Essay

The SAFE, the KISS, and the Note: A Survey of Startup Seed Financing Contracts

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INTRODUCTION

Over the past decade, there has been an explosion in seed financing for early-stage technology startups.[1] Increasingly, this seed financing is channeled to these companies via an entirely new form of investment contract—the deferred equity agreement.[2] One version of this agreement—the Simple Agreement for Future Equity (SAFE)—made its debut in 2013. Another version—the Keep It Simple Security (KISS)—first appeared in 2014. While these instruments have attracted extensive attention in the startup blogosphere, there exists remarkably little information about the role they play in the real world.[3] Nobody seems to know, for example, precisely *who* is using these new contracts. It is likewise unclear *where* exactly these agreements

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1. A seed financing is the initial round of capital raised by a startup company, which typically uses those funds to begin the development of a prototype or alpha version of a product as it works to demonstrate proof of concept.

2. For a useful survey of the wide variety of instruments through which capital is funneled to startups, see Brad Bernthal, *The Evolution of Entrepreneurial Finance: A New Typology*, 2018 BYU L. REV. (forthcoming 2018).

3. *See, e.g.,* Jose Ancer, *How LLC Startups Raise Money*, SILICON HILLS LAWYER (Aug. 1, 2018), http://siliconhillslawyer.com/2018/08/01/how-llc-startups-raise-money/ (asserting that SAFEs "dominate" the California startup market); Robin Sosnow, *SAFEs: The Investment Vehicle of Choice for Reg CF Issuers?*, CROWDFUND INSIDER (June 6, 2016), https://www.crowdfundinsider.com/2016/06/86528-safes-the-investment-vehicle-of-choice-for-reg-cf-issuers/ (arguing that SAFEs are commonly used by crowdfunding companies).

are being used. In a very real sense, the discussion about these new contractual forms is occurring in an empirical black hole.

This Essay aspires to bring light to the darkness. Drawing upon original lawyer survey data collected in the spring and summer of 2018, it offers a snapshot of the current landscape for startup seed financing contracts. This snapshot will be of interest to legal scholars and practitioners for several reasons. First, it constitutes the first systematic attempt to document the spread of an important contractual innovation—the deferred equity agreement—throughout the United States and Canada. Second, it shows that the traditional dichotomy between "West Coast" and "East Coast" venture financing deal terms is rapidly being replaced by a new dichotomy between startup lawyering "aficionados," who devote the majority of their practice to representing startup companies and their investors, and "dabblers," who spend only a small portion of their time working in the startup space.

In addition, this snapshot offers important insights into the existing legal literature that views contracts as products. We argue that the SAFE and the KISS—whatever their legal merits—bear more than a passing resemblance to the branded swag that is commonly given away by companies to build brand awareness. This is a finding with significant implications. Finally, this snapshot of seed financing contracts is relevant to practicing lawyers, particularly as these attorneys seek to advise clients on the extent to which these newer deferred equity contracts are actually being used by similarly situated companies and investors.

The Essay proceeds as follows. Part I provides a brief overview of seed financing contracts. Part II presents the results of our survey. Part III analyzes data that are publicly available from regulatory filings. Part IV concludes by discussing the implications for contract scholars and startup lawyers.

I. THE "NEW" SEED FINANCING CONTRACTS

In the 1980s and 1990s, investors who wished to fund a technology startup typically chose from three basic options when it came time to structure that investment.[4] First, they might choose to invest alongside the founders in exchange for plain-vanilla common stock. This investment structure was typically used in friends-and-family or angel rounds where the investors

4. John F. Coyle & Joseph M. Green, *Contractual Innovation in Venture Capital*, 66 HASTINGS L.J. 133, 146 (2014).

were personally known to the founders.[5] Second, they might choose to invest in exchange for convertible preferred stock that was senior to the founders' shares of common stock and came with a panoply of additional rights and privileges. This investment structure was typically used when the investors were institutional venture capital funds making a more significant, post-seed-stage capital contribution in the startup.[6] Third, and finally, they might choose to invest in exchange for a convertible note. This investment structure was typically used when the investors were making a bridge loan to a later-stage startup to keep it afloat until the next round of venture financing could be raised or an exit event (such as a sale or initial public offering) could be achieved.[7]

As the costs of launching a startup plummeted in the mid-2000s, this contractual infrastructure began to evolve.[8] The convertible note, in particular, was increasingly used to provide seed financing to technology companies at the earliest stages of their development.[9] This shift was driven partly by cost considerations. The legal fees associated with a convertible note were substantially lower than the fees associated with convertible preferred stock (which required much longer, more complex contracts and filings with state authorities) and yet still allowed noteholders to eventually receive many of the benefits that they would have foregone had they instead purchased common stock. The shift was also driven by a desire to "punt" the delicate issue of valuation to a later date. By deferring the valuation discussion, the company gained time to reach developmental milestones that would allow for a higher valuation down the road that would be less dilutive for the founders.

The convertible note was also perceived to be a useful instrument in this space because it offered investors downside protection if the company failed and upside potential if the venture succeeded. While the note was technically debt—and hence entitled to priority over equityholders in the event of a liquidation—the investor could convert it into convertible preferred stock if

5. William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1882 (2013) ("Significantly, angels tend to take common stock stakes, foregoing board seats, negative covenants, vetoes, and exit rights.").

6. JOSH LERNER ET AL., VENTURE CAPITAL AND PRIVATE EQUITY 288 (3D ED. 2005) ("Typically, venture capitalists do not buy common stock.").

7. Coyle & Green, *supra* note 4, at 151–54.

8. *Id.* at 155–57.

9. *Id.* at 160–65.

the company were ever to raise additional capital. As an additional inducement, most notes provided that they would convert to convertible preferred stock at a "discount" to the price paid by the new investor, thereby rewarding the investor for her far-sightedness and compensating her for the additional risk that she took by investing earlier than the new equity investor.[10] As time passed, it also became common for the note to set a ceiling on the price at which it would convert into equity—a valuation cap—that similarly incentivized investors to fund early-stage companies using this instrument.[11]

Although the convertible note came to play a major role in the market for seed funding in the years after 2005, it contained several undesirable features from the perspective of the company.[12] First, the notes accrued interest while they were outstanding. Though the interest rate was generally set low, and interest was not typically paid in cash (but rather tacked onto the principal and converted into equity), the need to keep track of exactly how much interest had accrued and the fact that it effectively increased the conversion discount was viewed as an unnecessary giveaway to investors and, perhaps even worse, a distraction adding unnecessary complexity at the time of conversion.[13] Second, the fact that the notes had a maturity date upon which the investors could ask the company to repay the principal worried many founders.[14] While neither the investor nor the company expected the note to be repaid—they assumed the note would convert into stock if the company proved to be successful—the existence of a maturity date gave the investor leverage to extract favorable concessions from the company in some cases.[15] In response to these perceived problems with the convertible note, lawyers in Silicon Valley set about devising solutions. One such solution was the Simple Agreement for Future Equity

10. The discount typically functions as a simple reduction of the price at which the noteholders' principal and interest converts into preferred stock. For example, if the next equity financing involves the company issuing Series A preferred stock to new investors at a price of $1.00 per share, and the noteholders are entitled to a 20% discount (which is a typical discount rate), the noteholders' principal and interest would convert into shares of Series A preferred stock at $0.80 per share.

11. The valuation cap is intended to ensure that the noteholders do not convert at a valuation that is far in excess of what the noteholders and the company envisioned at the time of their investment.

12. Coyle & Green, *supra* note 4, at 166.

13. *Id.*

14. *Id.*

15. *Id.*

(SAFE). Another was the Keep It Simple Security (KISS).

A. THE SIMPLE AGREEMENT FOR FUTURE EQUITY

The SAFE was developed by Carolynn Levy, an attorney and partner at Y Combinator, and was first released in 2013.[16] In many respects, the SAFE resembles the classic convertible note. Like the note, the SAFE will (1) convert into convertible preferred stock when the company issues such stock in a priced equity round, (2) typically contain a valuation cap that sets the highest valuation that can be used to determine the conversion price, and (3) convert into stock at a discount to the price paid by the new venture capitalist. Unlike the note, however, the SAFE lacks a maturity date and does not accrue interest. In essence, the SAFE is a convertible note that has had its debt-like features stripped away.

This unique combination of attributes means that it is difficult to classify the SAFE as either debt or equity. It lacks two of the key hallmarks of a debt instrument: an interest provision and a maturity date. It also does not appear to be equity because it does not give the investor the rights that are typically associated with holding equity, such as the rights to receive dividends or to vote on matters relating to the governance of the corporation. The SAFE is best conceptualized as an equity derivative contract by which the investor commits capital to the company today in exchange for the right to receive stock in the company in a future financing if certain contractual conditions are met. If this future financing never occurs, then the SAFE will likely be worthless. If this future financing comes to pass, however, then the SAFE will convert into the securities issued by the company pursuant to this financing—typically convertible preferred stock—at a discount to the price that the new investor is paying for that same stock.

Shortly after the SAFE was finalized in 2013, Y Combinator

16. *See* Paul Graham, *Announcing the Safe, a Replacement for Convertible Notes*, Y COMBINATOR BLOG (Dec. 6, 2013), https://blog.ycombinator.com/announcing-the-safe-a-replacement-for-convertible-notes/. Y Combinator is perhaps the best-known and most prestigious startup accelerator in the U.S. Founded in 2005 and based in Silicon Valley, Y Combinator runs a program in which startups receive office space, seed capital, and most importantly, high-profile connections and advisors in the technology industry in exchange for giving Y Combinator an equity stake in the startup. Some of the most successful Y Combinator portfolio companies include unicorns such as Airbnb, Dropbox and Stripe. *See generally* RANDALL E. STROSS, THE LAUNCH PAD: INSIDE Y COMBINATOR, SILICON VALLEY'S MOST EXCLUSIVE SCHOOL FOR STARTUPS (2013).

approached the institutional investors who frequently invest in Y Combinator companies to suggest that they use the SAFE to invest in the next batch of these companies. All of these investors agreed to use SAFEs to invest in the companies accepted into Y Combinator's 2014 winter program. With the rise of retail crowdfunding, the SAFE has gained a measure of additional notoriety—several crowdfunding websites offer versions of the SAFE to companies seeking to raise capital from retail investors via the internet.[17] A number of companies making initial coin offerings (ICOs) have also sought to raise capital by selling simple agreements for future tokens (SAFTs), a new SAFE-like instrument developed for use in the blockchain/cryptocurrency space.[18]

B. THE KEEP IT SIMPLE SECURITY

In 2014, a different startup accelerator based in Silicon Valley—500 Startups—released the Keep It Simple Security (KISS). This security comes in two varieties. The first variety, dubbed the "Debt Version," is a 500 Startups-branded form of a traditional convertible note.[19] The second variety of the KISS, dubbed the "Equity Version," removed the interest provision and maturity date from the debt version of the KISS, making it functionally quite similar to the SAFE.[20] In this Essay, we refer to this second, "Equity Version" of the KISS as the "KISS."

17. *See generally*, Joseph M. Green & John F. Coyle, *Crowdfunding and the Not-So-SAFE SAFE,* 102 VA. L. REV. ONLINE 168 (2016). *See also*, Joe Green, *SEC Rightly Concerned about 'So-Called SAFE' Securities in Crowdfunding*, REUTERS (June 1, 2017), https://www.reuters.com/article/bc-finreg-crowd funding-safe-idUSKBN18S63M.

18. *See* THE SAFT PROJECT, https://saftproject.com/ (last visited Sept. 21, 2018) (describing SAFT in a white paper and calling on others to help expand the idea beyond the US). According to the SEC's EDGAR filing system, from the time that Protocol Labs filed the first Form D listing a SAFT as the type of security issued on August 7, 2017, through July 27, 2018, there have been 88 Form D filings for SAFT offerings with an aggregate deal size for those issuers that reported an amount of nearly $2 billion.

19. This variety of the KISS includes fairly standard terms for a garden-variety seed-stage convertible note. It accrues interest at a rate of 5%, matures in eighteen months, automatically converts to equity if the company raises more than $1 million in a priced equity round, and may be converted into equity on the maturity date at the investor's option. *See* Summary of KISS Documents, https://500startups.app.box.com/s/bqhdzjvx8x8fsn8s4zlt (last visited Sept. 21, 2018) (summarizing the Debt and Equity versions of KISS).

20. *Id.* While the SAFE and the KISS work in basically the same way, there are some differences. For example, the SAFE will automatically convert when the company raises any bona fide priced equity round in which it issues preferred stock regardless of how much money is raised. The KISS, by contrast, will automatically convert only when the company raises at least $1 million in

The 500 Startups website provides a detailed account of the rationales that led to the creation of the KISS. Essentially, the drafters sought to address the perceived problems with the convertible note in a manner that struck a slightly different balance between investors and founders than the one set forth in the SAFE. In their words:

> There [are] an abundance of convertible security forms floating around these days – whether championed by accelerators, investors or law firms. And over the course of the last 4 years, we have seen hundreds (if not thousands) of permutations on the "standard" convertible note. Each has its merits, and the YC SAFE docs in particular were a big step forward in creating a true industry standard. . . . Still, we have yet to see a form that strikes the *right balance* for us – a balance between the interests of the founders as well as those of the investors. While historically investors have usually had more negotiating leverage than founders, sometimes we feel the pendulum has swung too far, and now smaller angel investors may well be the ones under pressure to accept unbalanced terms. The KISS legal docs were built on the shoulders of our predecessors and were designed with *balance* and *simplicity* in mind.[21]

Like the SAFE, the KISS is an equity derivative contract by which the investor commits capital to the company today in exchange for the right to receive stock in the company at the time of a future financing. Although 500 Startups suggests that the KISS is a very different animal than the SAFE, in function they are very similar. Indeed, a recent blog post about the KISS on the 500 Startups website observed that the two securities are "functionally close to being identical."[22] Nevertheless, the KISS was introduced into the world by 500 Startups as an alternative to the SAFE.

II. SURVEY DATA ON THE SAFE, THE KISS, AND THE CONVERTIBLE NOTE *CIRCA* 2018

Over the past five years, the relative merits of the SAFE, the KISS, and the classic convertible note have generated extensive discussion among startup lawyers.[23] To date, however, these

a priced equity round.

21. Gregory Raiten, *500 Startups Announces 'KISS'*, 500 STARTUPS BLOG (July 3, 2014), https://500.co/KISS/ (emphasis in original).

22. Adam Sterling, *KISSs and SAFEs and Notes. . ..Oh My!*, 500 STARTUPS BLOG (Feb. 6, 2018), https://500.co/kisss-safes-andnotes-oh/.

23. See, e.g., Jose Ancer, *SAFEs v. Convertible Notes, Updated*, SILICON HILLS LAWYER (Oct. 18, 2017), http://siliconhillslawyer.com/2017/10/18/safes-v-convertible-notes-updated/; Stephanie L. Chandler, *KISSing SAFEly or SAFEly KISSing: The New Financing Instruments for Startups*, JACKSON WALKER (Dec. 12, 2016), https://www.jw.com/news/kissing-safely-or-safely

discussions have occurred in an empirical vacuum. While anecdotal evidence abounds, there has been insufficient data to offer a full picture of where and how these instruments are actually being used in practice. No one seems to know for certain, for example, whether the SAFE or the KISS has made significant inroads in various startup ecosystems outside of Silicon Valley or if their reach is largely limited to that region.

In an attempt to remedy this informational deficit, Thomson Reuters Practical Law conducted an online survey of startup lawyers in the United States and Canada. The purpose of this survey, which ran from February 1, 2018, to May 31, 2018, was to obtain from practicing startup lawyers more detail about the types of investment contracts that they see in the early-stage startup finance space. The survey elicited 430 responses, of which 104 were excluded because the respondent did not practice in the United States or Canada, the respondent's practice did not encompass corporate or transactional work, or the respondent had never represented an emerging company or an investor in a seed financing transaction. The remaining 326 responses—237 complete, 89 partially complete—provide the core dataset that is analyzed in this Essay.

Startup lawyers hailing from 32 U.S. states and four Canadian provinces responded to the survey. We received the most responses from lawyers in California (65), New York (57), and Colorado (22).[24] The survey respondents spend the overwhelming majority of their time (94%) on transactional matters as opposed to litigation. Each respondent had represented at least one emerging company or investor in a seed financing transaction. On average, these attorneys devoted about half of their time (50%) to working with emerging company clients and their investors. Approximately 72% of the respondents stated that their startup clients were located in the city in which they practiced.

-kissing-the-new-financing-instruments-for-startups; David J. Sorin & Matthew E. Uretsky, *KISS the SAFE Goodbye? Another Alternative for Start-up Financing*, MCCARTER & ENGLISH (May 20, 2015), https://m.mccarter.com/kiss-the-safe-goodbye-another-alternative-for-start-up-financing-05-20-2015/; *What Are the Key Differences Between the Y Combinator SAFE and 500 Startups KISS?*, RUBICON (Dec. 15, 2016), http://www.rubiconlaw.com/what-are-all-the-key-differences-between-the-y-combinator-safe-and-500-startups-kiss/; Hash Zahed, *Is Convertible Equity Better than Convertible Note and Preferred Stock?*, SPZ LEGAL (Feb. 11, 2015), http://www.spzlegal.com/funding/convertible-equity-convertible-note-preferred-stock/.

24. Only 289 of the 326 respondents reported the city or state in which they practice.

Roughly 66% stated the same with respect to their investor clients.

On the whole, the survey respondents were more likely to represent startup companies than investors. Approximately 66% typically represented companies. Another 24% reported that their practice was evenly balanced between company-side and investor-side representations. Only 10% stated that the bulk of their practice focused on investor-side representations. As a group, the respondents reported that their investor-side representations were roughly equally balanced between institutional venture capitalists (46%) and angel investors (54%).

A majority of respondents (52%) reported that their typical early-stage startup client was a software company. Other respondents reported that their typical startup client was a biotechnology company (17%), a consumer internet company (10%), a social media company (2%), or a hardware company (1%). The remaining respondents either stated that they represented clients across all of these industries (10%) or that their clients were in industries that did not appear on the list (7%).[25]

Generally speaking, the survey set out to answer questions across four dimensions:

(1) Awareness. Have the survey respondents ever heard of the SAFE or the KISS?

(2) Use. Have the survey respondents ever been involved in a representation in which a SAFE or a KISS was used?

(3) Market Share. In the context of seed financing transactions, what percentage of transactions utilized a SAFE or a KISS as compared to priced equity or the classic convertible note?

(4) Modifications. Do companies and investors routinely modify the "standard" terms set forth in the SAFE and the KISS?

In answering the first two questions posed above, we analyzed the survey responses through two lenses. First, we analyzed the questions through the lens of *geography*. We sought to determine whether these instruments were known and used in

25. Other industries mentioned include agriculture, apparel, artificial intelligence, blockchain, consumer, finance, medical marijuana, entertainment, health, manufacturing, and oil and gas. It is important to note that even respondents who told us their "typical" client was in a particular industry most likely represent some clients from other industries as well (as indicated by the 10% of respondents who rejected the premise of the question and noted in the "Other" category that they represented clients across all of these industries).

startup ecosystems outside of Silicon Valley. Second, we analyzed the questions through the lens of *expertise*. We sought to determine whether the responses varied depending on whether an attorney was someone who spent all of her time doing startup work—a startup aficionado, in our parlance—or was more of a dabbler in the startup world.[26]

A. AWARENESS

Perhaps the most basic unanswered question in the literature is the extent to which startup lawyers outside of Silicon Valley are aware of the very existence of the SAFE and the KISS. In an attempt to answer this question, the survey asked respondents whether they were familiar with these instruments. Approximately 91% of survey respondents reported that they had heard of the SAFE. Approximately 66% reported that they had heard of the KISS. The level of awareness varied, however, according to geography. Lawyers who practiced in California, Texas, or Washington, for example, were generally more likely to have heard of the SAFE and the KISS than startup lawyers in Illinois, Missouri, or Ontario. Our findings are reported below for those states from which we received five or more survey responses.

26. For a more detailed discussion of what it means, in our view, to be a "startup law aficionado," see John F. Coyle & Joseph M. Green, *Startup Lawyering 2.0*, 95 N.C. L. REV. 1403, 1431–32 (2017).

TABLE 1: PERCENTAGE OF STARTUP LAWYERS REPORTING THEY HAD HEARD OF THE SAFE OR THE KISS, BY STATE/PROVINCE		
State (# responses)	**Heard of SAFE**	**Heard of KISS**
Washington (12)	100%	75%
Texas (13)	100%	62%
Arizona (7)	100%	57%
Massachusetts (13)	100%	54%
California (61)	98%	80%
Colorado (22)	95%	77%
North Carolina (12)	91%	75%
New York (55)	87%	71%
Minnesota (5)	80%	80%
Ohio (10)	80%	60%
Missouri (5)	80%	60%
Illinois (5)	80%	40%
Ontario (14)	71%	36%
Other States (40)	80%	58%
Total (274)	**91%**	**66%**

The survey respondents who had never heard of either the SAFE or the KISS, as a rule, tended to practice in cities that are not known for having a well-developed startup ecosystem. Several of the New York lawyers who had never heard of these instruments, for example, practiced in Buffalo or Rochester, as opposed to New York City. The lone California lawyer who had never heard of the SAFE practiced in Indian Wells, well outside the tech hubs of Los Angeles and the San Francisco Bay Area. Other startup lawyers who had never heard of either of these instruments hailed from Akron, Calgary, Charlotte, Chicago, Kansas City, Pittsburgh, Salt Lake City, and Tulsa. Survey respondents from Toronto—which sits in the Canadian province of Ontario—generally exhibited less awareness of both types of instruments than respondents from U.S. jurisdictions.

The levels of awareness also varied depending on the amount of time that the respondent typically spent representing

startups. We divided these responses into three categories. First, we identified those respondents who reported that they spent more than 75% of their time on startup work. We labeled these respondents the "aficionados." Second, we identified those respondents who reported that they spent between 26% and 75% of their time on startup work. We labeled these respondents the "regulars." Third, we identified those respondents who reported that they spent 25% or less of their time on startup work. We labeled these respondents the "dabblers." Our findings for each of these three groups are set forth below.

TABLE 2: PERCENTAGE OF STARTUP LAWYERS REPORTING THEY HAD HEARD OF THE SAFE OR THE KISS, BY PERCENT OF TIME SPENT REPRESENTING STARTUPS

Category	**Heard of SAFE**	**Heard of KISS**
Aficionados (76%-100%) (91)	99%	82%
Regulars (26%-75%) (127)	95%	72%
Dabblers (1%-25%) (65)	80%	44%
Total (274)	**91%**	**66%**

The aficionados tended to cluster in a relatively small number of states; altogether, just eight states accounted for more than 87% of the aficionados in our survey.[27] Overwhelmingly, the aficionados had heard of both the SAFE and the KISS. The dabblers, by contrast, were less concentrated in any single place. The single largest concentration of dabblers was in New York (23%) followed by California (9%) and Ontario (8%). While a substantial majority of the dabblers had heard of the SAFE, less than half had heard of the KISS.

In sum, the survey suggests that startup lawyers in the United States are generally more familiar with the SAFE than the KISS but that levels of awareness vary according to geography and levels of expertise. The mere fact that lawyers are aware that these instruments exist, however, tells us very little about whether they actually *use* them in practice. This topic is taken up in the next section.

27. These eight states were California (35% of aficionados), New York (17%), North Carolina (8%), Washington (7%), Texas (6%), Colorado (6%), Ohio (4%), and Massachusetts (4%).

B. USE

In addition to asking about basic awareness, the survey asked respondents whether they had ever represented an early-stage startup company or investor in connection with a seed financing using a SAFE or a KISS. Approximately 69% of respondents reported that they had participated in at least one representation involving a SAFE. Only 26% of respondents reported that they had participated in at least one representation involving a KISS. Again, the reported patterns of practice varied significantly by geography:

TABLE 3: PERCENTAGE OF STARTUP LAWYERS REPORTING THEY HAD BEEN INVOLVED IN AT LEAST ONE REPRESENTATION USING A SAFE OR A KISS, BY STATE/PROVINCE

State (# responses)	**SAFE Deal**	**KISS Deal**
California (61)	93%	49%
Texas (13)	85%	23%
New York (55)	78%	29%
Washington (12)	75%	42%
Arizona (7)	71%	0%
Colorado (22)	64%	14%
Massachusetts (13)	62%	23%
Minnesota (5)	60%	20%
North Carolina (12)	58%	8%
Ontario (14)	50%	14%
Ohio (10)	50%	20%
Illinois (5)	40%	0%
Missouri (5)	40%	20%
Other States (40)	43%	13%
Total (274)	**69%**	**26%**

There is a 22-point gap between respondents who indicated that they had heard of the SAFE (91%) and those who had actually been involved in a representation using a SAFE (69%). There is a 40-point gap between respondents who indicated that they had heard of the KISS (66%) and those who had actually

been involved in a representation using a KISS (26%). This finding suggests that both instruments are more widely known than they are used.

The data also show that startup lawyers from certain states were substantially overrepresented in KISS transactions. Whereas California lawyers constituted 22% of all survey respondents who answered this question, they made up 42% of respondents who had represented a client in a transaction involving a KISS. The lawyers from Washington were similarly overrepresented—they constituted 4% of survey respondents but 8% of respondents who had represented a client in a transaction involving a KISS.

The survey data also indicate that aficionados are, unsurprisingly, more likely to have been involved in a SAFE or KISS deal than regulars or dabblers:

TABLE 4: PERCENTAGE OF STARTUP LAWYERS REPORTING THEY HAD BEEN INVOLVED IN AT LEAST ONE REPRESENTATION USING A SAFE OR A KISS, BY PERCENT OF TIME SPENT REPRESENTING STARTUPS		
Category	**SAFE Deal**	**KISS Deal**
Aficionados (76%-100%) (68)	94%	39%
Regulars (26%-75%) (127)	76%	32%
Dabblers (0%-25%) (81)	37%	9%
Total (276)	**69%**	**26%**

Overall, the survey results suggest that if you are a lawyer in the United States who devotes a majority of your time to startup work, it is a near-certainty that you have been involved in a representation using a SAFE regardless of where you practice. That same lawyer, however, is much less likely to have been involved in a representation using a KISS. While there is some overlap between expertise and geography, this finding suggests that expertise is an important independent factor in explaining the spread of these new types of contracts. We will return to this insight later in the Essay.

C. MARKET SHARE

When an investor wishes to provide seed funding to a startup, that investor typically chooses to structure that investment in one of two ways. First, the investor may choose to take

an immediate stake in the company by investing via priced equity. She will agree with the company on a valuation and the terms of the equity security and will purchase, in most cases, convertible preferred stock. Second, the investor may choose to defer the conversation with the founder on valuation and leave it to the next investor—who may be in a better position to negotiate that point—to come to terms with the founder. In these instances, the investor likely chooses from several varieties of deferred equity investments. She may invest via a convertible note (the original deferred equity instrument), if she wants to have the protections of debt while retaining the eventual upside of equity. Alternatively, she may utilize one of the newer deferred equity contracts, such as a SAFE or a KISS.

In an attempt to ascertain how frequently each of these instruments is used, the survey asked respondents to estimate the percentage of transactions in which they were personally involved where the company issued deferred equity instruments—such as convertible notes, SAFEs or KISSes—instead of priced equity. The survey then asked the respondents to estimate the percentage of deferred equity transactions in which they were involved where startups issued SAFEs or KISSes instead of convertible notes. These findings are broken out on a state-by-state basis below for states in which we received five or more survey responses.

TABLE 5: ESTIMATED PERCENTAGE MARKET SHARE OF STARTUP SEED FINANCING INSTRUMENTS, BY STATE/PROVINCE			
State	Priced Equity	Convertible Note	SAFE / KISS
Arizona	40%	54%	6%
California	46%	29%	25%
Colorado	42%	48%	10%
Massachusetts	47%	40%	13%
Minnesota	57%	35%	8%
New York	52%	33%	15%
North Carolina	49%	46%	5%
Ohio	49%	39%	12%
Ontario	68%	29%	3%
Texas	44%	36%	20%
Washington	57%	31%	12%
Other States	53%	40%	7%
Overall	50%	36%	14%

These results indicate that priced equity continues to play an important role in seed financing transactions.[28] Overall, the respondents estimated that it is used in 50% of such transactions nationwide. When parties choose to utilize deferred equity instruments, the survey suggests that convertible notes are used 36% of the time and that newer instruments like the SAFE and the KISS are used 14% of the time. There were, however, noteworthy variations on a state-by-state basis. The states in which deferred equity instruments are most frequently used are Arizona (60%) and Colorado (58%). The states or provinces in which such instruments are least frequently used are Washington (43%), Minnesota (43%), and Ontario (32%).

28. The continued prevalence of priced equity in seed financings in the face of competition from the supposedly simpler and cheaper deferred equity instruments can perhaps be explained by innovations in equity financing contracts for seed-stage startups, such as the Series Seed financing documents, that have dramatically reduced the legal fees associated with conducting priced equity financing rounds. *See* Coyle & Green, *supra* note 4, at 171–176.

The survey also suggests that the SAFE and KISS are well on their way to supplanting the convertible note in California; an estimated 25% of transactions in that state now utilize the SAFE or the KISS as compared to an estimated 29% that utilize convertible notes. The survey also suggests that these newer instruments have made significant inroads in Texas and New York. In other states, by contrast, these instruments have failed to gain much in the way of market share. In Minnesota (8%), Arizona (6%), and North Carolina (5%), for example, the SAFE and the KISS are used in a relatively small percentage of seed financing transactions.

D. Modifications

The SAFE and KISS forms made available by Y Combinator and 500 Startups, respectively, are simply off-the-rack contracts that may be modified by the parties if they so choose. Accordingly, we also asked the survey respondents who had heard of the SAFE and the KISS whether they regularly modified these instruments to tailor them to the parties or the transaction.

With respect to the SAFE, 52% of the respondents stated that they use the Y Combinator form without substantial modification. Another 32% reported that they use a form of SAFE that has been modified but that is still largely based on the Y Combinator form. As one respondent explained: "Off the shelf is the most cost-effective form for clients, so in the interest of holding down legal fees we try not to negotiate or modify these agreements."

When the survey respondents did modify the SAFE, there were a number of common alterations. Twenty-three respondents reported that they modified the pro rata rights provision. Twelve respondents noted that they liked to add a most-favored-nation clause. Twelve respondents also reported—remarkably—that they like to add a maturity date to the SAFE.[29] Other popular changes included adding a provision allowing collective action by a subset of the holders (such as a majority-in-interest) of SAFEs issued in a series to amend the agreements on behalf of all SAFE holders in that series (12), tinkering with the conversion process (12), adding representations and warranties (10),

29. We found this modification to be particularly surprising because a SAFE with a maturity date is basically just a convertible note. Purely from a drafting perspective, it seemed strange to start with the SAFE form and build in a maturity provision when the lawyers likely had access to convertible note forms that would have been more suitable as a starting place.

and providing for information rights (8). The respondents also reported making changes to the language relating to dividends, fiduciary duties, shadow preferred stock, board seats, voting, shareholder agreements, LLCs, and redemption rights. This range of changes highlights the fact that although the SAFE is intended to be an "off-the-rack" document, it can be—and sometimes is—modified in practice.

With respect to the KISS, 69% of respondents stated that they use the 500 Startups form without substantial modification. Another 26% reported that they used the form with modifications. When the KISS is modified, these modifications are typically made to enhance investor rights, add representations and warranties, account for foreign laws, or increase the dollar threshold for a subsequent equity financing to trigger the conversion of the KISS into equity securities. A few respondents also stated that they had added a maturity date, a most-favored-nation provision, language tailored to LLCs, provisions for attorneys' fees, and language relating to indemnification.

The foregoing analysis throws into sharp relief the fact that deferred equity instruments have blurry edges. They exist on a continuum and it is sometimes difficult to distinguish one type of instrument from another. Although it is tempting to sort them into distinct boxes—and although we ourselves have engaged in just this type of sorting in this Essay—a "SAFE" may be transformed into a "convertible note" with just a few keystrokes. While the "standard" SAFE may be more company-friendly than the "standard" convertible note, a SAFE that has been loaded up with investor-friendly provisions at the request of an aggressive investor or their counsel may actually be far less company-friendly than a bare-bones convertible note. One must always be suspicious of labels and this is doubly true in the seed financing space. There is no substitute for a careful review of the language in the agreement.

At the same time, it is impossible to deny that the form with which one starts—whether it be a convertible note, a SAFE, or a KISS—will influence the final result. It is time consuming and costly to negotiate changes to contracts. This is particularly true in the realm of seed financing contracts, where all parties have an interest in keeping legal costs down. When the goal is to devote as much of the capital raised to growing the fledgling business as possible, there will often be pressure to avoid making extensive alterations to the base documents. Thus, even though changes to these documents are sometimes made, it is still useful

to know how often lawyers begin with a particular type of agreement.

III. PUBLICLY AVAILABLE DATA FROM 2014–2018

In a perfect world, we would seek to educate ourselves about seed financing contracts by examining the actual agreements rather than by surveying the lawyers who use them. The seed financing contract is, however, a shy and elusive creature. The vast majority of these agreements are tucked away in file cabinets or computer hard drives, hidden from the prying eyes of scholars. This makes it hard to study seed financing contracts directly and makes it necessary to conduct surveys of lawyers and other individuals familiar with their contents. In some cases, however, information about these sorts of agreements—though not the agreements themselves—are disclosed to the Securities and Exchange Commission (SEC). These moments offer scholars an invaluable glimpse into contract practice.

In an attempt to confirm that the results from our survey were accurate, we reviewed information provided by issuers conducting private placements under Regulation D.[30] Although there are methodological problems with relying too heavily on these sources, this information tends to confirm the survey findings reported above.[31] The publicly available data show that, from October 14, 2014 to July 24, 2018, there were 248 Form D filings that listed SAFEs as the type of security sold.[32] This compares to just 12 Form D filings that listed KISSes as the security

30. *See* U.S. Securities and Exchange Commission, Form D: Notice of Exempt Offering of Securities, https://www.sec.gov/files/formd.pdf (last visited Sept. 21, 2018).

31. Most startups conducting seed financings rely on the Regulation D safe harbors (in particular Rule 506(b)), *see* 17 C.F.R. § 230.506(b), from the registration requirements of Section 5 of the Securities Act of 1933 (the Securities Act), *see* 17 U.S.C. §§ 77a–77aa.31.Regulation D requires an issuer relying on these safe harbors to file a completed Form D with the SEC on its publicly available EDGAR filing system. For information about EDGAR, see U.S. Securities and Exchange Commission, *About EDGAR* (last modified Feb. 16, 2010), https://www.sec.gov/edgar/aboutedgar.htm.

32. An EDGAR full-text search on July 30, 2018 of Form D filings made in the prior four years that contained the text "SAFE" or "Simple Agreement for Future Equity" or "Simple Agreements for Future Equity" yielded 248 filings listing a SAFE as the type of security offered in Section 9 of Form D.

issued.[33] There were more than 1,500 filings related to convertible note offerings over a similar period.[34]

The Form D filings for SAFE offerings came from companies located in 37 states plus the District of Columbia. The top four states accounted for the majority of the filings, with California alone being responsible for 37%, followed by New York (11%), Illinois (7%), and Washington (5%). These filings also give some insight into the growth in popularity of the SAFE over time. There was only one filing in 2014 (the year after the SAFE was first introduced by Y Combinator), followed by 23 filings in 2015, 51 filings in 2016, 81 filings in 2017, and already 92 filings in 2018 (through just July 30).

The 12 Form D filings for KISS offerings came from companies located in seven states and one Canadian province. New York had the most with three filings, followed by California and Pennsylvania with two filings apiece, and British Columbia, Kentucky, Missouri, Texas, and Washington with one filing each. The first KISS filing was made in early 2016 followed by 2 more that year, 7 filings in 2017, and 2 filings so far in 2018 (through July 30).

To be clear, Form D filings provide some significant drawbacks for scholars attempting to study the current state of seed financing instruments. The information provided on Form D is limited and fails to give much context for how instruments like the SAFE and KISS are being used in practice. More importantly, the filings also tend to significantly underrepresent the actual number of financings conducted using these instruments.[35] Nevertheless, we were comforted that the evidence from

33. An EDGAR full-text search on July 30, 2018 of Form D filings made in the prior four years that contained the text "KISS" or "Keep It Simple Security" or "Keep It Simple Securities" yielded twelve filings listing a KISS as the type of security offered in Section 9 of Form D.

34. An EDGAR full-text search on August 2, 2018 of Form D filings made in the prior four years that contained the text "convertible note" or "convertible notes" or "convertible promissory notes" yielded 1,543 results.

35. Many early-stage startups are loath to publicly announce seed-stage financings, preferring to remain in "stealth-mode" for as long as possible to avoid alerting competitors to their activities. To accomplish this, many startups avoid making Form D filings by relying on the exemption in Section 4(a)(2) of the Securities Act. Companies taking this route have to comply with state blue sky laws and may need to make filings under the limited offering exemptions in the states in which their seed investors reside (although such filings are less closely watched than Form D filings and sometimes require less information). Even some startups that do rely on the Regulation D safe harbors sometimes choose not to file on Form D anyway, particularly in cases where deferred equity instruments are used. These companies instead choose to file a Form D for the

these filings relating to the geographic spread of these instruments across the United States was broadly consistent with our survey results.

IV. IMPLICATIONS

This final Part explores the insights that flow from the account of seed financing contracts set forth above. We first show that our empirical findings call into doubt the traditional distinction between "East Coast" and "West Coast" styles of startup investing and lawyering. We then argue that these contracts are a type of "product" that is not dissimilar to branded swag that is commonly given away by companies to build brand awareness.

A. EAST COAST VS. WEST COAST NORMS

The conventional wisdom has long held that venture capital contracts on the West Coast were more favorable to the company because the Silicon Valley venture capitalists viewed their relationship with portfolio companies as a "partnership."[36] Contracts on the East Coast, by contrast, were said to contain deal terms that were less favorable to the company because East Coast venture capitalists took a more "banker-like" approach to their portfolio companies.[37] Indeed, several respondents invoked this distinction in responding to survey questions about the SAFE and the KISS. One respondent stated that "SAFEs and KISSes are West Coast. When working with East Coast clients and investors, they usually haven't heard of it (or aren't comfortable with it)." Another respondent observed that "SAFEs are just starting to gain traction in Colorado and are much more prevalent in California." Still another respondent stated that "SAFEs seem to be very well-accepted in the Bay Area—I rarely get investor pushback. In contrast, almost every time I've tried to use them with Midwest or East Coast investors, the investor has refused."

subsequent equity offering into which the seed-stage convertible notes, SAFEs, or KISSes convert. Sometimes they will explicitly make note of the fact that the offering amounts listed in these Form D filings include the conversion of deferred equity instruments, but many times startups are silent on the Form D when this is the case, potentially leaving no public trace that the prior seed financing ever occurred. As a result, relying on Form D data alone when attempting to understand the state of startup seed financing may not simply provide an incomplete picture. It may in fact be misleading.

36. See John F. Coyle & Joseph M. Green, *Startup Lawyering 2.0*, 95 N.C. L. REV. 1403, 1430–31 (2017).

37. *Id.*

In previous work, we have argued that this East Coast/West Coast dichotomy is overly simplistic.[38] The survey results presented herein provide additional support for this conclusion. While the SAFE and the KISS are most frequently used in California—the quintessential West Coast state, especially when talking about tech startups—the runners-up are Texas, New York, and Massachusetts, none of which could be fairly characterized as "West Coast" states. Significantly, the survey responses from startup law aficionados—respondents who devoted more than 75% of their time to representing investors or startups—were generally consistent with one another irrespective of geographic location.

The key factor nowadays, it would appear, is not geography but the extent to which the relevant actors—the investors, the founders, and the lawyers who represent them—have been exposed to Silicon Valley norms. A lawyer who spends all or most of her time working with startups will inevitably be exposed to these norms. Once he or she is exposed to recent innovations like the SAFE or the KISS, the lawyer is more likely to recommend them to a client. One's status as a startup law aficionado, therefore, is an important variable separate and apart from geography that can help to explain the likelihood that the SAFE or the KISS will be used in a given transaction.

B. Contracts as Products

In recent years, a number of scholars have argued that contracts increasingly resemble products that are bought and sold in the consumer marketplace.[39] In a similar vein, we find it useful to think of the SAFE and the KISS as "products." While these instruments are clearly not the first thing that might pop into one's head when one thinks of a product, they are branded and marketed. The vast majority of contracts in this world, after all, are not given clever names that lend themselves to acronyms like the Simple Agreement for Future Equity or the Keep It Simple Security. Most agreements are given descriptively accurate—if boring and generic—labels like "Asset Purchase Agreement."

38. *Id.*

39. *See* Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 IND. L.J. 1125, 1126 (2000) ("The contract-as-product model is the typical model assumed by economists. In this model, the terms are part of the product, not a conceptually separate bargain; physical product plus terms are a package deal."); *see also* Arthur Allen Leff, *Contract As Thing*, 19 AM. U.L. REV. 131, 147 (1970) (noting that it is "arguable that the contract is *more* of a 'thing' than the goods which are sold pursuant to it").

The current branding efforts throw into sharp relief the fact that the SAFE and the KISS are different from other contracts in important ways.

That being said, the SAFE and the KISS are also unlike the typical consumer product in that they are not sold—they are given away for free. This presents a puzzle. Why should Y Combinator or 500 Startups spend so many hours developing and promoting a product only to give it away? The solution to the puzzle, we suggest, lies in the recognition that the SAFE and the KISS both function—to varying degrees—as branding opportunities for the accelerator that first created it.[40] In developing these form agreements and then sending them out into the world, these accelerators are seeking to burnish their reputation among entrepreneurs and investors by associating themselves with a useful product.[41] Just as law firms give away water bottles or jump drives bearing their firm names to law students in the hope that these students will remember them come recruitment time, so too do accelerators develop branded investment contracts in the hopes of attracting founders to their programs. In a sense, therefore, both the SAFE and the KISS are a novel form of tchotchke that is given away to promote brand awareness.

This is not to say, of course, that all types of swag are equally effective. Y Combinator is perhaps the best-known accelerator in the world. It did not *need* to develop the SAFE to enhance its reputation. It decided to do so, however, as a way of supporting entrepreneurs seeking to raise seed capital from investors. In this respect, Y Combinator acted more like a trade association acting on behalf of entrepreneurs than General Mills peddling Cheerios. While Y Combinator may have realized some incremental improvement in its reputation or expanded its geographical influence, it seems unlikely this was its primary motivation in developing the SAFE.

The story behind the KISS is more complicated. In publishing the KISS, 500 Startups explicitly sought to cast itself as an

40. When asked which instrument had the better "brand," the vast majority of respondents reported that the SAFE had a better brand than the KISS. One observed that the "KISS doesn't have much of a brand in my opinion." Another stated that "KISS has a brand problem because I always think it stands for 'keep it simple stupid.'" Still another stated simply: "In the same way YC has a stronger brand than 500 Startups, I think the SAFE has a stronger brand than the KISS."

41. Gregory Raiten, *500 Startups Announces 'KISS'*, 500 STARTUPS BLOG (July 3, 2014), https://500.co/KISS/.

alternative to Y Combinator. It referenced the SAFE in its announcement launching the KISS but then went on to suggest that the KISS was a *better product* than the SAFE. A subsequent blog post on the 500 Startups website—penned by a guest blogger not formally affiliated with 500 Startups—even suggested that the KISS was actually created prior to the SAFE:

> In 2014, 500 Startups, a global venture capital firm, took a little-known action that would help change the landscape of international venture finance. This action had nothing to do with investment dollars, new hires, or liquidation events. 500 Startups simply open-sourced their proprietary investment contract for early-stage investments, the KISS ("Keep It Simple Security"), to startups and investors around the world. In the next year, fellow venture capital giant Y Combinator followed suit and open-sourced their own proprietary investment contract, the SAFE ("Simple Agreement for Future Equity").[42]

This, needless to say, is not how it happened. Nevertheless, this revisionist history serves to burnish the reputation of 500 Startups by suggesting that it—and not Y Combinator—was the first to develop a new type of investment contract that is now widely used in seed financing transactions.[43] This innovation, it was hoped, would enable 500 Startups to attract high quality startups to participate in its accelerator. As the general counsel of 500 Startups put it when the KISS was first released:

> We've put in a lot of work to make KISS docs one of the best convertible instruments on the market, and we encourage companies seeking an investment from 500 to use KISS docs (either flavor is fine with us). In fact, we'd love to see KISS docs adopted by other investors, thereby reducing legal costs for everyone and eliminating some of the friction involved in closing a round of financing.[44]

In summary, we have one Silicon Valley accelerator (500 Startups) trying to make a name for itself and attract entrepreneurs to its accelerator program by giving away a standard form contract (the KISS) with the ultimate goal of luring founders

42. Adam Sterling, *KISSs and SAFEs and Notes. . ..Oh My!*, 500 STARTUPS BLOG (Feb. 6, 2018), https://500.co/kisss-safes-andnotes-oh/.

43. This is especially ironic as neither Y Combinator's SAFE nor 500 Startups' KISS documents were original in concept when released. They were both preceded by a strikingly similar agreement that was made publicly available in 2012 (a year before the SAFE and two years before the KISS). This agreement was the "convertible security" created by Yoichiru Taku, a partner at Wilson Sonsini, and Adeo Ressi, the founder of the Founder's Institute. *See* Coyle & Green, *supra* note 4, at 166–168.

44. Gregory Raiten, *500 Startups Announces 'KISS'*, 500 STARTUPS BLOG (July 3, 2014), https://500.co/KISS/.

away from a better-known Silicon Valley accelerator (Y Combinator). Such jockeying for market share is common when it comes to soft drinks. It is much less common in the context of standard-form contracts.

CONCLUSION

In this Essay, we have chronicled the spread of two particular contractual innovations—the SAFE and the KISS—outside of Silicon Valley in the years immediately following their creation in 2013 and 2014, respectively. As noted above, this account is primarily descriptive. We are not passing judgment on the utility of these instruments so much as we are trying to discover when and under what circumstances they are being used. We believe, however, that this account offers useful insights into startup investing norms and the role of contracts as products which we hope to explore in greater detail in future work.