INTRODUCTION
I get a lot of pushback from students and entrepreneurs alike with regard to my stance on convertible notes. The following is from one of many blog posts by investor Fred Wilson. Like me, Fred is not fan of notes even SAFE notes.

I have never been a fan of convertible notes. USV has done quite a few convertible and SAFE notes. We are not opposed to convertible and SAFE notes and will not let the form of security the founder wants to use get between us and investing in a company that we like.

But I continue to think that convertible and SAFE notes are not in the best interests of the founder(s).

Here is why:

1. They defer the issue of valuation and, more importantly, dilution, until a later date. I think dilution is way too important of an issue to defer, for even a second.
2. They obfuscate the amount of dilution the founder(s) is taking. I believe a founding team should know exactly how much of the company they own at every second of the journey. Notes hide this from them, particularly the less sophisticated founders.
3. They can build up, like a house of cards, on top of each other and then come crashing down on the founder(s) at some point when a priced round actually happens. This is the worst thing about notes and doing more than one is almost always a problem in the making.
4. They put the founder in the difficult position of promising an amount of ownership to an angel/seed investor that they cannot actually deliver down the round when the notes convert. I cannot tell you how many angry pissed off angel investors I have had to talk off the ledge when we are leading a priced round and they see the cap table and they own a LOT less than they thought they did. And they blame the founder(s) or us for it and it is honestly not anyone's fault other than the harebrained structure (notes) they used to finance their company.

The Series A focused VC firms that often lead the first priced rounds get to see this nightmare unfold all the time. The company has been around for a few years and has financed itself along the way with all sorts of various notes at various caps (or no cap) and finally the whole fucking mess is resolved and nobody owns anywhere near as much as they had thought. Sometimes we get blamed for leading such a dilutive round, but I don't care so much about that, I care about the fact that we are allowing these young companies to finance themselves in a way that allows such a thing to happen.

Here are some suggestions for the entire angel/seed sector (founders, angel investors, seed investors, lawyers):

1. Do priced equity rounds instead of notes. As I wrote seven years ago, the cost of doing a simple seed equity deal has come way down. It can easily be done for less than $5k in a few days and we do that quite often.
2. The first convertible or SAFE note issued in a company should have a cap on the total amount of notes than can be issued. A number like $1mm or max $2mm sounds right to me.
3. Don't do multiple rounds of notes with multiple caps. It always ends badly for everyone, including the founder.
4. Founders should insist that their lawyers publish, to them and the angel/seed investors, a "pro-forma" cap table at the closing of the note that shows how much of the company each of them would own if the note converted immediately at different prices. This "pro-forma" cap table should be updated each and every time another note is isssued. Most importantly, we cannot and should not continue to allow founders to issue notes to investors and not understand how much dilution they are taking on each time they do it. This is WRONG.

Honestly, I wish the whole scourge of notes would go away and we could go back to the way things were done for the first twenty years I was in the venture capital business. I think it would be a better thing for everyone. But if we can't put the genie back in the bottle, we can at least bottle it up a bit better. Because it causes a lot of problems for everyone.[1]

[1] https://avc.com/2019/05/unsafe-notes/