The University of Chicago
Simple Agreement for Future Equity: An Explanation of Terms
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Contents
Introduction

1. What is a SAFE?
   Why does the University of Chicago use SAFEs?
   Is the University of Chicago’s SAFE negotiable?
   Why does the University of Chicago offer different SAFEs for corporations and LLCs?

2. The University of Chicago SAFE: What are the terms?
   Purchase Amount
   Events
     (a) Equity Financing
     (b) Liquidity Event
     (c) Dissolution Event
     (d) Termination
   Most Favored Nation (“MFN”) Amendment Provision
     Why Does the University of Chicago Include the MFN Amendment Provision?
   Company Representations
   Investor Representations
   Miscellaneous Provisions

3. What terms are not here that are in other SAFEs?
   Valuation Cap
   Discount
   Voting Rights
   Repurchase Rights

4. What are the alternatives?
   Preferred Stock
   Convertible Preferred Stock
   Debt
   Convertible Debt
Crowdfunding

KISS (Keep It Simple Security)
Introduction
Entrepreneurs in the University of Chicago (“University”) community have requested information regarding the terms of investment offered by the following programs:

- University of Chicago Innovation Fund (IF);
- Edward L. Kaplan, ‘71, New Venture Challenge (NVC);
- John Edwardson, ‘72, Social New Venture Challenge (SNVC);
- Global New Venture Challenge (GNVC);
- College New Venture Challenge (CNVC);
- Alumni New Venture Challenge (ANVC);
- Polsky Accelerator;
- Polsky Founders’ Fund Fellowship (PF3); and
- Tarrson Social Venture Fellowship.

The University offers investments through these programs with a non-negotiable version of a Simple Agreement for Future Equity (SAFE). This summary provides (1) a general discussion of SAFEs, (2) a detailed description of the SAFEs offered by the University, (3) a note on terms that other SAFEs might include but that are not a part of the SAFEs offered by the University, and (4) a brief guide to alternatives to SAFEs.

This document does not constitute legal or financial advice. It is only a starting point to help you to understand SAFEs and decide whether or not to accept the University’s SAFE. Please consult your duly-qualified legal and financial advisors for legal and financial advice.

1. What is a SAFE?
A SAFE is a standard convertible equity instrument made between an investor and a startup company. Under a SAFE, the investor gives the company cash on signing the agreement, and the investor gets the right to receive equity in the future, usually when the company goes through its next round of funding. The terms of the SAFE investor’s equity are determined by the triggering round of funding.

A SAFE is not traditional preferred stock or a convertible note. A SAFE is like a convertible note in that both convert a cash investment into an equity stake at a future date, rather than on the date when the parties involved sign the instrument. However, a convertible note is a loan given to the startup by the investor, so it presents all the problems inherent to debt instruments, such as interest, maturity dates, the risk of insolvency, and subordination. A SAFE is not debt, but rather a promise made by the startup to issue equity to the investor in the future.

Similarly, a SAFE is like preferred stock in that the SAFE often results in the issuance of a preferred class of equity. However, unlike preferred stock issued outright, a SAFE does not require a valuation of the startup to be made at the time the investor and startup enter into the SAFE. The valuation of the startup for the purposes of the SAFE investment is determined only after certain conditions have been
met or certain events occur. Additionally, unlike preferred stock, a SAFE can also be used by limited liability companies (LLCs).

The idea behind SAFEs is that, because they are simple and standardized, investors and startup companies save both time and money to focus on growing the business; less time is spent negotiating terms of the investment, and less money is spent in legal fees to address the details of that investment. Accordingly, a SAFE is a short document, usually about 5 to 6 pages long. Depending on the investor, only a few terms, if any, are negotiable. SAFEs are generally viewed as favorable to startups.

The startup accelerator Y Combinator pioneered the SAFE in late 2013. Since then, SAFEs have become an established part of early-stage fundraising for startups. More information about Y Combinator’s SAFE can be found at https://www.ycombinator.com/documents/.

**Why does the University of Chicago use SAFEs?**

The University uses the SAFE as a way to ensure that the University is not in an adversarial negotiating position against its own faculty, students and staff. The intent of the SAFE is to eliminate the need for valuation and term negotiations between the two parties, especially given the early stage of the companies, and instead focus all of our energies on building and supporting great startups. In addition, SAFEs preserve time and money for both the University and entrepreneurs. By not getting bogged down with transaction and negotiation costs, startups and their founders can spend more time focused on their core businesses, and the University can focus on assisting them. It is currently contemplated that returns realized from the University’s SAFE investments would be re-invested into future SAFE recipients, further underscoring the need to keep transaction costs low to maximize the amount available for later reinvestment to benefit subsequent entrepreneurs in the University ecosystem. In the end, the SAFE is a way for the University to invest in startups across the campus while deferring to the external investor market to set the eventual terms.

**Is the University of Chicago’s SAFE negotiable?**

No, the University’s SAFE is not negotiable. The University believes that the SAFE’s terms, as described below, are already very favorable to entrepreneurs and generally better than available alternatives. For example, unlike other SAFEs, the University’s SAFE does not include a valuation cap or a discount rate. The University believes that offering a fair and non-negotiable SAFE up front best serves the mutual purposes for which the University uses SAFEs as outlined above.

**Why does the University of Chicago offer different SAFEs for corporations and LLCs?**

The University offers two variations of the same SAFE, depending on whether the startup is legally organized as a corporation or as an LLC. Although corporations and LLCs are both legal entities which are distinct from their owners, the differences between them are significant enough that using separate
versions of the SAFE provides clarity to the parties. For example, a key difference between corporations and LLCs which affects the terms of the SAFE is in how corporations and LLCs define ownership or equity. Equity interests in a corporation are known as stock, and a corporation’s equityholders are known as shareholders or stockholders. For LLCs, equity interests are known as membership interests, and an LLC’s equityholders are known as members. Thus, if the startup is a corporation, the University would receive preferred stock or common stock under the SAFE when the investment converts to equity. If the startup is an LLC, the University would receive some class of membership interest, with additional provisions made for the possibility that the LLC will later convert into a corporation.

This summary applies to both versions of the University’s SAFE; accordingly, it speaks generically of “equity” rather than specifically of “preferred stock,” “common stock,” or “membership interests.” Notes are included to identify ways in which the SAFE for corporations differs from the SAFE for LLCs, but the terms of each version are substantially the same. The explanations below provide a summary, and it is best to read the actual SAFEs to fully understand these distinctions. Additionally, startup founders should consult independent legal advice before deciding to organize the startup into a corporation or an LLC.

2. The University of Chicago SAFE: What are the terms?

Capitalized terms which are used and not defined below have technical meanings given to them in the University’s SAFEs.

**Purchase Amount**

The Purchase Amount is the aggregate amount of the cash investment made by the University in the startup. The University alone determines the Purchase Amount, taking into consideration (1) the amount requested by the startup, (2) the quality of the investment opportunity, and (3) the funds available for investment.

The University determines whether the Purchase Amount will be paid in a lump sum or in installments; if paid in installments, the University also determines the terms of the installment payments, including the amount of each installment payment and the schedule according to which the installment payments are made. The startup’s receipt of each installment payment is contingent upon the startup continuing to meet the eligibility requirements imposed by the program through which the SAFE investment is being made. If the SAFE provides for a single lump-sum payment of the Purchase Amount, the agreement between the University and the startup specifies the date on which that payment is to be made.

**Events**

The SAFE defines three possible events which will trigger the conversion or termination of the SAFE investment: (a) an Equity Financing, (b) a Liquidity Event, and (c) a Dissolution Event. The SAFE converts and terminates on the first of these events to occur. Only certain events will result in equity being
issued to the University; other events will require the startup to return the investment, potentially at the University’s option, as described below.

(a) Equity Financing
An Equity Financing is a round of financing occurring after the SAFE is entered into in which the startup issues and sells equity at a fixed pre-money valuation at an aggregate price of at least $250,000.

If the startup closes an Equity Financing, then the SAFE investment automatically converts to equity at such closing. The amount of equity given to the University is tied to the startup’s valuation as determined by the Equity Financing, and the equity is granted on the same terms as the equity given to other investors during the Equity Financing. So long as the University is given customary exceptions to any drag-along provision and pro rata rights (which are described in more detail below), the University will execute any documents generally required to be executed by other investors in connection with the Equity Financing.

If the startup is a corporation, the University receives preferred stock of the same class as the investors in the Equity Financing when the SAFE converts, with the number of shares of preferred stock to be issued equal to the Purchase Amount divided by the price per share of the preferred stock issued in the Equity Financing. If the startup is an LLC, then the University receives a membership interest equal to the Purchase Amount divided by the total amount of money raised by the startup during the Equity Financing, including the SAFE investment.

For information about what pre-money valuation is, see https://www.upcounsel.com/pre-money-valuation. For a comparison between pre-money and post-money valuations, see https://www.upcounsel.com/pre-money-vs-post-money.

(i) Customary Exceptions to a Drag-Along
The documents pursuant to which equity is issued to the University in an Equity Financing must have customary exceptions to any drag-along applicable to the University because the University holds such a small percentage of the startup’s equity. A drag-along rights provision compels an equityholder to accept the sale or liquidation of the company when specified equityholders agree to it; in that situation, equityholders who would otherwise not consent to the sale or liquidation are “dragged along.” Equityholders might not agree to a sale for various reasons, including disagreements over the valuation of the company.

In order to provide some investor protection in what it believes to be an otherwise startup-favorable SAFE, the University, like many investors, insists on exceptions if a drag-along is exercised. The exceptions include that the University will only give limited representations and warranties to the buyer in the drag-along sale and will only have limited liability and indemnification obligations. For example, when the University is a dragged-along investor, it is required only to disclose to the startup’s buyer that
the University holds a certain amount of equity in the company and has authority to sell its shares; the buyer must rely only on the representations and warranties made by the majority equityholders as to the company and other aspects of the acquisition. Additionally, the University would not be liable for damages caused by inaccurate information given to the acquiring party by the startup itself or the majority equity group.


(ii) Pro Rata Rights Agreement
If the Equity Financing documentation to be executed by the University does not provide for “pro rata” or “pre-emptive” rights, the startup must execute a Pro Rata Rights Agreement with the University as part of the transaction which converts the SAFE investment into equity. A Pro Rata Rights Agreement grants the University the option to participate in the startup’s future financing rounds in order to maintain the same ownership percentage in the startup as the University has immediately following the Equity Financing event, on a fully diluted basis (i.e., on a pro rata basis).

For a startup incorporated as a corporation, the SAFE calculates “pro rata” as the number of shares of all stock owned by the University immediately prior to the issuance of securities with respect to that round (and not just the preferred stock or the common stock that would have been issued through conversion of the SAFE) divided by the total number of shares of all outstanding stock immediately prior to the issuance of securities with respect to that round, on a fully diluted basis. For a startup organized as an LLC, the SAFE calculates “pro rata” as the portion of all membership interests owned by the University immediately prior to the issuance of securities with respect to that round divided by all membership interests outstanding immediately prior to the issuance of securities with respect to that round, on a fully diluted basis.

For more information about pro rata rights, see https://www.upcounsel.com/pro-rata-rights and the question about pro rata rights at https://www.cooleygo.com/frequently-asked-questions-convertible-debt/.

For more information about what it means to calculate equity ownership on a fully diluted basis, see https://startuplawyer.com/venture-capital/what-is-a-fully-dilated-basis.

Example
Suppose that the University invests $50,000 into a startup corporation through a SAFE. One year later, the startup raises $500,000 from VC Firm in exchange for 500,000 shares of preferred stock at a pre-money valuation of $2,000,000. The price per share is therefore $1 ($500,000 ÷ 500,000 shares) and the
post-money valuation is $2,500,000 ($2,000,000 + $500,000). The VC Firm owns 20% of the startup (500,000/2,500,000). At the closing of the round, the University’s $50,000 SAFE investment converts to $50,000 of preferred stock valued at $1/share, or 50,000 shares. The University now owns 2% of the startup (50,000/2,500,000).

**Why does the SAFE require that an Equity Financing raise at least $250,000 to trigger the SAFE’s conversion?**

The University allows startups to pursue and accept small investments during their infancy without worrying about giving the University equity prematurely. Because the University’s SAFE investment is relatively small (generally $25,000 to $100,000), a high minimum funding threshold keeps the University’s future ownership percentage appropriately small. Without a minimum threshold, a different investor providing $50,000 for a 25% ownership stake in the startup would trigger conversion of a $50,000 SAFE investment by the University into a 25% ownership stake in the startup, a result that neither the investor nor the University probably wants to see.

Additionally, the University’s interests are likely more consistent with, and protected by, larger investors. Small investors may include friends and family who are primarily concerned with supporting the startup’s founders rather than making sound investment decisions, and they may receive exceptionally favorable terms precisely because of their relationship with the founders. In contrast, large investors have an incentive to negotiate competitive terms to make their investments as successful as possible. Because the University’s SAFE converts to equity on the same terms as those offered to investors in the triggering Equity Financing, setting a $250,000 minimum for that trigger aligns the University with large and sophisticated investors.

**(b) Liquidity Event**

The SAFE defines a Liquidity Event as a “Change of Control” or “Initial Public Offering” (IPO), each of which are described in more detail below. Liquidity relates to access to cash; a person with more cash or with assets that are readily convertible to cash is said to be more liquid than a person with less cash or with assets that are not easily convertible to cash. Usually, the startup becomes more liquid following a Liquidity Event, or its investors’ interests in the startup are liquidated.

If a Liquidity Event occurs, the University has two options. The University can choose to (i) be a “Cash-Out Investor” and receive a cash payment equal to the Purchase Amount under the SAFE or (ii) have the SAFE investment convert to an amount of equity equal to the Purchase Amount divided by the fair market value of the startup, as determined at the time of the Liquidity Event.

If the University chooses to receive cash instead of equity, but the startup does not have enough cash to make this payment in full, then the University receives equity equal to the investment amount left unpaid in cash, and the amount of equity to be granted is calculated as described above. If there are multiple Cash-Out Investors in addition to the University, but the startup does not have enough cash to
pay all of the Cash-Out Investors in full, then the startup’s available funds are to be distributed pro rata among the Cash-Out Investors in proportion to their respective Purchase Amounts. For the remaining amount left unpaid, each Cash-Out Investor, including the University, receives equity equal to the investment amount left unpaid in cash, and the amount of equity to be granted is calculated as described above.

**Change of Control**

A Change of Control as defined in the SAFE can occur in three ways: (1) after a transaction or set of related transactions, one person or group becomes the beneficial owner (a person or group who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, has or shares voting or investment power) of more than 50% of the startup's outstanding stock having the right to vote for the election of the board of directors (if a corporation) or of the startup's outstanding voting securities (if an LLC); (2) after any reorganization, merger, or consolidation, the holders of voting equity immediately prior to the transaction or set of related transactions no longer hold a majority of the total voting power in the startup or successor entity; or (3) a transaction such as a sale, lease, exclusive license, or otherwise which disposes of all or nearly all of the startup's assets.

If a Change of Control is intended to be a tax-free reorganization and the University chooses to become a Cash-Out Investor, the startup can choose to reduce pro rata the amount of cash repaid to each Cash-Out Investor and grant equity to make up the difference as described above, so as to preserve the intended tax treatment.

**Example**

If a startup corporation sells 1,000,000 shares of common stock to Large Competitor for $2,000,000, the fair market value is $2 per share. Suppose the University elects to receive common stock, having made a SAFE investment of $50,000. Then, the $50,000 investment converts to 25,000 shares of common stock ($50,000 ÷ $2 per share). On the other hand, if the University elects to receive cash, the startup pays $50,000 cash to the University.

However, if the startup only has $30,000 in cash available to pay the University, then the University receives the $30,000 cash and 10,000 shares of common stock (the $20,000 outstanding payment due divided by $2 per share) to make up the shortfall. Suppose instead that another investor named Investor X has a $25,000 SAFE investment with the startup and elects to also receive cash. The startup’s $30,000 cash on hand gets distributed to the two Cash-Out Investors so that the University receives $20,000 ($30,000 × (50,000/75,000)) and Investor X gets $10,000 ($30,000 × (25,000/50,000)). In addition, the University receives 15,000 shares of common stock ($30,000 outstanding payment due divided by $2 per share), while Investor X receives 20,000 shares of common stock ($40,000 outstanding payment due divided by $2 per share).
**Initial Public Offering**

In an IPO, the startup offers members of the public the opportunity to purchase equity for the first time. An IPO is a considerable undertaking because numerous legal and financial conditions must be met before the IPO prices, and the expenses involved in an IPO are substantial.

**c) Dissolution Event**

A Dissolution Event under the University’s SAFE is essentially any event, voluntary or involuntary, that ends the startup’s operations. When a Dissolution Event occurs and the company winds up its affairs and distributes its assets, the University takes priority over equityholders with regard to the distribution of assets and is paid with other creditors. Thus, the University would have to be paid its full Purchase Amount under the SAFE before the startup’s equityholders receive any windup distributions. If there are multiple SAFE holders in addition to the University, but the startup does not have enough assets to repay all the SAFE-holding investors the full amounts they invested in the startup, then the company assets are distributed pro rata among all SAFE investors in proportion to the amounts each invested with the startup through a SAFE.

In this situation, the University never becomes an equityholder in the startup, and the SAFE investment is treated like a no-interest loan that must be returned to the University.

**Example**

Assume that a startup corporation has assets worth $70,000. The University holds a SAFE with a purchase amount of $50,000. The startup’s founders and employees collectively own 5,000,000 shares of common stock. After learning that an important patent application was rejected, the startup decides to liquidate the business and stop operating. The University would receive $50,000 cash and the common stockholders would receive the remainder of $20,000 ($70,000 - $50,000).

If the startup had only $10,000 of assets and the University was the only SAFE investor, then the University would receive $10,000 cash (because $10,000 is less than $50,000) and the common stockholders would receive nothing. If, however, the startup also had another SAFE investor (Investor X), with a purchase amount of $25,000, then upon dissolution, the University would receive $6,667 ($10,000 × (50,000/75,000)), Investor X would receive $3,333 ($10,000 × (25,000/75,000)), and the common stockholders would receive nothing (because $10,000 is less than $75,000 owed to the two SAFE investors).

**d) Termination**

The SAFE terminates and no longer applies to the investment once any one of these three events triggers an action, because the investment will either convert into equity (upon an Equity Financing), cash or equity (upon a Liquidity Event), or be returned as cash, if available, or be forgiven as an uncollectible loan (upon a Dissolution Event).
**Most Favored Nation ("MFN") Amendment Provision**

This provision comes into effect if the startup issues any convertible securities after the SAFE investment, but before the SAFE converts and/or terminates. Pursuant to the MFN Amendment Provision, the startup agrees to provide the University with written notice of all subsequent issuances of convertible securities and a copy of all relevant and reasonably requested documentation relating to those securities. If the University determines that the subsequent securities are preferable to the SAFE’s original terms, it may notify the startup of amendments necessary to make the SAFE at least as favorable to the University as the subsequent convertible securities would have been. The MFN Amendment Provision requires the startup to agree to amend the SAFE terms to match the terms of subsequent securities to the extent requested by the University.

**Example**

The University invests $50,000 in a startup through a SAFE. Three months later, the startup issues a $50,000 SAFE with a 20% discount to Abby Angel. One year later, the startup raises $500,000 from VC Firm in exchange for 500,000 shares of preferred stock at a pre-money valuation of $2,000,000, triggering an Equity Financing event.

At the time of the Equity Financing event, the price per share is $1 ($500,000 ÷ 500,000 shares) and the post-money valuation is $2,500,000 ($2,000,000 + $500,000). The VC Firm owns 20% of the startup (500,000/2,500,000). At the closing of the round, Abby Angel’s $50,000 SAFE investment converts to $50,000 of preferred stock valued at $0.80 per share (reflecting the 20% discount to the stock price), or 62,500 shares. Because of the MFN Amendment Provision, the University is entitled to the same discounted stock price as Abby Angel and will similarly take 62,500 shares ($50,000 at $0.80 per share). Each of Abby Angel and the University will take 2.5% equity (62,500/2,500,000).

**Why Does the University of Chicago Include the MFN Amendment Provision?**

The University provides a non-negotiable SAFE favorable to startups with the goal of reducing legal expenses and negotiation time, deferring to the external market to set the eventual terms. The University’s expectation in return is that whenever a security is offered to an external investor, the University should be offered those same terms in recognition of the early stage of its investment and the lack of other industry standard terms in the University’s SAFE, including the absence of a valuation cap and discount. Many negotiated provisions in other convertible securities term sheets may be more investor-friendly, including valuation caps, discount rates, liquidation preferences, and board membership rights. If the startup later signs another convertible securities agreement and, in doing so, has taken the time to negotiate other terms with a third-party investor (with whose interests the University is likely aligned, as described above), the University believes it is reasonable to have the option to adopt those terms in order to fulfill its stewardship responsibilities of its donors’ capital and to
ensure that the University generates returns that will eventually fund the next generation of startups on campus.

For more information about MFN clauses, see https://www.upcounsel.com/most-favored-nation and the appropriate section in https://emergingcompanies.foxrothschild.com/2016/06/articles/ownershipequity-issues/selecting-an-appropriate-safe-for-your-financing/.

Sample MFN clauses can be found at https://www.lawinsider.com/clause/most-favored-nation.

Company Representations
This section lists statements of fact made by the startup for the assurance of the University as its investor. The startup’s representations of fact are an essential component of the agreement, so it is vital that they are accurate. Essentially, the startup represents that it is duly incorporated as a corporation or organized as an LLC (whichever is appropriate), is in good standing, and has no other agreements or obligations that would prevent the issuance of the SAFE. The signers on behalf of the startup also represent that they have the authority to sign the SAFE and that no additional approvals from other corporate officers are necessary.

Lastly, the startup represents that it has ownership of its essential intellectual property, including its company name, trademarks, trade secrets, copyrights, and/or patents, and that it has not infringed on the intellectual property rights of others. If the representations are incorrect or fraudulently given, such misrepresentations may result in litigation, and the SAFE may be void or voidable, at the University’s option.

Investor Representations
This section lists statements of fact made by the investor for the startup’s assurance. The University represents that it is not legally restrained from entering into the SAFE and that it is an accredited investor as defined by the Securities Act. The University also represents that it is not authorized to sell and will not attempt to sell the SAFE to another party; that is, the University will hold the SAFE until the SAFE terminates. If the representations are incorrect or fraudulently given, such misrepresentations may result in litigation, and the SAFE may be void or voidable, at the Company’s option.

Miscellaneous Provisions
The SAFE lays out several additional terms to clarify how to interpret and legally enforce the agreement between the University and the startup.
(a) Changes to the SAFE require written consent of both the University and the startup. 
(b) This provision defines what constitutes “notice.” Notice is not necessarily actual notice, which is the actual receipt of the document by the other party. Notice with respect to a document is assumed to be
given (1) when the document is delivered personally or by an overnight courier to the relevant recipient party’s address, (2) 48 hours after being put in certified or registered mail, or (3) according to any other method allowed by changes to the SAFE.

(c) The University, as a SAFE investor, is not an equityholder until the SAFE has converted to actual equity. Until that conversion, the University does not have rights that accompany ownership of equity, such as voting rights.

(d) Neither the University nor the startup can assign or transfer the SAFE to another entity without the prior written consent of the other, with two exceptions for LLCs and corporations and an additional exception for LLCs only. First, the University can assign the SAFE to an entity that owns or is owned by the University or is owned by another party that also owns the University. Second, if the startup chooses to reincorporate (if a corporation) or reorganize (if an LLC) to change the startup’s domicile, then the startup can assign the SAFE to its redomiciled successor. Third, if the startup is an LLC but undergoes conversion into a corporation, then the SAFE can be transferred to the new corporation.

(e) In case any of the provisions of the SAFE are found to be unenforceable for whatever reason, the remaining provisions will still remain enforceable. This severability provision prevents the entirety of the SAFE from being thrown out because of one bad term.

(f) Illinois law is used to interpret the terms in the SAFE if a legal dispute arises over the SAFE’s provisions. If a lawsuit does arise over the SAFE or the investor-startup relationship defined by it, Illinois law is to apply even if the state’s own conflict-of-law provisions would provide for another jurisdiction’s laws to apply. Illinois law will be applied to any dispute even if the lawsuit is filed in another jurisdiction.

3. What terms are not here that are in other SAFE s?
SAFEs associated with other investors may contain a valuation cap, a discount, voting rights, repurchase rights, or other provisions that affect the basic mechanisms of the SAFE. Valuation caps and discounts are generally regarded as friendly to investors because they potentially allow the SAFE investment to convert to equity at a reduced price, resulting in a greater ownership stake for the investor than without such provisions. Similarly, a voting rights provision gives the SAFE investor influence over the startup’s operations without a board seat, leadership position, or equity ownership, under very limited circumstances. On the other hand, the SAFE also does not include repurchase rights provisions, which are regarded as friendly to startups because they allow startups and other investors to reduce or eliminate the SAFE investor’s potential ownership stake. Each of these provisions is discussed in turn below.

For more general information about terms that might be found in SAFE s used by other investors, see https://emergingcompanies.foxrothschild.com/2016/06/articles/ownershipequity-issues/selecting-an-appropriate-safe-for-your-financing/ and http://pnwstartuplawyer.com/SAFE-financing/.

Valuation Cap
A valuation cap protects the SAFE investor by setting the maximum valuation at which the SAFE will convert to equity. Because a SAFE does not involve full negotiations over the valuation of the company,
a SAFE investor may request a valuation cap to protect against an unforeseen high valuation in the future which would otherwise cause the SAFE to convert into an unacceptably small ownership stake. A valuation cap does not prevent the startup from being actually valued above the valuation cap at a future equity financing round, but it allows the SAFE investment to convert at the lesser of the valuation cap or actual valuation.

A valuation cap is not an actual valuation of the startup. However, it may set a baseline of negotiations for future investors, and they may request details for prior valuation caps, including those set out in SAFEs, to guide their analysis of the startup. Consequently, valuation caps are less favorable to startups beyond the protection given to the investor.

For further specific discussion about valuation caps, see http://www.startuplawblog.com/2014/02/21/what-is-a-valuation-cap/.

**Discount**

A discount rewards the SAFE investor’s relatively risky early-stage investment by allowing the SAFE to convert to equity at a price below the price set by the triggering event. The lower price results in more equity for the SAFE investor. Thus, similar to the valuation cap, a discount is less favorable to the startup.

For further discussion about discounts, see https://techcrunch.com/2012/04/21/convertible-note-seed-financings-econ-101/. For an opinion on why an investor may prefer a discount to a valuation cap, see https://www.joyancepartners.com/blog/2018/4/7/cap-or-a-discount-why-it-matters.

**Voting Rights**

Because a SAFE investor does not receive equity immediately, the investor usually gets no say in how the startup should operate until the SAFE investment converts into equity. However, some SAFEs enable the investor to vote on certain company matters under certain circumstances. Usually, the matters for which the SAFE investor is granted voting rights are limited to those matters which directly relate to, or directly affect, the SAFE.

Granting voting rights for SAFE investors before conversion into equity is very unusual. The crowdfunding platform Wefunder utilizes SAFE investments, and its SAFE allows for a Lead Investor Representative to amend the terms of the SAFE unilaterally if the startup’s follow-on financing requires changes to the SAFE. See https://help.wefunder.com/contracts/304785-safe-simple-agreement-for-future-equity.

In an Investor Bulletin, the SEC has raised concerns about voting rights in SAFEs used by crowdfunding platforms. See https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_safes.
Repurchase Rights
A repurchase rights provision gives the startup that receives a SAFE investment the right to “buy back” the SAFE from the investor, so that the SAFE investment will not convert into equity. Such a provision gives the startup some control over who among its earliest investors will become equityholders in the future, and it can assist startups in attracting future major investors like venture capital firms which might want limits on how many other equityholders can have a stake in the startup.

The Wefunder SAFE also has repurchase rights. For more information, see https://help.wefunder.com/contracts/304785-safe-simple-agreement-for-future-equity.

4. What are the alternatives?
Startups can receive financial support and investments through several methods, of which SAFE investments are only one example. No investment method fits every situation, and each involves different benefits and burdens to both startups and investors.

Preferred Stock
One way for startups to raise money is to directly sell equity in return for cash. Preferred stock is the prototypical equity security acquired by venture capitalists and angel investors, and it represents an ownership stake in the startup. The transaction documents providing for an investor’s purchase of preferred stock are the fruit of extensive negotiations between the parties. These terms may address a wide range of concerns and interests that the investor may have with the startup and the investment, including extensive representations and warranties, indemnity, purchase price payment mechanisms, and conditions to closing on the sale. Accordingly, negotiating such documents requires significant time and money.

In addition to the purchase terms, the startup and the investor must also negotiate the terms of the preferred stock itself. Such terms can generally be categorized as economic terms, control terms, and other terms. Economic terms include provisions on price, liquidation preference, pay-to-play, vesting, dividends, employee pool size, and antidilution. Control terms include rights to seats on the board of directors, protective provisions, drag-along agreements, conversion, and negative covenants. Other relevant terms include redemption rights, rights of first refusal, provisions governing founders’ activities, no-shop agreements, and anti-assignment clauses. Negotiating these terms also requires considerable time, attention, and resources; startups should not underestimate the legal costs of negotiated equity sales.

Convertible Preferred Stock

When an investor receives stock in a startup, the investor may have negotiated to receive convertible preferred stock. Convertible preferred stock is preferred stock with an option that the shareholder can exercise to convert that equity into shares of common stock. Although preferred stock has certain benefits over common stock, including priority over the startup corporation’s first dividend payments, common stock may become more lucrative to hold than preferred stock if the startup’s value grows significantly over time.


Debt

Debt is money borrowed from a lender which is to be repaid with interest. One benefit of taking on debt is that loans preserve the ownership stakes of existing equityholders since no equity is issued. Startups may have trouble securing loans from banks, however, because banks may find them too risky due to weak balance sheets, lack of operating history, and high rates of failure. Small business loans may be more accessible for startups since they are guaranteed by the government through the Small Business Administration (SBA). However, the guarantee is for the benefit of the lender rather than the borrower; the SBA guarantees that the lender will be repaid even if the borrower ultimately fails to do so, but the SBA will still attempt to collect the outstanding balance from the startup. In addition to having principal repayment, interest payments, and maturity dates, most loans also subordinate other financial obligations, so that lending banks can collect in full what they are owed before some other debtors and any creditors or investors collect anything. In addition, future investors may be scared away if the startup has too much debt because the associated interest payments will be a recurring expense for the startup and the lending bank’s subordination rights may prevent investors from recouping their investment should the startup ultimately fail.

Information about the Small Business Administration and SBA-backed loans can be found at https://www.sba.gov/funding-programs/loans.


Convertible Debt

Convertible debt is a loan that converts to equity at the occurrence of a particular event, such as a future financing round. Unless and until it converts into equity, convertible debt is a loan that accrues
interest, has a maturity date, and imposes the obligation of repayment on the borrower. The lender-investor may be incentivized to extend convertible debt by including a valuation cap or a discount, allowing the loan to convert to equity with a greater equity stake than usually expected based on the amount of the loan.


Crowdfunding
Startups can use crowdfunding platforms to raise money and gauge potential public support for their ideas. The motivating principle of crowdfunding is to raise large amounts of money not by seeking large investments from a small number of investors but by seeking small investments from a large number of investors. Some platforms allow investors to acquire equity, while others effectively enable investors to provide microfinance loans. There are also crowdfunding platforms which rely on other financing models. Perhaps the most well-known crowdfunding platforms are those that ask for donations without the promise of equity or repayment, instead using a rewards system to incentivize larger donations.

The world of crowdfunding platforms changes rapidly, and many platforms specialize in specific industries or themes. The Internet domain registrar GoDaddy hosts a list of platforms which has been updated annually, at https://www.godaddy.com/garage/top-20-crowdfunding-platforms/. Another list of platforms is hosted by the crowdfunding site Fundly, at https://blog.fundly.com/crowdfunding-websites/. With respect to startups, AngelList (https://angel.co/) provide equity-based platforms, so that investors receive equity in return for their investments. CircleUp (https://circleup.com/) provides both equity-based and debt-based investment opportunities. Fundable (https://www.fundable.com/) and Crowdfunder (https://www.crowdfunder.com/) gives startups flexibility on what kind of investments they want to work with. Kiva (https://www.kiva.org/) provides a debt-based crowdfunding platform where investors can provide microfinance loans. Wefunder (https://www.wefunder.com/) describes itself as a “Kickstarter for investing” and uses SAFEs to make investments into startups, and most investments through Republic (https://republic.co/) are also through SAFEs. Kickstarter (https://www.kickstarter.com/) and Indiegogo (https://www.indiegogo.com/) are popular crowdfunding platforms where startups usually incentivize investments through special rewards and benefits.

KISS (Keep It Simple Security)
The accelerator 500 Startups developed the Keep It Simple Security (KISS) in 2014 as an alternative to the SAFE. SAFEs were originally developed to fulfill a specific contingency during the early stages of a startup. Ideally, a startup begins with its founders committing or securing enough funding at the time of founding to sustain the startup's operations until it has matured enough to reach the equity financing stage with venture capital firms and other external investors. The SAFE was originally intended to be a
form of bridge financing, to give a startup not yet at the equity financing stage some financial help before its original funds get exhausted.

The rapid popularity of the SAFE has led to its use beyond this original intention, with some investors and startups using multiple SAFEs for seed funding and others using them to delay or defer traditional equity financing, without making adjustments to the basic mechanisms of the SAFE to reflect these different contexts. The KISS was developed to provide a relatively sophisticated compromise between non-negotiable convertible notes and SAFEs, which prioritize simplicity (and hence keeping legal costs and negotiation times to a minimum) at the cost of flexibility, and the full-on negotiations that characterize equity financing with venture capital firms.

A key difference between SAFEs and KISSes is that the latter takes into account the possibility that the startup may undergo multiple rounds of KISS financing with new and existing investors. While some SAFEs, including the SAFE used by the University, recognize the possibility that the startup may seek funding from other SAFE investors, they usually only contemplate each SAFE investor making one such investment into the startup. KISS documents explicitly recognize that the startup may seek multiple rounds of KISS financing from the same investors before undergoing traditional equity financing. To incentivize continued investment through multiple rounds, a KISS can provide major investors additional rights and benefits over those of smaller investors.

A KISS can come in two versions. The “equity” version is similar to a SAFE in that the KISS investment is a payment in return for the promise of future equity. The “debt” version, on the other hand, treats the KISS investment as a loan, with a defined interest rate and maturity date, unless and until the investment converts to equity. The debt version of the KISS is thus a form of convertible debt.

More information about the KISS is available at https://500.co/kiss/.