly, for physical assets like cell lines, ensure the materials are properly cataloged and physically secured. You should direct your technical team to put together master cell banks as part of the physical shutdown of your facility and ensure proper maintenance of those freezers or liquid nitrogen storage units during the liquidation process.

Stakeholder management

Board

The quality of your stakeholder management is the number one determinant of how gracefully your company fails. As a founder, your reputation with your investors and board members is one of the most important things you'll keep after your company winds down. "Never let a good crisis go to waste"—instead, use it to prove your mettle, that is your ability to cope with difficult situations. Proactivity is the name of the game here; it's essential to keep your board fully apprised of the situation. Are there early signs that fundraising will be a challenge? Communicate that to your board. Are you getting no traction in M&A? Communicate that to the board. This is the time to lead with bad news because there is nothing worse than a board member turning

up to a board meeting to suddenly discover the company is about to run out of money, when it is too late to do anything about it—and by communicating early, you increase the chances that board members (and other stakeholders) can guide and assist you in the process.

The last month of runway is crunch time. Start holding regular formal board calls (e.g. every week). Make sure that the board members are aware of wind-down plans so that they're ready to approve them quickly as and when needed, and make sure your legal counsel is on these calls.

Investors

Like your board members, it is wise to spare your investors a nasty surprise. Keep all investors up to date through routine emails and monthly calls with any major investors not on your board. You will likely need their sign-off in case of a sale or wind down. Although they may not be happy with the terms, it is critical they are informed to minimize the risk of delays in closing a deal. Furthermore, keeping all of your investors accurately informed of your situation minimizes the risk of future lawsuits, so you never need to use that D&O tail insurance you have diligently put in place. Again, this is not the time for magical thinking and sugarcoating bad news. While those communication strategies can be effective as you try to grow your business, they are not useful for a wind-down situation.

Employees

Silicon Valley is full of stories of founders who kept telling employees that everything was awesome until suddenly, one day, it was not—resulting in the entire team getting fired and the company disappearing seemingly overnight. Whatever you do, don't be that founder. This is a terrible way to treat your employees; these people will never want to work for you again, and they will warn all their smart, professional friends too. Remember, you hired brilliant employees, many of whom have startup experience. Sooner or later, they will figure out things are not going well and will assume the worst. One of our favorite executive coaches summed it up when he said that without information, people will make stuff up, and what they make up will invariably be worse than reality. So, it's much better to be open and transparent, no matter how uncomfortable.

In the last months of SCiFi Foods, it became apparent that raising a Series B was unlikely. The best-case scenario was getting acquired without most of the staff, and the worst-case scenario was wind down through ABC, which is exactly what we told our team. It was a hard conversation, but everyone appreciated the honesty. We worked to keep the team informed through weekly all hands and made it clear that we understood that some of them may start looking for other jobs, and it was OK to discuss this in the office. The result was that every

remaining employee stayed with us until the end, and they continued being productive in the lab. We were making technical progress until the final week! At the end of SCiFi, we gathered everyone for lunch at a nice local restaurant and did a closing ceremony to help mark the transition. We invited everyone to share a few last thoughts with the team before leaving the table. People left individually after sharing their last words, and the ceremony ended when the last person got up. This proved to be a poignant way to mark the end of our journey together at SCiFi and get toward closure.

Press

Eventually, word will get out that your company is winding down. People may notice when all of your employees suddenly have "#opentowork" on their LinkedIn, and any "confidential" emails you send to a large number of investors are likely to get forwarded around. This is exactly what happened to us: we were not planning on making a public announcement, but a journalist from an industry magazine reached out to us and published an article within days of entering the ABC process. We were wary of having the announcement be out of our control, so after a brief statement to the journalist, we quickly wrote our announcement and posted it on LinkedIn to ensure we were in control of the narrative. Besides our LinkedIn announcement, we kept our communications to the press minimal while ensuring that anything we said was 100% consistent with what we told our investors. Luckily, we received a lot of praise from the industry for being open about the process, and our post was widely read and shared.

Checklists

Minus one year

- [ ] Kick-off fundraising
- [ ] Develop relationships, ideally partnerships, with potential acquirers
- [ ] Make sure your IP portfolio is in good standing
- [ ] Make sure physical asset tracking is in good standing
- [ ] Proactive layoffs

Minus six months

- [ ] If still no term sheet in sight, start the formal M&A process alongside fundraising
- [ ] Start forecasting potential trouble to the board, investors, and employees
- [ ] Start work on preliminary wind-down budget
    - [ ] Payroll and (insurance) benefits

- ☐ PTO
  - ☐ D&O insurance
  - ☐ ABC wind-down costs
- ☐ Do deep, proactive layoff if you failed to do so at minus one year

Minus three months

- ☐ Finalize wind-down budget with "drop dead" cash balance
- ☐ Line up D&O tail insurance
- ☐ Line up D&O partner
- ☐ Weekly monitoring of bank account balances and payments
- ☐ Stop paying non-essential vendors, rent, etc.
- ☐ Continue forecasting trouble to the board, investors, and employees

Minus one month

- ☐ Freeze bank accounts to prevent spurious ACH payments
- ☐ Daily monitoring of finances
- ☐ Begin weekly board calls
- ☐ Begin weekly all-hands meetings
- ☐ D&O tail policy is ready to execute
- ☐ ABC is ready to execute

Minus one week

- ☐ Be ready to send wind-down docs to the board and shareholders for sign-off
- ☐ Ensure D&O tail insurance is in place
- ☐ Safely shut down the lab and secure physical assets
- ☐ Prepare layoff documents
- ☐ Have a farewell lunch with the staff
- ☐ Layoff all staff except founders
- ☐ Ensure PTO is paid out

Minus zero

- ☐ Consult for ABC firm
- ☐ Inform all stakeholders of ABC with a detailed email
- ☐ Call key investors or minor investors who want to discuss the situation
- ☐ Consider a self-published press release
- ☐ Take care of yourself, consider a vacation to get out of town and decompress
- ☐ Celebrate a graceful wind-down