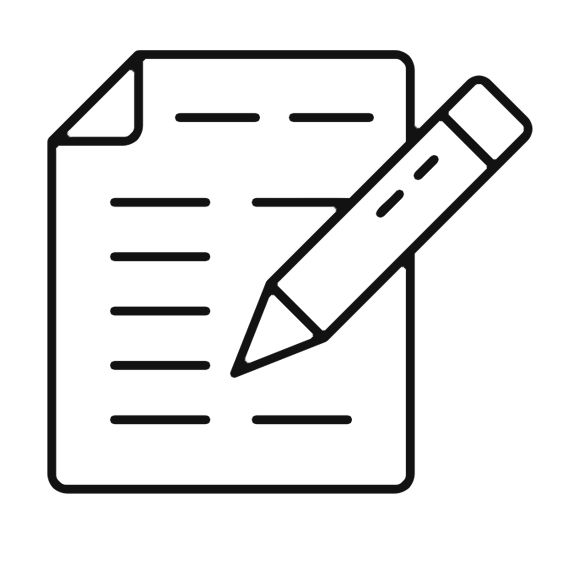
Automated  
Convertible Note

A quick and easy way to create a customizable convertible note based on US market standards. The note can also be tailored to include digital token-related provisions. Try it out now - no login required.

[**TRY IT TODAY**](https://legal-toolkit.openlaw.io/flow/Automated%20Convertible%20Note?accessToken=aa5d4370-0a9c-4ad9-8b63-e1a0ba6f808f)



Made by ConsenSys Legal in collaboration with Latham & Watkins LLP

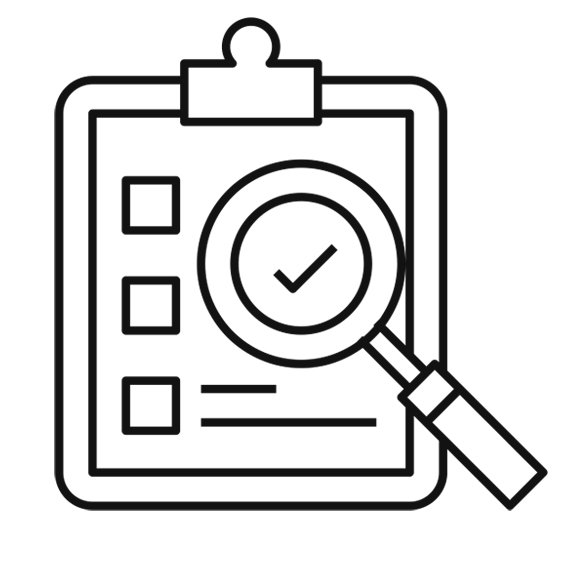


Generate

Create a tailored Convertible Note in a matter of minutes. Built on OpenLaw.

**[Generate here](https://legal-toolkit.openlaw.io/flow/Automated%20Convertible%20Note?accessToken=aa5d4370-0a9c-4ad9-8b63-e1a0ba6f808f)**

**[→](https://legal-toolkit.openlaw.io/flow/Automated%20Convertible%20Note?accessToken=aa5d4370-0a9c-4ad9-8b63-e1a0ba6f808f)**



Evaluate

Calculate the impact on founder equity for when your Notes convert.

**[Evaluate here](https://docs.google.com/spreadsheets/d/1meMI9vZkH1PASmvTrhBrZS9A9DBX71A0nefAVxEs6TM/edit" \l "gid=1130804136)**

**[→](https://docs.google.com/spreadsheets/d/1meMI9vZkH1PASmvTrhBrZS9A9DBX71A0nefAVxEs6TM/edit" \l "gid=1130804136)**



Collaborate

Comments on our form? Go to The Brooklyn Project annotator to help us improve it.

**[Collaborate here](https://thebkp.com/s/automated-convertible-note-6b95db92bf60)**

**[→](https://thebkp.com/s/automated-convertible-note-6b95db92bf60)**

**THE PRIMARY FEATURES OF THE AUTOMATED CONVERTIBLE NOTE**



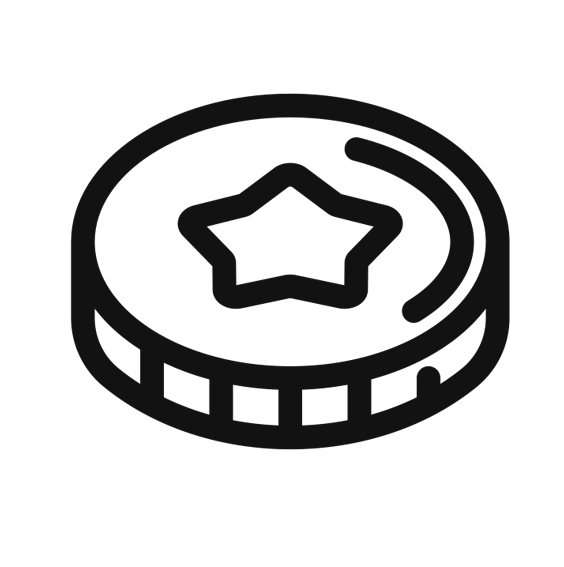
Automated Drafting

Create a tailored Convertible Note, whether you are an issuer or an investor, in minutes, not hours.



Customizable Market Standard Terms

Use a simple form to choose the things that matter to you, we’ll provide the appropriate legal language. Minimize negotiation and wordsmithing so you can focus on creating value.



Token Provisions

Got tokens? Include optional protections to address the issuance or distribution of digital tokens.

LEARN MORE ABOUT THE AUTOMATED CONVERTIBLE NOTE

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Intro

Welcome to ConsenSys’ Automated Convertible Note! We’re thrilled to collaborate with [Latham & Watkins LLP](https://www.lw.com/practices/TokenizationandBlockchain), a global law firm with a practice at the cutting-edge of tokenization and blockchain-related legal, regulatory, and business issues – to develop this resource and make it publicly available. We would also like to thank 500 Startups for collaborating with us on the use of the form KISS as the basis for the Automated Convertible Note. In this article, we start with a brief introduction to traditional convertible notes and then explain what the Automated Convertible Note is, why we put it together and how it works. We also discuss how our note is different from traditional convertible notes. Finally, we include ways that you can work with our team to improve the Automated Convertible Note tool as well as our form convertible note. We hope you’ll like it and find it useful.

What is a convertible note?

Early stage companies typically spend a significant amount of time fundraising. Depending on the stage the company is in, its business plan and the investors it talks to, capital formation may take the form of debt or equity, and in certain cases, a hybrid of the two.

A convertible note, or convertible debt, is a debt security that is convertible into equity of the issuer in certain circumstances. It is a popular form of early-stage financing instrument among venture capital firms and angel investors that invest in startup companies. In this article, we assume that you have some familiarity with convertible notes, but would encourage you to take a look [here](https://www.lathamdrive.com/resources/insights/3-most-common-seed-financing-alternatives-weighing-the-pros-and-cons) (see the section on Convertible Debt) and [here](https://feld.com/archives/2011/10/how-convertible-debt-works.html) for a deeper dive on its structure and how it works.

As we explain in detail in the section below entitled “How is it different from a typical convertible note”, we have taken a traditional convertible note and added mechanisms to address the possibility that the convertible note issuer (i.e. the company) may also distribute digital tokens. We think these changes make our form convertible note suitable for investing in startups that are building products and networks for the tokenized economy.

What is the Automated Convertible Note?

The Automated Convertible Note is a tool that allows users to quickly and dynamically generate custom-tailored versions of our form convertible note by simply answering a few questions. Our form convertible note is based on 500 Startups’ form KISS (“Keep it Simple Security”), which is a traditional US startup financing instrument that is commonly used by venture capital firms and angel investors. Accordingly, it is substantially similar to other publicly available notes and should generally be easily recognizable by most legal practitioners as “market standard”. However, we have modified it with what we believe are important changes to address issues surrounding digital token offerings (see the section “How is it different from a typical convertible note?” below).

Why did we put it together?

At ConsenSys, we invest in many startups that develop products, platforms or networks that leverage blockchain technology. As part of the process, we’ve encountered many different forms of convertible notes and early-stage investment instruments, but they all seem to lack something. Some deviate materially from market commercial terms. Others neglect to properly address issues created by the possibility (and sometimes strong likelihood) that the issuer may distribute digital tokens prior to the conversion or repayment of such convertible notes. As a result, we have developed our own form convertible note, which we typically use both when we invest ourselves, and when we take on outside funding for our projects. We have found that automating the form agreement saves substantial time and resources for our internal legal team, and our organization as a whole. Our hope is that by sharing the Automated Convertible Note other companies will also have the ability to spend less time and money on the fundraising process, and instead focus on BUIDLing. This way, we hope to help accelerate growth in the new tokenized economy.

How does it work?

The Automated Convertible Note is built using [OpenLaw](https://www.openlaw.io/" \t "_blank), a ConsenSys platform that allows users to dynamically generate draft agreements based on the inputs they select and information they provide. You can access the Automated Convertible Note [here](https://legal-toolkit.openlaw.io/flow/Automated%20Convertible%20Note?accessToken=aa5d4370-0a9c-4ad9-8b63-e1a0ba6f808f). The Automated Convertible Note asks you to provide relevant details (e.g. name of the company and principal amount of the note) and choose from a number of options (e.g. discount rate and specific investor rights) through a short questionnaire. The Automated Convertible Note includes instructions and guidance notes designed to answer many questions you might have. After completing the questionnaire, you can download a Word or PDF version of a convertible note which is tailored to your inputs, with just a click of a button.

How is it different from a typical convertible note?

The key difference between our form convertible note and a typical convertible note is that our convertible note addresses the possibility that the issuing company may distribute digital tokens. We believe this addresses a material unmet need because the potential distribution of digital tokens by companies introduces specific economic and regulatory concerns that issuers and investors should address before entering into a long term relationship.

Background

From an economic perspective, digital tokens can, depending on how they are structured and held by the company that created them and its founders, create value that may not otherwise be captured in the equity securities investors expect to receive upon conversion of their notes. For instance, this value can instead be found in the network created and bootstrapped by the company and may therefore be captured in the digital tokens that power that network. Given this potential disconnect between the value of a company’s equity securities and the value of its digital tokens, we often find it helpful to structure investments so as to (1) align the incentives of the founders and the investors with respect to value creation through the allocation of interests in both equity securities as well as digital tokens and (2) account for the potential value capture inherent in the digital tokens to be distributed by the company receiving the investment.

From a regulatory perspective, the distribution of digital tokens is fraught with regulatory risk, particularly in the United States, where the regulatory framework applicable to digital tokens continues to develop. As a result, investors in blockchain technology companies may fear that their portfolio companies can become embroiled, even if only reputationally, in regulatory action driven by poorly structured or executed token sales. Due to this regulatory risk, investors often prefer to be consulted by their portfolio companies prior to any token distribution in order to help ensure such digital tokens are properly distributed in a manner compliant with all applicable regulations and best practices.

Token Sale Blocker

Our form convertible note addresses the concerns identified above in a number of different ways. First, in scenarios where the company is (a) unlikely to issue tokens or (b) likely to issue tokens, but plans to do so in close coordination with the investors, our form convertible note provides the user with the option to include a “token blocker.” This blocker would require the company to obtain the consent of its investors prior to conducting a token sale, thereby providing investors in the convertible note with the opportunity to be consulted prior to any such sale.

Token Sale Conversion Mechanism

Second, in scenarios where the company has already begun structuring or formulating a potential token sale at the time of its financing or where there is a greater likelihood that a potential token sale will occur, it may be more appropriate for the parties to agree on what should happen upon the occurrence of such token sale. Our form convertible note therefore includes Initial Token Sale Conversion and Initial Token Sale Payment mechanisms. Upon the consummation of a token sale, the convertible note will either (i) remain in place, (ii) convert into equity securities of the company or (iii) be repaid (potentially at a premium) by the company. To illustrate how this right operates, let’s consider a simple example: assume that nine months following a convertible note financing, the company that issued the notes informs its investors that it is ready to launch a token sale. The company discloses the token structure and terms of the sale to the investors, at which point, such investors should be capable of deciding whether the sale is in its best interest as a prospective holder of equity securities or whether it should exit from its investment in the company by electing for the repayment. If the investors value the equity of the company, they may elect to continue to hold the convertible note (for conversion in connection with a future equity round) or elect to convert to equity securities based upon a predetermined formula in connection with the token sale. Alternatively, if the investors decide to exit, they can exercise their right to be paid the Initial Token Sale Payment amount by the company, which payment may be at an agreed multiple of the original investment to compensate the investor for being an early backer. With these rights, companies and investors should view the initial token sale event as being somewhat analogous to a merger or acquisition event, which is where we have borrowed the concept of Initial Token Sale Conversion rights and initial Token Sale Payment rights.

Token Purchase Option

In the interest of maximizing flexibility, the form convertible note also includes an optional token purchase option for the investor in the event of a token sale. This token purchase option enables the investor to purchase a portion of the digital tokens being issued in such token sale and therefore provides the investor with the ability to become a participant on the company’s network or platform. We believe this arrangement is materially different from the token rights of similar instruments (such as the SAFT) because (i) the convertible note does not permit the company to pre-agree to a distribution of digital tokens, and the investor’s original investment does not convert into such digital tokens, (ii) the investor would still need to satisfy the relevant requirements to purchase the digital tokens (e.g. complying with any applicable laws or any conditions in the terms of sale requiring the purchaser to prove use or consumption of the tokens), (iii) any such purchase of tokens would need to be documented separately and (iv) such token sale would presumably take place after the company had already used the proceeds from the investors’ investment in the notes for development of the company’s network technology.

If the parties decide to include a token purchase option, the form convertible note includes certain protective provisions to mitigate regulatory issues that may arise if the digital token or a distribution of the digital token is likely to trigger application of securities laws. For example, an investor could defer its token purchase option for a year or until such time when purchases by such investor would not cause regulatory complications, e.g. as a result of the development and decentralization of the token issuer’s network. Alternatively, if these regulatory issues cannot be or are unlikely to be resolved, then the parties have the ability to negotiate and agree on an alternative arrangement to preserve the rights of the investor, economic or otherwise. We believe this approach should mitigate many of the securities law problems that projects and investors have been experiencing, including the complications facing token projects trying to launch consumer utility tokens after having sold tokens directly or indirectly to pure, passive investors.

Relatedly, the form convertible note also includes provisions to address potential commodities law concerns. If the token purchase option were to be deemed a commodity option subject to regulation by the Commodity Futures Trading Commission (CFTC), the company and the investor may be able to benefit from certain exemptions. The application of CFTC regulation and the availability of any such exemption should be analyzed on a case-by-case basis and we encourage you to speak to competent counsel.

How can I comment or suggest changes?

We welcome your feedback and suggestions. We have made the form convertible note available on [The Brooklyn Project](https://thebkp.com/s/automated-convertible-note-6b95db92bf60), where you can share your thoughts through our custom-made annotator. As for the Automated Convertible Note tool itself, please send any feedback to legaltech@consensys.net.

Important Disclaimers

Please note that the Automated Convertible Note is not meant to replace competent counsel. None of the materials provided hereby are intended to be treated as legal advice or to create an attorney-client relationship. The materials on this site might not reflect all current updates to the law or applicable interpretive guidance and the Automated Convertible Note disclaims any obligation to continuously update its forms in real time. We strongly urge you to contact a reputable attorney in your jurisdiction for any questions or concerns. The use of the convertible note generator is subject to our [Terms and Conditions](https://consensys.net/convertible-note-terms-of-use/).

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ABOUT THE CONTRIBUTORS

* [Federico F. Soddu](https://www.linkedin.com/in/federico-f-soddu-31a5136b/)
* [David Cios](https://www.linkedin.com/in/david-cios)
* [Wee Ming Choon](https://www.linkedin.com/in/wee-ming-choon-9039814)
* [Carl Lundeholm](https://www.linkedin.com/in/carl-lundeholm-7a54a42a)
* [Joyce Lai](https://www.linkedin.com/in/joyce-lai-a907647)
* [Miles Jennings](https://www.lw.com/people/miles-jennings)
* [David Concannon](https://www.lw.com/people/david-concannon)
* [Yvette Valdez](https://www.lw.com/people/yvette-valdez)
* [Stephen Wink](https://www.lw.com/people/stephen-wink)
* [Ashley Weeks](https://www.lw.com/people/j-ashley-weeks)