Keep Moving Forward

OTTENJOHNSON
ROBINSON NEFF+RAGONETTI

>> ottenjohnson.com

OTTEN JOHNSON ALERT

SEC Warns Investors That an Investment in a SAFE May Not Live Up To Its Name

July 2017 • Trevor A. Crow

The Securities and Exchange Commission (SEC) Office of Investor Education and Advocacy recently issued an investor bulletin warning investors participating in crowdfunding offerings about a popular new security, the Simple Agreement for Future Equity, commonly referred to as a “SAFE.” This update provides a summary of the concerns that investors should consider before investing in a SAFE as outlined in the SEC’s investor bulletin.

What is a SAFE?

The SAFE instrument was initially created for investing in early-stage technology startups. A SAFE is not the same as common stock in a company. Instead, a SAFE is an agreement between the investor and the company in which the company promises to give the investor equity in the future if certain events occur.

Key Issues to Consider when Investing in a SAFE

What are the conversion triggers?

- As previously mentioned, SAFEs are not equivalent to a current equity position in the issuing company. The terms of the SAFE may provide various scenarios that may (or may not) occur in the future with respect to the company that trigger conversion to equity. For example, a SAFE may be triggered if the company is

acquired by or merged with another company. Other common triggers include an initial public offering of securities by the company or another round of financing involving equity securities in the company.
- If none of the triggering events occur, the SAFE is not converted into equity and the investor is typically left with nothing. This could happen if a company makes enough money from operations that it does not have to raise additional capital, it is not acquired by another company, and does not have an initial public offering.
- Some SAFEs provide that the conversion to equity triggers upon the company's issuance of preferred stock. If the company subsequently raises money by selling more SAFEs, common stock, convertible notes, or through a bank loan, then the SAFE will not convert to equity even though the company raised more capital.

SAFEs are not the same as convertible notes

- Convertible notes are debt obligations in which the investor loans money to the company. In exchange, the investor receives a promissory note from the company for repayment, interest on the loan for a period of time, and an ability to convert the outstanding amount into equity of the company at certain triggering events. This is different from a SAFE because a convertible note represents a current legal obligation of the company to the investor for the outstanding amount of the note that would have priority over equity holders.

Other terms to consider

- Conversion terms. These are the terms that provide for the amount of equity an investor receives upon the occurrence of a triggering event. These terms should be reviewed to determine whether the original investment amount is converted or if the SAFE provides for an increase in the investment amount that is converted to account for the time value of money. Also, the investor should consider whether the valuation of the company at the future financing affects how much equity the investor will receive upon conversion.
- Repurchase rights. Does the SAFE provide that the company can repurchase the future right to equity instead of it being converted to equity? If so, on what terms?
- Dissolution rights. What happens to the SAFE and the money invested if the company dissolves?
- Voting rights. Because SAFEs are not considered an equity interest, investing through a SAFE does not provide voting rights that typically accompany ownership of common stock. A SAFE may (or may not) provide contractual rights to vote on certain matters concerning the SAFE.

Bottom Line

Despite the name, investment in a SAFE involves nuanced issues that most investors would not consider simple or standard. Many important terms such as the triggering events and the conversion price can vary depending on the company issuing the

SAFE. Thus, it is critical that investors read and understand a company's disclosures and the actual terms of the SAFE that the particular company is offering.

Otten Johnson's attorneys have substantial experience with helping clients navigate business issues like those highlighted in this alert. For more information, or for help evaluating your current situation contact any of the attorneys in the Business Transactions & Tax Practice Group.

More Great Reads

Rocky Mountain Real Estate Blog
The latest real estate and land use news and updates. Read More

Rocky Mountain Sign Law Blog
Regulatory, best practices, and other First Amendment news. Read More

950 Seventeenth Street, Suite 1600, Denver, CO 80202
Phone 303.825.8400 | Fax 303.825.6525 | ottenjohnson.com