

NEITHER THIS NOTE NOR THE SECURITIES ISSUABLE UPON CONVERSION HEREOF HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY APPLICABLE STATE SECURITIES LAW, AND NO INTEREST HEREIN OR THEREIN MAY BE SOLD, DISTRIBUTED, ASSIGNED, OFFERED, PLEDGED OR OTHERWISE TRANSFERRED UNLESS (A) THERE IS AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS COVERING ANY SUCH TRANSACTION, (B) THE COMPANY RECEIVES AN OPINION OF COUNSEL FOR THE HOLDER OF SUCH SECURITIES (CONCURRED IN BY COUNSEL FOR THE COMPANY) THAT SUCH TRANSACTION IS EXEMPT FROM REGISTRATION, OR (C) THE COMPANY OTHERWISE SATISFIES ITSELF THAT SUCH TRANSACTION IS EXEMPT FROM REGISTRATION.

[COMPANY NAME]

### CONVERTIBLE PROMISSORY NOTE

[\$XXXXXX]

[City], [State]  
[Month] [Day], [Year]

FOR VALUE RECEIVED, [Company Name], a [ ] corporation (the "**Company**"), promises to pay to the order of [Name of Holder] (the "**Holder**") the principal amount of [\$XXXXXX] (the "**Principal Amount**") upon the terms and subject to the conditions set forth herein (this "**Note**"). This Note is one of a series of the Company's notes known as the [202X] Convertible Promissory Notes (collectively referred to as the "**Notes**"), all of which contain similar terms, except as to the name of the holder, the date of issuance, [the Maturity Date, Default Conversion Price and Valuation Cap (as such terms are defined below)], the principal amount and other nonmaterial details. The Notes are intended to provide financing to the Company in anticipation of a Qualified Financing (as defined below).

"**Majority Holders**" means the holders representing a majority-in-interest of the aggregate Principal Amount of all then outstanding Notes. Any prepayments shall be made pro rata among the holders of all of the Notes based on the relative outstanding Principal Amounts of the Notes.

**1. Closing** Each closing (a "**Closing**") of the purchase of the Notes shall take place at such time and place as the Company and the Holders mutually agree upon. At each Closing, each Holder shall deliver the Principal Amount to the Company and the Company shall deliver to each Holder one or more executed Notes. Each Note shall be for a Principal Amount of not less than \$25,000, unless a lower Principal Amount is approved by the Company. **Subsequent Closings.** In any subsequent closing (each a "**Subsequent Closing**"), the Company may sell additional Notes to prospective Holders that are accredited provided that the aggregate Principal Amount of all Notes shall not exceed \$X0X00,000 without the prior consent of the Majority Holders (as defined above). Each Subsequent Closing shall take place at such locations and at such times as shall be mutually agreed upon by the Company and such purchasers of additional Notes.

**3. Interest.** Interest shall accrue on the outstanding Principal Amount, from the date hereof until the date this Note is converted or paid in full, at the rate of [eight percent (8%)] per annum and shall be compounded annually on a 365 day basis (the "**Interest Rate**"). All accrued interest shall be due and payable in full upon maturity, conversion or prepayment of this Note, as provided herein. All cash payments received by the Holder in respect of this Note shall be applied first to accrued interest and thereafter to the repayment of the outstanding Principal Amount.

**4. Maturity Date.** If not sooner paid or converted according to the terms hereof, the outstanding Principal Amount plus all accrued and unpaid interest thereon shall be due and payable in full eighteen

**Commented [A1]:** A wide range of percentages is used here, up to 18%. 8% is a common middle value.

months from the date of the first note issued (the "**Maturity Date**"). Upon or at any time after the Maturity Date, in lieu of demanding payment, Majority Holders determined by principle invested may elect at their option and sole discretion to convert the outstanding Principal Amount plus accrued and unpaid interest under this Note into a number of shares of the Company's common stock (the "**Common Stock**") or shares of the authorized class or series of preferred stock most recently issued by the Company (the "**Preferred Stock**") equal to the quotient obtained by dividing:

**Commented [A2]:** Shorter and longer terms up from 6 to 36 months are also used, with 18 months being a common value. We recommend 18 months as it often takes longer to achieve results sufficient to achieve the qualified financing and this avoids the costs and hassles of extending the notes. Also, the notes may be offered for sale for 3-6 months which shortens the effective time the company has to make progress with the capital.

**Commented [A3]:** We strongly recommend drafting the notes to all have the same maturity and require note holders to act as a group. This greatly reduces the administration cost of the notes and prevents single note holders from disrupting adjustments to the notes if appropriate. We often see super majority requirements (e.g. 60% approval thresholds) for changes. As it may take up to 6 months to sell the final notes and close the round, this is a further reason to use a longer maturity date for the notes, such as 18 months.

(a) the outstanding Principal Amount plus any accrued and unpaid interest under this Note, by

(a) (i) if convertible into Common Stock, the conversion price obtained by dividing (x) **PRE-MONEY COMMON VALUATION** by (y) the Company's Fully Diluted Number of Shares; or (ii) if convertible into Preferred Stock, the original issue price of the class or series of Preferred Stock into which the Note is converted as set forth in the Company's Articles/Certificate of Incorporation (such conversion price, the "**Default Conversion Price**"). "**Fully Diluted Number of Shares**" means the number of common equivalent shares of the Company outstanding determined by the sum of the outstanding shares of Common Stock of the Company and the number of shares of Common Stock issuable upon conversion of all outstanding securities convertible into Common Stock and the exercise of all stock options and warrants outstanding immediately before any conversion, and including any shares reserved for issuance, at the time of such conversion, under the Company's stock option plans or arrangements (but excluding (i) the Notes and shares issuable upon conversion of the Notes and (ii) any shares of equity securities issued in the Qualified Financing). In the event that the Principal Amount and accrued interest thereon is not paid in full on the Maturity Date and the Holder has not exercised its conversion right specified above, the Note will continue to accrue interest at the Default Rate (as defined below).

**5. Extension.** At Maturity the Majority Holders as a group can elect to extend the notes for a period of time. Typical extension terms might be a 12 month extension in exchange for a 5% increase in the discount rate. Note Holders may have other requests of the company as well..

**6. No Prepayment.** The Company may not prepay this Note in whole or in part without the prior written consent of the Holder.

**7. Qualified Financing.** In the event of, and simultaneously with the initial closing of, a preferred stock financing after the date hereof with at least \$[1,500,000] of new invested capital (excluding the Notes and any other outstanding debt securities (including convertible debt securities or SAFEs) issued by the Company) or a preferred stock financing in a lesser amount if approved in writing by the Majority Holders (in either case, a "**Qualified Financing**"), the outstanding Principal Amount and accrued interest under the Notes shall automatically convert into shares of the same series of preferred stock as is issued in the Qualified Financing at a conversion price equal to the lesser of (a) the price obtained by multiplying (i) the price per share paid in the Qualified Financing by (ii) the applicable Conversion Percentage (as defined below); or (b) the price obtained by dividing (i) **VALUATION CAP** (the "**Valuation Cap**") by (ii) the Company's Fully Diluted Number of Shares (calculated immediately prior to the initial closing of the Qualified Financing). The "**Conversion Percentage**" shall be set at eighty percent (80%). In conjunction with such conversion, the Holder shall become a party to and shall execute all applicable definitive agreements relating to such Qualified Financing (the "**Qualified Financing Agreements**").

**Commented [A4]:** Commonly this ranges from \$1M to \$3M. There are a number of considerations. Since this financing will set the price paid for the shares, it is important that the financing be substantially larger than the total amount of the note. A number too low has at least two drawbacks: (1) if the raise isn't enough to meet the company's funding needs, then the investors convert into the stock of a company that is not positioned to succeed, and (2) a number too low invites a sham/insider investment of a small amount at an artificially high valuation in order to force the conversion at that high valuation. On the other hand, if the hurdle is too high it can inhibit the company's ability to attract investors, since they won't want to come in if prior convertible notes cannot be forced to convert as part of the financing. With that in mind, a good way to look at this is that this conversion hurdle should be the same as the minimum-to-close on the following equity round (if one) as the considerations are very similar and avoids this last pitfall.

**8. Acquisition.** Immediately prior to the closing of a merger, share exchange, consolidation, acquisition of all or substantially all of the assets or stock, reorganization or liquidation of the Company that results in the stockholders of the Company immediately prior to such transaction owning less than 50% of the voting capital stock of the Company (or its successor or parent corporation) immediately after the transaction or, in the case of a sale of assets or liquidation, the Company owning after the transaction less than substantially all of the assets owned by the Company prior to the transaction (other than an issuance of

equity securities for the primary purpose of raising capital) or any other event that constitutes a “**Deemed Liquidation Event**” under the Company’s articles/certificate of incorporation (an “**Acquisition**”) that occurs prior to the satisfaction in full by the Company of all outstanding Principal amount and accrued interest under this Note (including through the conversion of such amounts into capital stock of the Company), In conjunction with such conversion in connection with an Acquisition, the Holder shall execute all documentation required to be executed by other stockholders of Company in connection with the Acquisition (the “**Acquisition Agreements**”), including without limitation escrow, indemnification and other similar agreements.

**9. Effect of Conversion.** Upon conversion of this Note into shares of the Company's capital stock in accordance with the terms hereof, and, if and as applicable, upon receipt by the Company of signature pages to the Qualified Financing Agreements or the Acquisition Agreements executed by the Holder, the Company shall promptly issue and deliver to the Holder (a) a certificate or certificates for the shares issuable upon such conversion of this Note (“**Conversion Shares**”) and (b) a capitalization table that reflects the Company’s Fully-Diluted Number of Shares as of the Conversion Time (as defined below) certified as accurate and complete by a senior officer of the Company. Such conversion shall be deemed to have been made, in the case of conversion pursuant to Section 4, as of the close of business on the Maturity Date or such earlier date as mutually agreeable to the Company and Holder; in the case of a Qualified Financing, simultaneously with the completion of the initial closing of the Qualified Financing; (provided, however, that the Fully Diluted Number of Shares shall be calculated, in connection with a Qualified Financing, as at the time immediately prior to the initial closing of the Qualified Financing); and in the case of an Acquisition, immediately prior to the closing of such Acquisition (in each case, the “**Conversion Time**”). The Holder shall be treated for all purposes as the record holder of such Conversion Shares as of the Conversion Time. No fractional Conversion Shares shall be issued in connection with any conversion of this Note, and any fractional shall be rounded up or down to the nearest whole share in lieu of any such fraction (and any fraction representing one-half of a share shall be rounded up). The issuance of Conversion Shares to the Holder upon conversion of this Note in accordance with its terms shall constitute satisfaction in full of the obligations of the Company under this Note.

**10. Event of Default.** . If the Company (a) fails to pay when due any principal or interest payment on the due date hereunder, and such payment shall not have been made within five (5) days of the Company's receipt of the Majority Holders’ written notice to the Company of such failure to pay; (b) materially breaches any other covenant contained in this Note and such failure continues for 15 days after the Company receives written notice of such material breach from the Majority Holder; (c) voluntarily files for bankruptcy protection or makes a general assignment for the benefit of creditors; or (d) is the subject of an involuntary bankruptcy petition and such petition is not dismissed within 60 days, then in any such case then the Majority Holders may, upon written notice to the Company, declare the Notes in default and immediately due and payable in full. From that date forward, this Note shall bear interest at a rate of the lower of (i) the sum of (x) the Interest Rate; and (y) twelve percent (12%) per annum; and (ii) the highest rate allowed by applicable law (the “**Default Rate**”), until paid in full or converted.

**11. Representations and Warranties by the Company.** The Company hereby represents and warrants to the Holder as follows: (a) the Company is a corporation duly incorporated and in good standing under the laws of the State of [ ]; (b) the Company is not in violation of or in default under its charter documents or any material judgment, order, writ, decree, statute, rule, or regulation that is applicable to the Company or any material mortgage, indenture, agreement, instrument, or contract to which the Company is a party; (c) all corporate action on the part of the Company, its directors and stockholders necessary for the authorization, sale, issuance and delivery of this Note has been taken; (d) the Company will take all corporate action necessary to ensure the Conversion Shares issued upon conversion of this Note will, upon issuance, be duly authorized, validly issued and fully paid in accordance with the articles/certificate of incorporation of the Company; (e) this Note, when executed and delivered by the Company, shall constitute a valid and legally binding obligation of the Company, enforceable against the

**Commented [A5]:** This is typically either WA or DE

Company in accordance with its terms, except as limited by applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance, and other laws of general application affecting enforcement of creditors' rights generally, and as limited by laws relating to the availability of specific performance, injunctive relief or other equitable remedies; (f) the execution and delivery of this Note does not violate any material judgment, order, decree, statute, rule, or regulation applicable to the company or violate any individual's mortgage, indenture, agreement, instrument, or contract to which the company is a party; and (g) the Company has no indebtedness for borrowed money, other than the Notes and as disclosed on Schedule A attached hereto. The Company further represents and warrants that it is a "qualified small business corporation" for purposes of Section 1202 of the Internal Revenue Code ("**Section 1202**") and the rules and regulations thereunder (a "**QSBC**") and that that, upon issuance, the Conversion Shares are eligible for the gain exclusion provided by Section 1202 if the holding period and other requirements of Section 1202 required to be satisfied by the Holder are so satisfied. The Company agrees to provide any documentation reasonably requested by the Holder necessary for Holder to properly claim the Section 1202 gain exclusion.

**Commented [A6]:** This refers to the tax legislation making gains tax free for investments held in a C Corp for 5 years, with some other restrictions. One drawback of the note is that the 5 year clock does not start until it is converted.

**12. Representations and Warranties by the Holder.** By acceptance of this Note, the Holder represents and warrants to the Company as of the time of issuance of this Note as follows: (a) this Note and any Conversion Shares issued upon the conversion hereof (collectively, the "**Securities**") will be acquired for the Holder's own account for investment and not with a view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act of 1933, as amended (the "**Securities Act**"), or applicable state securities laws; (b) the Holder understands that the Securities have not been registered under the Securities Act or applicable state securities laws by reason of an exemption from the registration requirements of such laws, that the Company has no present intention of registering the Securities, and that the Securities may not be transferred unless such transfer is registered under the Securities Act or is exempt from registration; and (c) the Holder (i) is an "accredited investor" as that term is defined in Rule 501 of Regulation D under the Securities Act, (ii) has the ability to bear the economic risks of the Holder's investment in the Securities and (iii) has not been offered the Securities by any form of general solicitation.

**13. Information Rights.** So long as this Note is outstanding, the Company agrees to deliver to Holder any information provided to stockholders of the Company in their capacity as such and, upon request of Holder, such other information that a stockholder of the Company would be entitled to receive by law or under the charter documents of the Company. So long as this Note is outstanding, the Company will deliver to Holder (a) annual unaudited financial statements within sixty (90) days following year-end and annual audited statements, if any, within ten (10) days of completion; and (b) quarterly unaudited financial statements within thirty (60) days following quarter-end (c) a listing of all note holders, outstanding principle & interest, and their contact information.

**14. Notices.** All notices provided for in this Note shall be in writing and deemed to be duly given upon (a) personal delivery, (b) four business days after deposit in the United States mail, certified or registered, postage prepaid and (c) one business day after deposit with a reputable, national overnight courier service for next business day delivery with all charges prepaid. A copy of all notices (which shall not constitute delivery hereunder) shall also be sent by email on the same day notice is first given by one of the methods described in the preceding sentence. Notices shall be sent to the addresses set forth below (in the case of the Company), on the signature page hereto (in the case of Holder) or at such other address as a party may designate by ten (10) days advance written notice to the other party given in the foregoing manner:

If to Company:

**15. Governing Law.** This Note, and any disputes arising under this Note, will be governed by and construed in accordance with the laws of the State of Washington, without giving effect to any conflict of laws principle to the contrary. The Company and the Holder agree that the state and federal courts located in King County, Washington will have exclusive jurisdiction over any dispute between them arising out of this Note.

**16. Assignment.** The rights and obligations of the Company and the Holder shall be binding upon and shall inure to the benefit of their successors, assigns and transferees. Holder may not assign or otherwise transfer this Note without the prior written consent of the Company.

**17. Waiver and Amendment.** Any provision of this Note may be amended, waived, or modified upon the written consent of the Company and the Majority Holders; *provided, however*, that if any amendment or waiver affects a Holder differently and in a materially adverse manner relative to the other Holders, the consent of such Holder shall be required for such amendment or waiver.

**18. Collection Costs.** The Company agrees to pay all costs and expenses, including without limitation reasonable attorneys' fees, incurred by the Holder in any action brought to enforce the terms of this Note and/or to collect this Note, and in any appeal thereof.

**19. Headings.** Headings used in this Note have been included for convenience and ease of reference only, and will not in any manner influence the construction or interpretation of any provision of this Note.

**20. Only Company Liable.** In no event shall any stockholder, officer, director or employee of the Company be liable for any amounts due or payable pursuant to this Note.

**21. Expenses.** Each of the Company and the Holder will bear its own expenses associated with the negotiation and execution of this Note.

**22. Counterparts.** The Note may be executed in two or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

**23. Statutory Notice. ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT OR FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.**

\* \* \*

The Company has caused this Convertible Promissory Note to be signed by its duly authorized officer and dated the day and year first above written.

**[COMPANY NAME]**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**AGREED AND ACCEPTED:**

**[HOLDER]**

Name: \_\_\_\_\_  
Address: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Email: \_\_\_\_\_

