

This article first appeared in Tijdschrift voor Jaarrekeningenrecht (*Accounting Law Review*), 2022-02.

The Safe dissected: does this hybrid financing instrument qualify as equity or debt?¹

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In recent years, Dutch start-ups have become more interested in using the American Simple Agreement for Future Equity (Safe) as a financing instrument. But what is the Safe and for what purpose is the instrument used? Can the Safe be used as a financing instrument under Dutch law and what adjustments are required for this?

The use of the Safe raises the question of whether the instrument qualifies as debt or equity based on the agreed terms. The directors of the start-up and the appointed auditor should conform to the answer to that question when preparing the financial statements. If it qualifies as debt, what adjustments should be made to the model so that Safe can be considered equity?

1. What is the Safe?

1.1 The Safe is a model participation agreement developed by YCombinator³, and concerns a financing agreement intended to be governed by the law of one of the states in the United States of America. The following models are available: (i) based on a post-money valuation cap and no discount, (ii) application of a discount and no application of a valuation cap and (iii) no application of a discount or a valuation cap, but of the Most Favoured Nation (MFN), i.e. a right to the application of more favourable terms and conditions of subsequently issued convertible securities. Meanwhile, model agreements based on a valuation cap without the application of a discount have been drafted subject to the laws of Canada, Cayman Islands and Singapore.

1.2 The model participation agreement is commonly used by start-ups prior to the first investment round to raise capital from early stage investors. The Safe has been developed to serve as a financing tool that qualifies as equity⁴; it is seen as an alternative to early stage *fundraising*, which requires a valuation of the company, and to the usual convertible loan, which has the disadvantage of qualifying as debt in principle.

1.3 The model agreements made available by YCombinator create a right to acquire a certain number of preference shares in a company for a purchase price that is paid immediately as an advance on the shareholding. The Safe model based on a valuation cap without the application of a discount gives the investor, in summary, the following rights vis-à-vis the start-up:

- (a) prior to the closing of an investment round, the right to acquire a number of preference shares equal to the highest number of either (i) the advance paid divided by the lowest issue price for preference shares, or (ii) the advance paid divided by the post-money

¹ This article is an English translation of the article "De Safe ontleed: kwalificeert dit hybride financieringsinstrument als eigen vermogen of vreemd vermogen?" which was published in Dutch in Tijdschrift voor Jaarrekeningenrecht (*Accounting Law Review*) 2202-2, p. 35-42.

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³ See <http://www.ycombinator.com/documents/>

⁴ In its Safe User Guide, YCombinator refers users of the model to their local legal advisors for such an assessment. YCombinator confirms that the published model of the Safe is always intended to be a financing instrument that qualifies as equity. Section 5(g) of the Safe model further provides that the parties agree to qualify the Safe as equity at all times for tax purposes and to report the Safe only as such in their respective tax returns.

valuation cap divided by the number of issued shares, convertible securities and options (*Safe Price*);⁵

- (b) as a result of a transfer of control or an initial public offering, the right to a pro rata share of the proceeds realised by the company up to the highest amount of either the advance paid (*Cash-Out Amount*) or the amount to be paid on the number of ordinary shares into which the Safe would convert (*Conversion Amount*), in cash or, if offered to the shareholders, in another form;⁶
- (c) in the event of the company being wound up, dissolved or declared bankrupt, the investor is entitled to a maximum of the value of the advance paid,⁷ whereby the claim is subordinate to all creditors, has equal ranking with the holders of preference shares, but has priority over the holders of ordinary shares;⁸
- (d) after the distribution of profits by the start-up to shareholders, the right to a profit distribution equal to the amount paid per ordinary share multiplied by the advance payment paid divided by the post-money valuation cap divided by the number of shares, convertible securities and options issued per a certain liquidity event (*Liquidity Event*) and excluding the unissued option pool (*Liquidity Price*).⁹

2. Application of the Safe as a Dutch law financing instrument

2.1 Attractiveness of the Safe as a pre-seed funding instrument for start-ups

Accelerators, start-ups and investors in the start-up ecosystem in the Netherlands have been interested for years in standard templates of financing documentation that are simple, balanced and effective. A money loan agreement is a relatively simple document, albeit that the conditions for the claimability of the principal, the term and the desired security require attention and elaboration. The addition of a mechanism by which the principal with interest due can be converted into shares requires a valuation of the company and requires additional provisions and documentation (a shareholder resolution and a draft deed of issue). Since the introduction of the Safe in 2013 on YCombinator's accelerator platform, start-ups in particular have favoured the Safe, as the templates are freely accessible, have a professional look due to the U.S. investment terminology used and are often applied by start-ups.

2.2 Necessary changes to the Safe

The application of Dutch law to the Safe as a financing instrument is certainly possible with some substantial adjustments.¹⁰ In my opinion, without these modifications the Safe does define the conditions under which the investor provides the agreed amount to the start-up, however the investor would not acquire an enforceable right to acquire shares and the conditions under which

⁵ Art. 1 (a) Safe model.

⁶ Art. 1 (b) Safe model.

⁷ Art. 1 (c) Safe model.

⁸ Art. 1 (d) Safe model.

⁹ Art. 5 (c) Safe model.

¹⁰ In its Safe User Guide, YCombinator refers users of the model to their local legal counsel to assess the effectiveness of the Safe under their jurisdiction.

the shares are issued would not be defined under Dutch law. I will deal with some of the desired amendments to the Safe below.

2.2.1 Grant of a right to acquire shares

Because the Safe is intended to provide the investor with a right to acquire shares, a shareholders' resolution must have been adopted, prior to the Safe being entered into, to provide that right and to exclude the pre-emptive right accruing to shareholders.¹¹ The Safe must contain a provision confirming that resolution.

2.2.2 Investor's rights in connection with the granting of rights to acquire depository receipts for shares

If the Safe intends to grant the investor a right to acquire depository receipts of shares, it will have to state whether these depository receipts will carry meeting rights and which special conditions are described in the administration conditions that apply to the depository receipts of shares; preferably, provisions will be included that elaborate on the following subjects (i) the exchangeability of depository receipts, (ii) the transfer requirements for effectuating the transfer of depository receipts, (iii) the transferability of shares held by a foundation trust office (STAK), and (iv) the binding of depository receipt holders to drag-along obligations and entitlement to tag-along obligations.

2.2.3 Transfer of rights under the Safe

The Safe model provides¹² that, regardless of the title under which the Safe is transferred, it is transferable only with the consent of each party. Excluded from the consent requirement for transfer are certain permitted transfers, including the transfer by universal title of the Safe as a result of death and a transfer of the Safe to another company controlled by the Safe investor. The closed nature of a B.V., however, would prevent persons who, when executing the Safe, would have been bound as shareholders by transfer restrictions of the applicable statutory restriction regime. For that reason, it is desirable that the Safe should declare the applicable statutory restriction regime, including any offer obligations as a result of events determined in the articles of association, to apply *mutatis mutandis*.¹³ If the reference to permitted transfers is maintained, it should exclude those transfers to which the blocking rules would apply *mutatis mutandis*. Whether this applies equally to depository receipts for shares should depend on the administration conditions laid down by the STAK Board at the time.

If rights to acquire shares are transferred as referred to in article 5 (d) of the Safe model by the start-up to another company, a new shareholders' resolution must be taken to grant the right to acquire shares in the new company that acquires the rights and obligations under the Safe.

2.2.4 Issuance of shares to implement the Safe

In order to implement the Safe, a number of shares are issued to which the investor is entitled by virtue of the calculated issue price. These shares are not issued by means of an 'automatic

¹¹ Art. 2:206 (2) DCC and art. 2:206a (6) DCC.

¹² Art. 5 (d) Safe model.

¹³ GS Rechtspersonen, art. 2:195 BW, aant. 3.4.6; Asser/Van Olfen & Rensen 2-IIa 2019/380; otherwise Perrick, VDHI, Vol. 167, para. 4.6.2.

conversion¹⁴, but by virtue of the execution of a notarial deed of issuance of shares immediately preceding the closing of the financing round to which the Safe refers; in practice, these Safe shares will be issued by means of a separate notarial deed.

2.2.5 Protection of the Safe investor's interests

Because the issuance of the Safe shares as described above requires the cooperation of the start-up in the preparation of the closing of the new financing round, the interest of the Safe investor in a careful execution of the Safe will have to be protected. This can be achieved by the Safe investor in the Safe giving an irrevocable mandate to the start-up to issue the Safe shares or Safe depositary receipts to the Safe investor prior to or, at the latest, at the closing of the new financing round, by signing the notarial deed of issuance of shares or the deed of allotment of depositary receipts.

2.2.6 Limitation of dividend right of Safe investor

The Safe gives the Safe investor the right to demand payment of a dividend from the start-up, if the start-up has made any dividend payments to shareholders. This dividend right thus also leads to payment of a dividend, as soon as an interim dividend is paid out to shareholders. Although a payment by a start-up to its shareholders of an (interim) dividend would be unlikely, retaining this dividend right could lead to a risk for the start-up in such a case. If the start-up were to make a loss over the financial year after all, the amount paid out as interim dividend would have to be paid back by the shareholders; however, the Safe investor would in that case not have to repay the dividend amount to the start-up.

2.2.7 References to US legislation

References in the Safe to US legislation¹⁵ cause uncertainty and should be deleted. Special attention should be given to the process of notifications described in article 5 (b) of the Safe and the reference in article 5 (g) of the Safe to U.S. tax legislation for the agreed qualification of the Safe as equity. These provisions should be redrafted according to Dutch law.

3. Classification of the Safe as equity or debt

3.1 At the latest when drawing up the annual accounts, the management of the start-up company that has issued a Safe will have to qualify the value of the Safe as equity or debt. After all, the annual accounts must, according to generally accepted accounting standards, be drawn up in such a way that a responsible opinion can be formed about the company's capital and solvency.¹⁶ The annual accounts must accurately show the size and composition of the capital at the end of the financial year.¹⁷

¹⁴ See art. 1 (a) Safe model. By using the concept of 'conversion', from a technical point of view the Safe would qualify as a debt by definition, which is set off against the claim of the start-up by virtue of the full payment of the Safe shares; the intention, however, is that the 'purchase amount' is an advance on the issue price that the Safe investor is already paying for the Safe shares to be issued in due course.

¹⁵ See the definitions of "Change of Control," "Direct Listing," "Initial Public Offering," and the qualification of a Safe investor in Section 4(b) Safe model.

¹⁶ Art. 2:362 (1) Dutch Civil Code.

¹⁷ Art. 2:362 paragraph 2 BW.

- 3.2 The start-up has an interest in a positive solvency ratio and will therefore want to qualify the Safe as equity. The investor who, by virtue of a Safe agreed upon with the start-up, has a right to acquire a percentage of at least five per cent of the issued share capital, can also have an interest in qualifying the Safe as equity; after all, his Safe then qualifies as a substantial interest¹⁸ and the investor-company is entitled to the participation exemption.¹⁹
- 3.3 Under US law, the qualification of the Safe as equity seems to serve mainly a tax purpose, namely the application of a full or partial participation exemption.²⁰ To achieve this tax purpose, the Safe model contains in its article 5 (g) an explicit confirmation by the parties that at all times the Safe will be classified exclusively as equity for tax purposes. However, the US *Internal Revenue Service* (IRS) is not bound by the agreement to qualify the Safe as equity mentioned in clause 5(g) of the Safe model.²¹ However, the investor would have a weaker argument if this provision were not mentioned in the Safe. In qualifying a particular Safe as equity or debt, the IRS takes into account all relevant facts²², including (i) the existence of subordination or seniority of creditors, (ii) the debt-to-equity ratio of the start-up, (iii) the relationship between shareholders and holders of the Safe, (iv) the name given to the investment vehicle, and (v) the intentions of the parties.
- 3.4 Also under Dutch law, all relevant facts and circumstances are taken into account for the qualification of the Safe as equity or outside capital. The law does not have a definition of equity, but Article 2:373 (1) of the Dutch Civil Code describes which balance sheet positions comprise the equity. The guidelines of the Dutch Accounting Standards Board (RJ) prescribe that in principle the legal form of the instrument is decisive for the separate financial statements²³, and for the consolidated financial statements the economic reality of the contractual provisions.²⁴ Case law indicates that for the fiscal qualification of a grant of money the civil qualification of the grant will be decisive.²⁵ Under Dutch law, the following requirements are relevant for the qualification as equity:
- (i) subordination of the investor/lender to all the company's creditors²⁶ (Subordination Requirement);

¹⁸ Art. 4.6 Income Tax Act 2001.

¹⁹ Art. 13.1 Corporate Income Tax Act 1969.

²⁰ U.S. Code § 1202 - Partial exclusion for gain from certain small business stock, <https://www.law.cornell.edu/uscode/text/26/1202>

²¹ <https://www.withum.com/resources/do-safes-qualify-as-stock-for-purposes-of-section-1202/>

²² <https://www.lowenstein.com/news-insights/publications/client-alerts/tax-treatment-of-safes-taks>:

"In determining whether an instrument is debt or equity for U.S. federal income tax purposes, a number of factors are taken into consideration by the IRS and the Tax Court. Specifically, factors that have been considered include (1) whether there is a fixed maturity date and schedule of payments; (2) whether there are interest payments, and if such interest payments are at a fixed interest rate; (3) whether there is a right to enforce payment of principal and interest; (4) whether there is a contingency on the obligation to repay; (5) whether there is subordination or preference to debt of the company; (6) the debt-to-equity ratio of the company; (7) whether the instrument converts into equity of the company; (8) the relationship between holdings of stock in the company and holdings of the instrument in question; (9) the names given to the instrument (e.g., if the parties call the arrangement debt); and (10) the intent of the parties."

²³ RJ 240.207. However, for financial years commencing on or after 1 January 2020, RJ 240.207 and RJ 240.208 also make it possible for separate financial statements to opt for the economic reality to determine the classification of an instrument as equity or debt.

²⁴ RJ 290.804.

²⁵ HR 7 February 2014, no. 12/04640, ECLI:NL:HR:2014:181, V-N 2014/9.12.

²⁶ HR 11 March 1998, no. 32 240, BNB 1998/208 and HR 7 February 2014, no. 12/04640, BNB 2014/80.

- (ii) recoverability by creditors of the amount provided by the investor/money lender (guarantee function of the money supply)²⁷ (Guarantee Requirement);
- (iii) the existence or otherwise of an enforceable obligation of the Company to transfer cash or other financial asset to the lender under circumstances that are potentially adverse to the Company²⁸ (Redemption Requirement);
- (iv) the existence of a contractual obligation to issue a fixed number of shares²⁹ (Determination Requirement);
- (v) the existence or absence of conditions on the payment of dividends³⁰ (Dividend Requirement); and
- (vi) the civil law form of the provision of money, and in the case of a loan, the extent of the lender's participation in the company³¹ under the terms of the loan (Participation Requirement).

3.5 Upon analysis of the Safe under Dutch law, I establish that under the conditions of the Safe model the Safe meets the subordination requirement, but does not (entirely) meet the Guarantee Requirement, the Repayment Requirement, the Determination Requirement, the Dividend Requirement and the Participation Requirement. This reinforces the view that based on the Safe model the Safe qualifies as debt and not as equity.³² I will explain this in more detail below.

3.5.1 Requirement of subordination to the Safe

The investor's claim to obtain the investment amount of the start-up in a *liquidity* event, which the Safe model defines as a transfer of control or an IPO, or an *insolvency event*, which the Safe

²⁷ See also GS Juridspersonen, artikel 373 Boek 2 BW, aant. 1.2, IJsselmuiden, Th.S., who defines equity as "the capital placed at the disposal of the company for an indefinite period of time" and J.N. Bouwman and M.J. Boer, NTFR-B 2014/9, Kapitaal is toch geen geldening! which, based on the Supreme Court's judgments of 7 February 2014 (HR 7 February 2014, no. 12/04640, BNB 2014/80 (Cumpref) and HR 7 February 2014, no. 12/03540, BNB 2014/79 (RPS)), conclude that the Supreme Court has ruled that a repayment obligation does not affect the fiscal qualification of the provision of money as capital, and that for the qualification issue, it is decisive whether the provision of money is part of the guarantee capital. Similarly, S.A. Stevens v. Kengatharam TvOB 2018-3 p 65-77.

²⁸ RJ 290.802: "With the exception of a written put option under paragraph 808, a financial instrument (or a separate component of a financial asset or financial liability) shall be presented as equity in the following cases: a. the instrument does not include an obligation 1. to deliver cash or another financial asset to another party; or 2. to exchange financial instruments with another party under potentially adverse conditions; [...]" See Ondernemingsrecht 2004, 72, C.J.A. van Geffen, De grens tussen eigen en vreemd vermogen. Referring to the treatment of IAS 32 by the Dutch Accounting Standards Board (RJ), Van Geffen states that mandatorily redeemable shares or mandatorily convertible shares are classified as debt: "In general, a financial instrument is classified as equity only if no repayment obligation arises and it is unlikely that it will arise." In HR 22-02-2019, no. 18/03178, A.-G. P.J. Wattel: "The fact that a repayment obligation is conditional and repayment uncertain does not remove the repayment obligation and therefore does not exclude the fact that the provision of money is, for tax purposes, loan capital".

²⁹ RJ 290.802: "[...]; b. if the instrument will or may be settled in the issuing legal entity's own equity instruments, there shall not be a contractual delivery of a variable number of equity instruments. Only a fixed number of equity instruments are equity instruments; [...]"

³⁰ Ondernemingsrecht 2004, 72, C.J.A. van Geffen; Handboek Jaarrekeningenrecht (VDHI, Volume 164), 2020, par. 30.3.1, J.B.S. Hijink.

³¹ HR 11 March 1998, no. 32 240, BNB 1998/208. In this judgment, the Supreme Court ruled that a provision of money under civil law that is designed as a loan only qualifies as a so-called participation loan and can therefore be recharacterized as equity, if:

- the remuneration for the provision of money is dependent on profits,
- the debt is subordinated to all unsecured creditors, and
- the debt has no fixed term, but is only payable in the event of bankruptcy, suspension of payments or liquidation.

³² See <https://www.archipeltaxadvice.nl/insights/tax-start-ups-de-safe-als-early-stage-financieringsinstrument/>. Otherwise: TOP 2021/110 - Rooij de, N. and Van Rath, B.G., The SAFE: a suitable financing instrument for Dutch start-ups in the seed phase?

model defines as the cessation of business activities, a general transfer of the assets for the benefit of creditors or the dissolution of the company, is subordinated to all creditors.³³

3.5.2 Guarantee requirement of the Safe

Since the start-up company repays the investor the amount of the investment even in the case of a *liquidity event* and not only in the case of an *insolvency event*, it cannot be said that the amount of the investment unconditionally belongs to the start-up's liable equity capital.

3.5.3 Refund requirement for the Safe

The Safe commits the start-up to repayment of at least an amount equal to the investment amount, in the event of a *Liquidity Event* or an *Insolvency Event*. If one of these events occurs, the Safe will not convert into shares in the capital of the start-up and the investor will not become a shareholder of the start-up.

3.5.4 Requirement of certainty of the Safe

The Safe gives the investor a right to acquire a variable number of shares, in the sense that that number of shares depends on the issue price agreed upon during a new investment round. Only after this issue price has been determined, is the number of shares to which the Safe gives the right fixed, after application of an agreed valuation cap or a discount on the issue price. Also in the event of a consideration in shares in the case of a transfer of control or an initial public offering (as described in section 1.3 (b)), the number of shares into which the Safe converts is only fixed after that event. This leads to the conclusion that the number of shares to which the Safe investor is entitled is variable, so that classification as equity under RJ 290.802 would not be permitted.

3.5.5 Dividend requirement for the Safe

The Safe provides the investor with a claim against the start-up for the immediate distribution of a pro rata dividend amount, if a profit distribution has been paid out to holders of ordinary shares. The investor thus also obtains a claim to receive a dividend amount in the event that an interim dividend has been paid out to shareholders. While shareholders, in the event that the start-up company realises less profit for the financial year, are obliged towards the start-up company to repay the excess amount of profit distributed, the holder of the Safe who received the profit distribution during the financial year does not have this obligation. On the basis of the Safe model I conclude that the dividend right granted to the holder of the Safe is therefore not dependent on the realised annual result, which strengthens the qualification as debt.³⁴

3.5.6 Requirement to participate in the Safe

The Safe is intended to provide the investor with a right to acquire shares in the start-up in return for payment of the investment amount. In addition, the investor has a claim against the start-up to a pro rata amount of dividend (see above in paragraph 3.5.4). The conversion right is however only exercised in the event of a qualifying financing round (*Equity Financing*). Since the Safe model expressly elaborates cases in which the investor has the right to receive back at least the amount

³³ Art. 1 (d) Safe model.

³⁴ Ondernemingsrecht 2004, 72, C.J.A. van Geffen.

of the investment, namely the *Liquidity Event* and the *Dissolution Event*, it must be concluded that the Participation Requirement is not entirely fulfilled.³⁵

4. A Dutch law alternative for the Safe

4.1 A design of the equity financing instrument under Dutch law

In practice, however, start-ups need a simple-to-use investment instrument that is similar to the Safe and that qualifies as equity and can be classified as such in the financial statements. Instruments with these characteristics that have been designed as a Dutch law alternative to the Safe are already being used. Because these instruments differ significantly from the Safe and qualify as equity, these instruments are given different names. Like the Safe, these alternative instruments satisfy a need among start-ups to bind interested investors to the terms of a future participation in the start-up as soon as possible and in a simple manner, and to receive the investment amount from them immediately. For the sake of convenience, in this article such an instrument is called Pre-Paid Participation (**PPP**). Below, I will elaborate on the specific provisions that are included in a PPP in deviation from the Safe.

4.1.1 Right to acquire shares against immediate payment of the issue price

The PPP entails granting an investor the right to acquire shares in the start-up's capital (or certificates thereof) against immediate payment of the issue price. This right to acquire shares is granted by the general meeting of the start-up under the suspensive condition that the PPP is entered into by the investor and the start-up.³⁶ The payment of the advance on the issue price is booked under the equity position, other reserves.³⁷

4.1.2 Dividend entitlement

The PPP gives the PPP investor the right to demand payment of a profit distribution from the start-up, if the start-up has realised profits over a financial year, the general meeting of the company has decided to distribute realised profits to the shareholders and the company has paid out these profits. The PPP investor is therefore not entitled to a profit distribution if the start-up has paid out an interim dividend to shareholders. This fulfils the Dividend requirement.

4.1.3 Issue of PPP shares

The PPP may provide for the shares to be issued in execution of the PPP if any of the following events occur:

- (a) the unconditional closing of the first financing round after the date of the PPP, whereby the start-up issues shares to parties other than employees or a STAK in connection with an employee participation (*Financing Round*); or
- (b) the unconditional closing of the transfer of more than 50% of the shares in the start-up leading to a transfer of control or a listing of shares in the start-up (*Exit*); or

³⁵ HR 11 March 1998, no. 32 240, BNB 1998/208.

³⁶ Art. 2:206 (2) Dutch Civil Code.

³⁷ Art. 2:373 paragraph 1 sub f BW; RJ 240.210.

- (c) The application for a moratorium or bankruptcy, or the dissolution of the start-up (*Dissolution Event*).

Under the conditions of a PPP, the PPP shares will always have to be issued. Any remaining amount of the investment amount after issuance of the PPP shares will be booked as share premium. The investor has no right towards the start-up to repay the investment amount, so the Repayment Requirement is met.

4.1.4 Procedure for issuing PPP shares

The start-up sends a notice of the expected share issue event to the PPP investor a certain number of business days before the intended date of issue of the PPP shares. The notice confirms (i) the number of PPP Shares to be issued to the PPP Investor and (ii) the date of issue, in the case of a Financing Round or an Exit (iii) the identity of the new investor, and (iv) the number of shares to be acquired by the new investor and the agreed issue price, and in the case of an Exit the purchase price per share.

On the date of issue, the start-up will issue the PPP shares to the PPP investor by executing a notarial deed of issue. This deed of issue will be passed in the event of a Financing Round immediately preceding the issue of shares to the new investor, and in the event of an Exit immediately preceding the delivery of shares to the buyer. In the deed of issue, the PPP shares are issued under the condition precedent of the execution of the deed of issue of shares to the new investor and of the deed of transfer of shares to the purchaser, respectively.

Following the issue of the issue of the PPP shares, the investment amount booked as other reserves at the time of payment is moved pro rata to the equity positions, issued capital and share premium.³⁸

4.1.5 Protection of the interests of the PPP investor

The PPP investor is protected by an irrevocable order to the start-up to issue the PPP shares to him before or, at the latest, at the closing of the new financing round. As an extra security, the PPP can stipulate that a discount is applied to the calculated issue price of a certain percentage for every three months that the start-up is in default with the issue of PPP shares.

4.1.6 Transfer of rights under the PPP

The PPP should provide that the rights under the PPP are transferable or encumbered with a limited right only with the consent of each party. The applicable statutory blocking rules included in the articles of association of the start-up at any time, including any offering obligations as a result of statutory events, will apply mutatis mutandis to a transfer of the rights under the PPP.

4.2 Qualification as equity

The PPP qualifies as equity if the PPP fully meets the requirements for such qualification and its classification as equity is permitted under RJ 240 and RJ 290. Under RJ 240.207, the PPP that is structured as described in Section 4.1 can be classified as equity. If the PPP provides a right to a

³⁸ Art. 2:373 (1) a and b BW; RJ 240.210.

fixed number of PPP shares, which is the case when the PPP is based on a fixed valuation, classification as equity is also permitted under RJ 290 and the Determination Requirement is met. The PPP meets the Dividend Requirement (see Section 4.1.2 above), contains no obligation to repay the investment amount (Repayment Requirement), and a *Liquidity Event* or an Insolvency Event (*Dissolution Event*) will also lead to the issuance of the PPP shares, thus meeting the Subordination Requirement and the Participation Requirement. The PPP explicitly considers the investment amount as a paid advance on the issue price that the investor pays to the start-up for the acquisition of the shares that are issued on the occasion of the new financing round or at a Dissolution Event. The investment amount, once received by the start-up, thus forms part of its guarantee capital, so that the Guarantee Requirement is met.

5. Summary and conclusion

Increasingly, the Safe is being used by Dutch start-ups to attract pre-seed investments. Applying the Safe as a usable financing instrument under Dutch law requires several necessary adjustments to the Safe model, which are explained in this article. Even with these adjustments, however, the Safe is qualified as a debt financing instrument, and recharacterization as equity will only be feasible if the Safe model is changed in such a way that the requirements for qualification as equity are met.

The start-up that wants to shape a future participation of an investor in the pre-seed phase as an equity financing instrument will find a tested Dutch-law alternative to the Safe in the PPP that is shaped as described in Chapter 4.