PRACTICAL CONSIDERATIONS OF SIMPLE AGREEMENTS FOR FUTURE EQUITY OR "SAFES" IN CANADA

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Simple Agreements for Future Equity or "SAFEs" are investment contracts that allow investors to convert their investments in a company into securities upon the occurrence of a triggering event. SAFEs are typically used by early stage companies when the value of a company is not yet established and provide a company with a favourable and simplified alternative to convertible loans without employing more traditional and complicated characteristics such as interest rates or an established term. While common in the United States and well accepted by the investment community, particularly in the technology sector, SAFEs have not seen the same level of utilization and acceptance in Canada, although there has been a recent uptick in interest in SAFEs in Canada given the fact that there is a large amount of cheap capital waiting to be deployed and companies currently have the edge in bargaining power for investment dollars.

Characteristics of SAFEs

The main components of SAFEs typically include:

- the right to be converted into securities of a company upon the occurrence of a triggering event, often a subsequent financing of a certain amount or the occurrence of a liquidity event. The conversion of the SAFE typically occurs at a discount to the price per security offered in the later financing. Given SAFEs are not yet an established investment mechanism in Canada there is no Canadian "market" discount. However in the United States conversion discounts are often between 10%-25% of the price of the securities offered under the financing round constituting the triggering event;
- valuation caps are often used to establish the maximum valuation of the company at which a SAFE will convert into securities thereby creating a floor for the percentage of the company the investor is purchasing;
- a triggering event discount, valuation cap, both or neither (the latter being less common);
- sometimes, a "most favoured nation" provision may be used where, if future investors receive more favourable terms, holders of SAFEs will have the option of receiving the more favourable terms;
- holders of SAFEs are not shareholders of the company and accordingly do not have the typical rights of a shareholder; and

- there is no requirement that the company repay the investments or that the triggering event will occur. Accordingly SAFE holders will likely have limited recourse to recoup their investment if the triggering event fails to occur.

SAFE Positives for Companies

The use of SAFEs provide many benefits for companies including:

- unlike convertible loans:
  - companies are not obligated to repay the investment to the SAFE holder;
  - there is no "drop-dead date" by when conversion must occur; and
  - companies do not pay interest thereby preserving capital which is crucial at the growth stage;
- SAFEs allow companies to obtain financing expediently because the forms of agreements are simple and contain relatively few terms thereby decreasing the need for negotiation between parties; and
- SAFEs can be entered into on an individual basis as opposed to coordinating a concurrent closing of a financing with many investors.

SAFE Negatives for Companies

Notwithstanding the benefits of SAFEs, they are not risk free and companies need to be aware of the risks, including:

- SAFEs are an inherently less investor favourable investment and less common in Canada. Accordingly, investors may be wary of an investment instrument with which they are not familiar meaning that companies may face an uphill battle explaining and getting investors comfortable with the concept;
- investment banks may be less likely to recommend SAFEs to their clients as opposed to traditional equity investments;
- sophisticated investors seeking to invest large amounts of capital may reject SAFEs as they are likely to negotiate bespoke investment characteristics and rights not typically contained in SAFEs; and
- SAFEs may create challenges for a company seeking to list its securities on a Canadian public stock exchange prior to the occurrence of a triggering event while its SAFEs remain intact and in force. While having SAFEs will not necessarily bar a company from later listing on a Canadian exchange, the exchanges are less familiar with SAFEs and so more involved pre-filing discussions respecting this aspect of a company's capital structure would likely be required by the exchanges.

SAFEs represent a novel (in Canada) financing structure for early stage and growth companies, particularly in the technology sector, allowing for quick access to capital without giving up immediate equity or interest payments. If you are looking for advice respecting SAFEs and they role they can play in capital raising, please reach out to the authors of this bulletin to discover how McMillan LLP's Technology and Capital Markets teams can assist.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.