

**University of Illinois at Urbana Champaign**  
**Simple Agreement for Future Equity: An Explanation of Terms**  
Revised 4/6/2021

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## **Introduction**

Entrepreneurs in the University of Illinois (“University”) community have requested information regarding the terms of investment offered by the following programs:

- Cozad New Venture Challenge
- Startup City Scholars Program

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 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.

## **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 and are substantially similar to the terms of the equity received by investors in the triggering round, with adjustments for economic terms such as liquidation preference as appropriate.

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 that is issued outright, a SAFE does not require the startup and investor to make a valuation of the startup at the time they 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 for startups organized as 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, so long as they carefully track the terms of each SAFE and the likely effect on their capitalization tables upon conversion.

The startup accelerator Y Combinator pioneered the SAFE in 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 Illinois 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 reinvested 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 most of the eventual terms.

### **Is the University of Illinois’ SAFE negotiable?**

No, the University’s SAFE is not negotiable. The University believes that the SAFE’s terms, as described below, are already favorable to entrepreneurs and generally better than available alternatives. 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 Illinois 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 equity holders are known as shareholders or stockholders. For LLCs, equity interests are known as membership interests or units, and an LLC’s equity holders are known as members. Thus, if the startup is a corporation, the University would receive shares of preferred stock or common stock when the SAFE investment converts to equity. If the startup is an LLC, the University would instead receive units of some class of membership interest, with additional provisions in the SAFE to account 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,” “membership interests,” or “units.” 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 and tax advice before deciding to organize the startup into a corporation or an LLC, or to enter into a SAFE with the University.

## **The University of Illinois 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.

### **Lump Sum vs. Installment Payments**

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 University makes those installment payments. 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.

### **Discount Rate**

The SAFE takes into account the University’s relatively risky early-stage investment in the startup by including a Discount Rate so that, if the SAFE investment converts into equity due to a later Equity Financing, the University will receive equity at a lower price per unit of equity than the price paid by investors in the Equity Financing. The Discount Rate in the University’s SAFE is 80%. The lower price results in 25% more equity for the University upon conversion than through a SAFE without such a Discount Rate. An illustrative example of conversion due to an Equity Financing is included below.

For further discussion about discounts, see <https://techcrunch.com/2012/04/21/convertible-note-seed-financingsecon-101/>.

### **Valuation Cap**

The valuation cap for this SAFE is \$15 million.

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 but provide protection to the investor.

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

## **Events**

The SAFE defines three possible events that 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 or 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.

### **(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 valuation. Depending on the choices made by the startup in the negotiations leading to the Equity Financing, the fixed valuation can be a pre-money or post-money valuation.

If the startup closes an Equity Financing, then the SAFE investment automatically converts to equity at such closing. Taking into account the effect of the Discount Rate, 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, with adjustments for certain economic terms, for example, a different liquidation preference to reflect the size of the University's investment relative to the Equity Financing source's investment. So long as the University is given customary exceptions to any drag-along provision (which is 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 that mirrors the rights of the Equity Financing source's preferred stock as adjusted as described above. The University receives a number of shares of such class of preferred stock equal to the Purchase Amount divided by 80% of the price per share of the preferred stock issued to investors in the Equity Financing. If the startup is an LLC, then the University receives a membership interest or class of units that similarly mirrors the membership interest or class of units issued to the Equity Financing source as adjusted as described above. If the LLC's equity interests are measured in units, then the number of units the University receives is calculated in the same way as above with respect to preferred stock in a corporation. If the LLC's equity interests are measured in relative membership interests, then the amount of the membership interest the University receives equals 125% of the Purchase Amount divided by the total amount of money raised by the startup during the Equity Financing, including the SAFE investment and all other converting SAFEs.

For information about what a 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>.

### ***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 equity holder to accept the sale or liquidation of the company when specified equity holders agree to it; in that situation, equity holders who would otherwise not consent to the sale or liquidation are "dragged along." Equity holders 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 equity holders 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.

For more information about drag-along provisions, see

<http://www.startupcompanylawyer.com/2007/11/07/whatis-a-drag-along-or-bring-along-provision/>,  
[https://www.taylorwessing.com/synapse/funding\\_dragalong.html](https://www.taylorwessing.com/synapse/funding_dragalong.html), and  
<https://corporatefinanceinstitute.com/resources/knowledge/deals/drag-along-rights/>.

### ***Example of an Equity Financing***

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 standard preferred stock at a pre-money valuation of \$2,000,000 with a fully diluted capitalization of 2,000,000 shares of common stock. The price per share is therefore \$1 ( $\$500,000 \div 500,000$  shares) and the post-money valuation is \$2,550,000 ( $\$2,000,000 + \$500,000 + \$50,000$ ). The VC Firm owns approximately 20% of the startup (500,000 shares/2,562,500 shares (see below)). This funding round constitutes an Equity Financing as defined in the SAFE, and at its closing, the University's \$50,000 SAFE investment converts to \$50,000 of SAFE preferred stock valued at the discounted \$0.80 per share (80% of \$1 per share), or 62,500 shares ( $\$50,000/\$0.80$ ). The University now owns approximately 2.5% of the startup ( $62,500/2,562,500$ ).

### **(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 receives a payment from the proceeds of the Liquidity Event equal to the greater of (i) the Purchase Amount, which in this situation is called the Cash-Out Amount, or (ii) the amount, called the Conversion Amount, payable to the University as if it received an amount of equity (common stock, in the case of a corporation) equal to the Purchase Amount divided by 80% of the fair market value of a unit of equity (common stock, in the case of a corporation) in the startup as determined at the time of the Liquidity Event. The proceeds from the Liquidity Event can include cash and other assets, including stock consideration, received in connection with the Liquidity Event and made

available for distribution. If the startup's other investors, including equity holders, get a choice as to the form and amount of the proceeds from the Liquidity Event, then the University is entitled to that same choice.

The University's right to payment in a Liquidity Event or Dissolution Event (described below) is subject to a liquidation priority defined by the SAFE. The priority of payment differs slightly depending on whether the University is owed the Cash-Out Amount or the Conversion Amount. The University's right to payment of the Cash-Out Amount is junior to the rights of the startup's creditors, on par with other SAFE holders and preferred equity holders, and senior to the rights of common equity holders. If the startup does not have enough cash to make the Cash-Out Amount payment in full, the University receives a pro-rata share of the cash available split between other SAFE holders and preferred equity holders. The University's right to payment of the Conversion Amount is on par with the rights of common equity holders and with other SAFE holders and preferred equity holders who are also to receive Conversion Amounts, but junior to the rights of creditors and other preferred stockholders who are to receive Cash-Out Amounts.

### ***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, 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, the startup can choose to reduce the cash portion of the Cash-Out Amount or Conversion Amount owed to the University so as to preserve the intended tax treatment, so long as the startup does not reduce the total proceeds payable to the University and applies such reduction in the same manner and on a pro rata basis to all securityholders who have equal priority with the University in the Liquidity Event or Dissolution Event, as described above.

### ***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.

### ***Example of a Liquidity Event***

Suppose that the University makes an investment of \$50,000 in a startup corporation through a SAFE. The startup later sells 1,000,000 of its 2,000,000 shares of common stock calculated on a fully diluted basis to Large Competitor for \$2,000,000 in cash, resulting in a Change of Control, and hence Liquidity Event, at \$2 per share of common stock. The Cash-Out Amount would be the Purchase Amount, or \$50,000. The Conversion Amount would be the amount payable on a number of shares of common stock equal to the Purchase Amount divided by 80% (the Discount Rate) of the price of the stock in the Change of Control, or 31,250 shares of common stock ( $\$50,000 \div (80\% \text{ of } \$2 \text{ per share})$ ). The Conversion Amount would then be \$62,500 ( $\$2 \times 31,250 \text{ shares}$ ). Since the Conversion Amount would be greater than the Cash-Out Amount, the University would receive the Conversion Amount. If the startup has insufficient funds available to pay the University, then depending on the amount of funds available, the University would either not receive any payment, to the extent that those standing senior in priority to the

University are entitled to all available funds, or a partial payment, on a pro rata basis with other similarly situated securityholders as described above.

### **(c) Dissolution Event**

A Dissolution Event under the University's SAFE is essentially any event, voluntary or involuntary, that ends the startup's operations. A Dissolution Event is treated like a Liquidity Event, with the same priority of payments, except that the University is paid the Cash-Out Amount only, not the Conversion Amount.

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

#### ***Example of a Dissolution Event***

Suppose 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 holders of common stock would receive the remainder of \$20,000 (\$70,000 - \$50,000) because the University has higher priority than the holders of common stock.

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 holders of common stock would receive nothing. If, however, the startup having only \$10,000 of assets also had another SAFE investor (Investor X), with a Purchase Amount of \$25,000, then upon dissolution, the University would receive \$6,667, representing its pro rata share of the available \$10,000 as amongst other SAFE holders ( $\$10,000 \times (\$50,000/\$75,000)$ ), Investor X would receive \$3,333 ( $\$10,000 \times (\$25,000/\$75,000)$ ), and the holders of common stock 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, assets, 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 of the Effect of the MFN Amendment Provision**

The University invests \$50,000 in a startup through a SAFE. Three months later, the startup issues a \$50,000 SAFE with a 50% Discount Rate 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 ( $\$500,000 \div 500,000$  shares) and the post-money valuation is \$2,600,000 ( $\$2,000,000 + \$500,000 + \$100,000$ ). The VC Firm owns approximately 20% of the startup ( $500,000/2,600,000$ ). At the closing of the round, Abby Angel's \$50,000 SAFE investment converts to \$50,000 of preferred stock valued at \$0.50 per share (reflecting the 50% Discount Rate to the stock price), or 100,000 shares. Because of the MFN Amendment Provision, the University is entitled to the same discounted stock price as Abby Angel, notwithstanding the 80% Discount Rate in the University's SAFE, and will similarly take 100,000 shares ( $\$50,000$  at \$0.50 per share) instead of the 62,500 shares it would have received based on the 80% Discount Rate. Each of Abby Angel and the University will hold approximately 4% of the startup's equity ( $100,000/2,600,000$ ).

### **Why Does the University of Illinois 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. 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>. 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 of 1933, as amended. 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. However, the startup can impose a change on the University if the startup obtains written consent from other SAFE holders holding a majority of the total Purchase Amounts in SAFEs with the same Discount Rate as the University's SAFE, provided that no change is made to the Purchase Amount or the MFN Amendment Provision, the startup first attempts to negotiate such changes with the University, and the changes affect all such SAFE holders equally.

(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 or by email to the relevant recipient party's email 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 equity holder 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. However, if the startup pays a cash dividend or distribution to holders of its common equity, then the University is also entitled to a dividend or distribution payment calculated as if the University owned an amount of equity equal to the Purchase Amount divided by 80% of the fair market value of a unit of common equity at the time of the dividend or distribution.

(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.

### **Pro Rata and Information Rights Agreement**

In addition to the SAFE itself, the University may require the startup to execute, simultaneously with the SAFE, a side letter called a Pro Rata and Information Rights Agreement that spells out additional terms and conditions associated with the SAFE investment. This Pro Rata and Information Rights Agreement appropriately includes provisions about the University's pro rata rights and information rights in relation to the startup.

The intent of the side letter is to ensure specific rights for the University as an early investor, while maintaining the startup's ability to choose which of its other investors it may or may not extend those rights to.

### **Pro Rata Rights**

If the startup undergoes an Equity Financing, this side letter provides the University with “pro rata rights,” or the option to participate in the startup's Equity Financing in order to maintain the same ownership percentage in the startup as the University has immediately prior to the Equity Financing, calculated by dividing the amount of the equity interest issued to the University as a result of a conversion of its SAFE by the “Company Capitalization” as defined in the Pro Rata and Information Rights Agreement.

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/>.

### **Information Rights**

The startup is obligated to regularly disclose basic financial information to the University. This information will be used for internal reporting and performance tracking purposes as well as external reporting. External use of any information will be in an anonymized and aggregated format unless specific permission is granted by the startup. Specifically, the startup must provide the University with (1) annual unaudited financial statements for each fiscal year of the startup that include its end-of-year balance sheet, income statement, and cash-flow statement; (2) quarterly unaudited financial statements for each fiscal quarter, except for the last quarter of the fiscal year, that include its end-of-quarter balance sheet, income statement, and cash-flow statement; and (3) any other information that the University may reasonably request that is related to the startup's business or financial condition. All financial statements must be prepared in accordance with generally accepted accounting principles and practices, with quarterly statements subject to changes resulting from normal year-end audit adjustments, and the startup must provide audited versions of these annual and quarterly statements and other documents if they are available.

### **What terms are not here that are in other SAFEs?**

SAFES associated with other investors may contain a valuation cap, voting rights, repurchase rights, or other provisions that affect the basic mechanisms of the SAFE. Valuation caps are generally regarded as friendly to investors because, similar to discount rates, 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 SAFES used by other investors, see <http://pnwstartuplawyer.com/SAFE-financing/>.

### **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](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>.

## **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.

The National Venture Capital Association has generated forms of Series A preferred stock issuance documentation. These forms have become the most commonly used in the venture capital industry. They are available at <https://nvca.org/model-legal-documents/>. Similarly, Series Seed has generated forms of Series Seed preferred stock issuance documentation to be used for priced seed rounds. These forms have

also become the most commonly used for such rounds. They are available at <https://www.seriesseed.com/>.

For a very basic overview of equity investments, see <https://www.nolo.com/legal-encyclopedia/raising-moneythrough-equity-investments-30041.html> and <https://www.taftlaw.com/news-events/law-bulletins/not-all-startupfunding-is-created-equal-how-to-choose-the-right-financing-structure>.

## **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.

More information about convertible preferred stock is available at <https://www.upcounsel.com/convertiblepreferred-stock>. For an example of the potential financial impact of convertible preferred stock, see <https://www.thebalance.com/convertible-preferred-stock-for-beginners-357976>.

## **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>.

More information about other kinds of loans can be found at <http://www.rubiconlaw.com/startup-financingoptions/> and [https://www.kauffmanfellows.org/journal\\_posts/venture-debt-a-capital-idea-for-startups](https://www.kauffmanfellows.org/journal_posts/venture-debt-a-capital-idea-for-startups).

## **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.

More general information about convertible debt can be found at <https://www.cooleygo.com/convertible-debt/>, <https://startuplawyer.com/seed-rounds/how-convertible-debt-works>, and <https://www.startupgrind.com/blog/theultimate-guide-to-understanding-convertible-debt/>.

## **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/>) provides an equity-based platform, 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/>.

## **What Terms are Common?**

Various third parties such as law firms and other service providers track venture capital transactions on a rolling basis to report trends in funding, including industries receiving the most funding, geographic funding concentrations, number of deals and average deal size, and common terms included in each deal (to the extent such information is publicly available). These entities report their findings quarterly or annually. Consulting these resources before you begin negotiating the terms of a third party investment can provide a helpful framework for evaluating whether the terms the third party offers are consistent with the prevailing market approach. Some examples of these resources are available at the following links: <https://www.wsgr.com/en/insights/>; <https://www.cooleygo.com/trends/>; <https://nvca.org/research/pitchbook-nvca-venture-monitor/>; <https://www.fenwick.com/startups/pages/default.aspx>.