SAFE Agreements: Structural Flaws, Drafting Mistakes, and Cap Table Best Practices

BY DENNIS JAY CAGAN

Introduction

Over the past decade, the Y Combinator SAFE (Simple Agreement for Future Equity) has become one of the most commonly used financing instruments in early-stage startup investing. Its popularity stems from its simplicity, low legal cost, speed of execution, and founder-friendly structure. For many companies raising their first outside capital, a SAFE can be an effective way to defer valuation negotiations until a later institutional financing.

That said, simplicity should not be mistaken for completeness. In my experience advising founders, boards of directors, and investors, the standard SAFE contains several structural flaws that deserve careful consideration before it is adopted without modification. Most of these issues can be addressed through thoughtful drafting and disciplined administration, but they are often overlooked because the document itself appears deceptively simple.

The purpose of this article is not to discourage the use of SAFEs. On the contrary, I believe they can be valuable financing tools when used appropriately. Rather, my objective is to identify some of the more common issues I encounter and offer practical suggestions for avoiding problems that often surface months or years later during institutional financings, acquisitions, or liquidity events.

Part I – Fundamental Structural Flaws in SAFE Agreements

The following issues are largely inherent in the standard SAFE itself. They are not necessarily fatal defects, but they are structural characteristics that founders and investors should understand before relying on the standard document without modification.

1. No Investor Control or Governance Rights

While it may be favorable to the company, just be aware that unlike preferred stock or even convertible promissory notes, a SAFE generally provides investors with no voting rights, board representation, information rights, or protective covenants prior to conversion. While this gives founders maximum operating flexibility, it also leaves investors with little visibility into the company's progress after making their investment.

> **BEST PRACTICE:** *Consider providing significant SAFE investors with periodic financial reporting or other limited information rights, even if no formal governance rights are granted. Transparency often builds stronger long-term investor relationships.*

2. Uncapped or Excessively High Valuation Caps Can Break Alignment

The valuation cap is intended to reward early investors for accepting greater risk, and protect them from out-sized gains in valuation. However, an uncapped SAFE—or one with an unrealistically high valuation cap—may significantly reduce that benefit. If the company later raises capital at a much higher valuation, early investors may receive far less ownership than they reasonably expected,

creating disappointment at precisely the moment the company should be celebrating a successful financing.

> **BEST PRACTICE:** *Establish a valuation cap that reflects a realistic estimate of the company's current stage of development while still preserving meaningful upside for both founders and investors.*

3. Stacked SAFEs Create Conversion Chaos

One common startup mistake is issuing multiple SAFE agreements with different valuation caps, discounts, MFN provisions, and other economic terms. While each financing may seem reasonable at the time, the cumulative effect can become extremely difficult to model and may produce unexpected dilution or disputes during the first priced financing.

> **BEST PRACTICE:** *Whenever possible, standardize the terms of all SAFE financings conducted during the same fundraising campaign. Consistency simplifies future conversions and makes the capitalization table easier for founders, investors, and future financing partners to understand.*

4. Most Favored Nation (MFN) Clauses Can Complicate Future Financings

The Most Favored Nation provision is designed to protect early investors by allowing them to adopt more favorable economic terms offered in subsequent SAFE financings. While well intentioned, widespread use of MFN clauses can complicate future fundraising by reducing the company's flexibility to negotiate different terms with different investors. Every new SAFE may require a review of all prior MFN rights before it can be issued.

> **BEST PRACTICE:** *Use MFN provisions thoughtfully and understand their long-term implications. They can be valuable investor protections, but they should not unnecessarily limit the company's ability to structure future financings.*

5. Conversion Mechanics Are Frequently Too Vague

One of the most common oversights is that many SAFE agreements fail to define precisely what constitutes a Qualified Financing or exactly how conversion will occur. Questions often arise regarding minimum financing amounts, multiple closing dates, bridge financings, strategic investments, or partial closings. These uncertainties frequently appear only when the company is under pressure to complete a financing quickly.

> **BEST PRACTICE:** *Define the conversion trigger as clearly as possible. The agreement should specify what qualifies as a financing event, how the conversion price will be calculated, and exactly when conversion becomes effective.*

6. No Maturity Date or Repayment Obligation

Unlike convertible promissory notes, most SAFE agreements contain neither a maturity date nor a repayment obligation. If the company never completes a Qualified Financing, the SAFE may remain outstanding indefinitely, leaving both the company and the investor in an uncertain position for years, and creating a potential for litigation.

> **BEST PRACTICE:** *Consider adding a negotiated maturity date together with a clearly defined conversion mechanism if no Qualified Financing has occurred by that date. The goal is not necessarily repayment but rather eliminating perpetual uncertainty.*

Part II – Common Drafting and Implementation Mistakes

The majority of problems associated with SAFE financings are not caused by the SAFE itself, but by the way companies draft, administer, and manage them over time. The following are among the most common mistakes I encounter when reviewing capitalization structures and preparing companies for institutional financing.

1. Failing to Define a Qualified Financing

Many SAFE agreements simply refer to a "Qualified Financing" without clearly defining what that means. Is it a $250,000 bridge round? A $2 million institutional financing? Does it include convertible debt? Strategic investments? Multiple closings? Ambiguity often leads to disagreement at precisely the time the company is trying to close an important financing.

> **BEST PRACTICE:** *Clearly define the minimum financing amount and specify exactly which types of transactions will trigger conversion.*

2. Inconsistent Terms Among Multiple SAFEs

Companies frequently issue SAFEs over an extended period using different valuation caps, discounts, conversion provisions, and investor rights. While each agreement may appear reasonable when signed, the cumulative effect can create a capitalization structure that is difficult to administer and nearly impossible for new investors to evaluate.

> **BEST PRACTICE:** *If multiple SAFE financings are anticipated, use substantially consistent terms whenever practical. Standardization simplifies future conversions and improves investor confidence.*

3. Failing to Model Future Dilution

Because SAFEs are not immediately reflected as outstanding shares, many founders underestimate their eventual impact on ownership. The surprise often comes during the first institutional financing when several SAFE agreements convert simultaneously, reducing founder ownership far more than expected.

> **BEST PRACTICE:** *Update a fully diluted capitalization model every time a SAFE is issued so management understands the cumulative effect of future conversions before entering the next financing round.*

4. Ignoring the Impact on Future Investors

Professional investors rarely evaluate a SAFE in isolation. They examine the entire capitalization structure, including every outstanding SAFE, option, warrant, and convertible security. A poorly managed collection of SAFE agreements can make a company appear disorganized and increase the time, cost, and complexity of due diligence.

> **BEST PRACTICE:** *Manage SAFE agreements with the same discipline applied to any other equity security. Today's convenience should not become tomorrow's obstacle.*

5. Treating SAFEs as "One-and-Done" Documents

Many founders assume that once a SAFE has been signed, it can simply be filed away until a future financing occurs. In reality, every new SAFE should trigger a review of the capitalization table, dilution model, investor rights, and future financing strategy.

> **BEST PRACTICE:** *Review all outstanding SAFE agreements after each financing and before every significant corporate transaction to ensure the company's capitalization records remain accurate and current.*

6. Overlooking Accounting and Tax Implications

Although SAFEs are intended to simplify financing, they do not eliminate accounting or tax considerations. Depending on the circumstances, they may influence 409A valuations, financial statement disclosures, purchase price allocations in acquisitions, and other corporate reporting requirements.

> **BEST PRACTICE:** *Discuss the accounting and tax treatment of SAFE financings with qualified legal and accounting advisors before issuing multiple agreements or entering into a significant financing or acquisition.*

7. Poor Documentation and Recordkeeping

It is surprising how often companies cannot locate fully executed SAFE agreements, amendments, side letters, or related board approvals. Missing documentation creates unnecessary uncertainty during due diligence and can delay financings or acquisitions while records are reconstructed.

> **BEST PRACTICE:** *Maintain a complete file for every SAFE, including the executed agreement, board approvals, amendments, correspondence, and a reference to its location on the company's capitalization schedule.*

Part III – Cap Table Best Practices for SAFE Agreements

One of the most common misconceptions about SAFE agreements is that they require little or no attention after they are signed. Nothing could be further from the truth. While a SAFE does not represent outstanding equity prior to conversion, it does represent a future ownership interest that can materially affect the capitalization of the company. Proper cap table management is therefore essential.

A well-maintained capitalization schedule is more than an ownership list—it is one of the first documents prospective investors, lenders, acquirers, and auditors review when evaluating a company. Poor records undermine credibility. Well-organized records demonstrate discipline, professionalism, and sound corporate governance.

1. Maintain a Separate SAFE Register

Outstanding SAFEs should not be included in the company's issued ownership schedule because they do not yet represent issued shares. Instead, maintain a separate SAFE register that tracks every outstanding agreement in one place.

At a minimum, the register should identify the investor, investment amount, agreement date, valuation cap, discount, MFN provisions, Qualified Financing definition, current status, and any amendments. This allows management to understand exactly what obligations remain outstanding before each financing.

> **BEST PRACTICE:** *Treat your SAFE register with the same care as your stock ledger. It should always be complete, current, and immediately available during due diligence.*

2. Maintain an Ongoing Pro Forma Conversion Model

One of the biggest surprises for founders occurs when multiple SAFE agreements convert simultaneously. Because SAFEs are future equity rather than current equity, their cumulative impact is often underestimated until the company begins negotiating its first priced financing.

Management should continuously maintain a pro forma capitalization model showing what ownership would look like if every outstanding SAFE converted under its current terms. This allows the board and management to understand future dilution before making additional financing decisions.

> **BEST PRACTICE:** *Update the pro forma capitalization schedule every time a SAFE, option grant, warrant, or other convertible security is issued.*

3. Link Every SAFE to the Supporting Documentation

Every entry on the SAFE register should be traceable to the executed legal documents. During financings and acquisitions, missing agreements, unsigned amendments, or inconsistent records frequently delay closing and create unnecessary legal expense.

A complete file should include the executed SAFE, board approval, amendments, correspondence affecting the agreement, and documentation of any subsequent conversion.

> **BEST PRACTICE:** *Never rely solely on spreadsheets. Every financial entry should have corresponding legal documentation.*

4. Use Appropriate Cap Table Software

Simple spreadsheets may work during a company's earliest stages, but as multiple financing rounds, option grants, SAFEs, warrants, and other convertible securities accumulate, manual recordkeeping becomes increasingly difficult and prone to error.

Modern capitalization management platforms provide automated modeling, document management, audit trails, and scenario analysis that greatly simplify administration.

> **BEST PRACTICE:** *As ownership structures become more complex, migrate from spreadsheets to professional capitalization management software that can support future financing activity.*

5. Present Dilution Honestly

One of the quickest ways to lose credibility with sophisticated investors is to minimize or obscure the impact of outstanding SAFE agreements. Experienced investors will discover those obligations during due diligence, and unexplained discrepancies inevitably undermine confidence in management.

Transparency builds trust. A realistic presentation of both current ownership and anticipated dilution demonstrates that management understands the company's capitalization and is prepared for institutional investment.

> **BEST PRACTICE:** *Never surprise investors with previously undisclosed dilution. Present both the current capitalization table and a fully diluted pro forma ownership schedule whenever discussing future financing.*

6. Review Outstanding SAFEs Before Every Financing

SAFE agreements should never be viewed as static documents. Before every financing, acquisition, merger, or other significant corporate transaction, management should review every outstanding

SAFE to confirm its terms, determine whether conversion rights have been triggered, and evaluate the effect on the capitalization table.

Many problems attributed to SAFE agreements are actually the result of failing to review existing obligations before entering into a new transaction.

> **BEST PRACTICE:** *Make a complete SAFE review a standard item on the board's financing checklist before approving any new capital raise or liquidity event.*

Final Thoughts

SAFE agreements have earned their place as one of the most useful financing instruments developed for early-stage companies. Their simplicity, speed, and relatively low legal cost have helped thousands of founders raise capital more efficiently than would have been possible through traditional priced equity rounds.

At the same time, simplicity should never be confused with the absence of complexity. Every SAFE has the potential to affect future ownership, founder dilution, investor expectations, and subsequent financing transactions. Those consequences deserve the same thoughtful planning and disciplined administration applied to any other equity financing.

In my experience, the majority of problems associated with SAFEs do not arise because the instrument itself is inherently defective. Rather, they result from inadequate planning, inconsistent drafting, poor capitalization management, and a failure to appreciate the long-term implications of decisions made during a company's earliest stages. Do not accept the 'standard' Y Combinator SAFE as the end document, it requires further thoughtful additions and modifications to actually be *safe*.

Used thoughtfully, a SAFE can be an excellent financing tool. Used carelessly, it can create unnecessary confusion, strained investor relationships, and expensive legal disputes years later.

Like every corporate financing instrument, the SAFE is only as good as the discipline with which it is drafted, administered, and managed.

The Shadow CEO® SAFE Readiness Checklist

Ten Questions Every Founder Should Ask Before Issuing a SAFE

Before issuing any SAFE Agreement, management and the Board of Directors should be able to answer "Yes" to each of the following questions.

- ☐ **1. Have We Clearly Defined the Qualified Financing?**
  Does the SAFE precisely define the financing event that triggers conversion, including any minimum investment amount and the types of financings that qualify?

- ☐ **2. Is the Valuation Cap Fair to Both the Company and the Investor?**
  Does the valuation cap appropriately balance founder dilution with providing meaningful upside to early investors?

- ☐ **3. Have We Modeled the Fully Diluted Ownership?**
  Have we prepared a pro forma capitalization schedule showing the effect of every outstanding SAFE, option, warrant, and other convertible security after conversion?

- ☐ **4. Are All Outstanding SAFEs Consistent?**
  If multiple SAFEs have been issued, have we reviewed them for inconsistent valuation caps, discounts, MFN provisions, and conversion mechanics that could complicate future financings?

☐ **5. Have We Considered a Maturity or Sunset Provision?**

If a Qualified Financing never occurs, does the agreement clearly define what happens next, rather than allowing the SAFE to remain outstanding indefinitely?

☐ **6. Has the Board Formally Approved the Issuance?**

Has the Board of Directors approved the SAFE and recorded that approval in the corporate minutes as part of its fiduciary oversight responsibilities?

☐ **7. Have We Updated the SAFE Register and Cap Table?**

Have all capitalization records, pro forma ownership schedules, and supporting documentation been updated immediately after the SAFE is executed?

☐ **8. Have We Evaluated the Accounting and Tax Consequences?**

Have management, legal counsel, and the company's accountants considered any implications for financial reporting, 409A valuation, tax treatment, and future due diligence?

☐ **9. Will This SAFE Complicate Our Next Financing?**

Have we considered how institutional investors, lenders, or future acquirers are likely to view this SAFE and its effect on the company's capitalization?

☐ **10. Are We Being Completely Transparent with Investors?**

Have we fully disclosed the impact of existing and proposed SAFEs on ownership, future dilution, and conversion mechanics so there are no surprises later?

ABOUT THE AUTHOR



Dennis Cagan consults nationwide in his Trademarked role as a Shadow CEO®. He is a noted high-technology entrepreneur, executive, and board director. He has founded or co-founded over a dozen different companies, taken some public, been a CEO of both public and private companies, a venture capitalist, a private investor, a consultant, and a long-time professional board member – 74 corporate fiduciary boards. His book, 'The Board of Directors of a Private Enterprise', is considered one of the definitive works on the subject. Mr. Cagan is a respected CEO and Chairman. He founded his first software firm in 1968. In 1976 he founded his fifth company. In 1980 it was ranked #32 on the first Inc. 100. His first public board seat was when he took the company public in 1981. In 1979 he was the Keynote Speaker at the first COMDEX Show in Las Vegas. In 2011 he was inducted into the IT Hall of Fame - Channel Wing, administered by CompTIA. In 2013 he was honored by NACD and the Dallas Business Journal as one of 12 Outstanding Directors in North Texas. Mr. Cagan resides in Sarasota, FL, and can be contacted at dennis@caganco.com.

©2025-2026 by Caganco Incorporated. All rights reserved. No portion of this document may be reproduced in any form whatsoever without prior written permission from the publisher.