

# Keeping track

## Common issues with cap tables and how to address them

INTERVIEWED BY ADAM BURROUGHS

A company's capitalization table, simply put, details who has what ownership within a company. That's straightforward when the company has a single owner. But as other equityholders are introduced, it can become much more complicated.

While an accurate cap table is crucial for determining who gets paid what when a company is sold, it's also important every day of the company's life.

"Companies should start dealing with their cap table from day one and will need to stay on top of it throughout the entire life of the enterprise," says Michael E. Fink, a shareholder at Babst Calland. "An orderly, up-to-date cap table is central to well-informed business decisions."

*Smart Business* spoke with Fink about the role of the cap table and how failing to accurately maintain it can be costly.

### HOW ARE CAP TABLES USED?

Cap tables are critical when a company seeks new investment, such as via a private placement of preferred stock. That's because every investor — both new ones as well as current investors, who typically need to approve new investment — needs to know its position on the cap table post-investment and what impact a contemplated investment would have on its position.

As companies get new funding and prior owners see their positions diluted, a cap table tracks who has how much equity and what type. Introducing multiple equity series often imposes multiple voting thresholds, so the cap table allows management and stakeholders to see what sort of voting

### Michael E. Fink

Shareholder  
Babst Calland

412.394.6477  
mfink@babstcalland.com



**WEBSITE:** For more insight on how to properly maintain a cap table, connect with Michael or visit [www.babstcalland.com](http://www.babstcalland.com).

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blocs serve to approve any corporate action. Such actions can range from mundane to fundamental, such as approving a merger or replacing somebody on the board of directors.

### WHAT ISSUES ARISE WITH CAP TABLES?

One of the biggest challenges regarding the cap table is simply maintaining it. Any action impacting the company's capitalization needs to be memorialized correctly. The cap table is supposed to be a factual reflection on the state of affairs; without an accurate record of the facts, it can't be used to make informed decisions. It also makes policy discussions and other issues regarding the direction of the company — taking on more debt, issuing more shares, or bringing new investors into the fold — difficult. Unfortunately, poorly maintained cap tables are more common than many would expect.

Frequently, issues discovered in a cap table are used as leverage when negotiating — by a dissatisfied investor, for example, or by a potential acquirer who may, if the problems are significant, walk away from a deal. Occasionally, actual legal disputes can arise from missteps with a cap table. For instance, an investor may believe that it did not receive the return on investment from

the company that it should have, and press for a legal resolution.

### HOW MIGHT COMPANIES ADDRESS THESE ISSUES?

Often the problem of a poorly maintained cap table stems from having either too many people making changes, or no one at all. Especially with startups, management may not be aware of the level of diligence needed to maintain their cap table. It's of utmost importance that companies take steps to prevent errors from creeping in and compounding in the cap table.

Every company should appoint someone to be the ultimate authority on its cap table — one person with the final authority for maintaining and signing off. Ideally, they'd have a business or legal background. If that expertise doesn't exist within an organization, it could work with an external partner who stays in communication with the company, ensuring that timely and correct updates are made. In any case, the executive officers need to understand who has that authority and when they need to inform that person of any changes.

Cap tables must be maintained accurately and in a timely manner. Those who aren't familiar with cap tables shouldn't try to wing it. A half-hour phone call with a knowledgeable attorney can save weeks of aggravation down the road. ●