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Advising Venture & Early-Stage Clients: Current Ear-to-the-Ground Assessment

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William & Mary Tax Conference
November 7, 2014
Advising Venture & Early-Stage Clients
Current Ear-to-the-Ground Assessment
Presented by Gary D. LeClair, Esq. with Research Assistance from
David M. Lay, Esq. and Andrew W. White, Esq.

I. Equity Crowdfunding – Hype?

- A. Using internet to sell securities, typically to large numbers in relatively small amounts
- B. Not yet permitted federally. About 12 states have intrastate crowdfunding exemptions
- C. SEC's proposed implementing rules under the JOBS Act have not been finalized
- D. Proposed rules viewed by many as overly burdensome and impractical
- E. Key elements of proposed crowdfunding rules:
 - 1. Aggregate limit of \$1 million from all investors during 12 months
 - 2. Per investor limit: (i) if annual income and net worth < \$100,000, then can invest during 12 months greater of \$2,000, 5% of annual income, and 5% of net worth; or (ii) if either annual income or net worth ≥ \$100,000, then can invest during 12 months greater of \$100,000, 10% of annual income, and 10% of net worth
 - 3. Crowdfunding offering must be conducted via internet through single FINRA-registered broker or SEC-registered "funding portal"
 - 4. Significant up front financial and non-financial disclosure requirements to investors and SEC, including GAAP accrual financials and tax returns for offerings ≤ \$100,000; CPA reviewed GAAP financials for offerings of \$100,000 to \$500,000; and audited financials for offerings >\$500,000
 - 5. Post-offering reports to be delivered to investors & SEC annually, including same type of financials that were required to file at commencement of offering
- F. SEC estimate: broker/portal & compliance fees will eat up 13%-39% of proceeds in < \$100,000 raises
- G. Potentially large number of unaccredited equityholders resulting from crowdfunding round, coupled with annual disclosure requirements/costs, can be potential impediment to later VC/angel round

II. "T-Shirt" Crowdfunding – Hope?

- A. Raising money via internet and social media (Kickstarter, Indiegogo, etc.) in return for "rewards" (e.g., books, concert tickets, video games)
- B. No sale of securities, so no dilution of existing equityholders
- C. Sometimes used to test market demand for company's products and develop customer/fan base

D. Money raised can range from hundred to a million of dollars

E. Smart watch company Pebble E-Paper Watch raised >\$10 million on Kickstarter in 37 days. Oculus raised over \$2 million; subsequently sold to Facebook for \$2 billion

III. Rule 506(c) – Reality?

A. Overview

1. Advertising and general solicitation prohibited in traditional Rule 506 "Reg D" offerings
2. Rule 506(c) adopted under JOBS Act to enable general solicitation if: (i) each purchaser is an accredited investor (or the issuer reasonably believes they are) and (ii) issuer takes "reasonable steps" to verify accredited status
3. Rule does not mandate specific verification procedures. Does provides certain safe harbor verification methods, including written confirmation from attorney/CPA/certain others that she has taken reasonable verification steps within past 3 months and determined that the investor is accredited
4. Failure to take reasonable steps precludes reliance on 506(c), even if all investors actually are accredited
5. The "old" Rule 506 [now Rule 506(b)] remains in effect. General solicitation is prohibited, but "reasonable verification" not required (self-certification generally OK)
6. Most issuers still rely on 506(b) to avoid reasonable verification requirement

B. A Case Study: WealthForge

1. WealthForge is a Richmond-based registered broker dealer and pioneer of using "fintech" in private placements
2. Proprietary technologies include Transaction Engine to facilitate private placements using online tools
3. Promotion of an offering on a public website is a clear form of general solicitation
 - a. Use of Transaction Engine for 506(c) offerings:
 - i. Issuer places "Information on Investing" link on its homepage
 - ii. Investors complete subscription paperwork, including submission of specified materials to verify accredited status, electronically; issuer reviews submissions and may accept or reject subscription
 - b. Use of Transaction Engine for other Reg D offerings that do not permit general solicitation:
 - i. No public-facing investment information, but direct electronic communications (email with link to Transaction Engine) with investors with prior relationship is acceptable

- ii. Investors complete subscription paperwork electronically (self-certification of accredited status is generally OK); issuer reviews submissions and may accept or reject subscription
- 4. As broker-dealer may earn a “Success Fee”
- 5. Crowdfunding is not a priority

IV. Venture Capital Developments in Virginia

A. Entrepreneurship: All the Rage

- 1. Most colleges have entrepreneurship curriculum, some host meet-ups including Startup Weekends, Lean Start-Up, “1,000,000 Cups”
- 2. Organizations such as MAVA, SEVC, Venture Forum RVA host pitch competitions
- 3. Accelerators provide mentorship and capital (“Incubators” are passe)

B. CIT (Center for Innovation and Technology) Continues to be Active

- 1. Makes seed and early stage investments through CIT Gap Funds
- 2. Perceived seal of approval

C. Evolution of Dinner Club model:

- 1. New Dominion Angels: pass-the-hat (not a dedicated fund) dinner club format
- 2. New Richmond Ventures (Richmond), Fortify Ventures’ The Fort (DC), NextGenAngels (DC), 80Amps (Richmond), 1776 (DC)
 - a. Seed and/or Series A plus varying levels of acceleration, from simply sharing contacts to providing daily mentorship and co-working space
 - b. Some have focus on specific industry or technology

V. General Venture Capital Trends

A. Established Market Terms Reign

- 1. West Coast vs. East Coast
- 2. Negotiations limited to:
 - a. Pre-money value
 - b. Dilution from option pool
 - c. Board seats

d. Veto rights

3. Delaware Corps and “C” Corps still Preferred

B. Emergence of Seed Round Convertible Note Offerings (See Exhibits B and C)

1. Convert at $\approx 20\%$ discount to first round

2. Covenant light/no guaranties

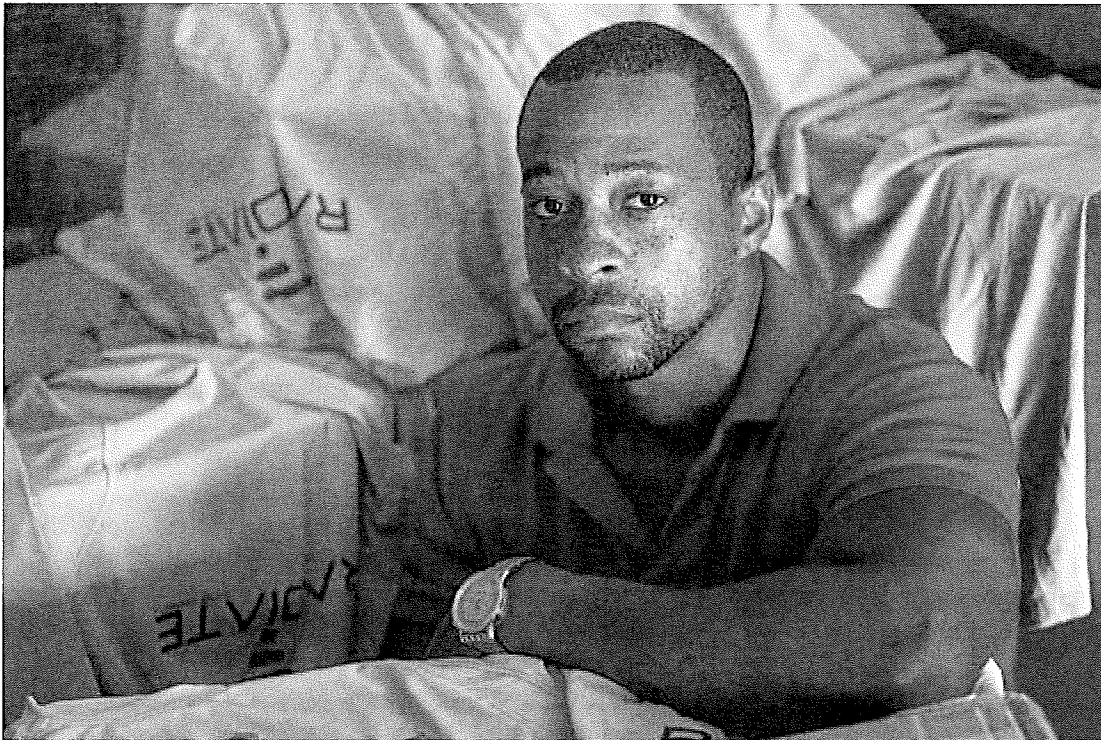
3. Poker money from savvy investors who also have a value add

C. Still “Go West Young Man/Woman”

When a Kickstarter Campaign Goes Very Wrong

Radiate Athletics Raises Over \$500,000, but Scrambles to Meet Demand for Workout Shirts That Change Color

By Angus Loten
Sept. 10, 2014 8:11 p.m. ET



Radiate Athletics' Kenneth Crockett Jr. is still trying to get shirts to contributors following the company's fundraising campaign last year. *Kyle Grantham for The Wall Street Journal*

Many entrepreneurs are using crowdfunding campaigns to raise the profile of their nascent businesses and products, while also raising funds. But the tactic sometimes backfires when a startup isn't prepared for the demand that follows.

Consider the plight of Radiate Athletics and its co-founder Kenneth Crockett Jr. , whose \$55 workout shirts feature "thermochromic" technology so that the fabric changes color during a workout, which the company says shows the muscles that are being used the most.

Last year, Mr. Crockett set out to raise \$30,000 on Kickstarter, where backers contribute to projects in exchange for rewards, ranging from token coffee mugs to preordered goods and services.

Once on Kickstarter, Radiate began a one-month campaign in which it promised to provide one shirt to anyone who gave the company more than \$29. Its reward for the top tier, those who gave \$5,000 or more, was 10 shirts and a tour of Radiate's West Chester, Pa., offices.

Mr. Crockett, who was an early-round participant in The Wall Street Journal's 2013 Startup of the Year contest, hoped the strategy would help the fledgling company to gain attention for its product and pay for its first production run.

Until that point, Mr. Crockett, a former broker in the finance and mortgage industry, had made samples of the shirts by hand in his basement. He figured Radiate could produce small batches of the shirt at a small South Carolina apparel manufacturer.

By the time the month ended, in April 2013, Radiate had raised \$579,599 from 8,556 contributors, many of whom opted for more than one shirt. And that's where everything started to fall apart.

Radiate, just three years old and with three full-time employees, was suddenly on the hook to deliver more than 30,000 orders, some by August 2013, as promised in its online pitch to contributors.

But in June 2013, the South Carolina manufacturer informed Mr. Crockett that it wouldn't be able to handle the order. For starters, he said, the printer ran into problems during a test run, when the shirts' heat-sensitive dyes didn't take to its moisture-resistant fabric. In September, he found a new manufacturer in China that could produce 30,000 shirts in a single week.

The dying process again caused setbacks, mainly because Radiate had promised shirts that were machine washable. To do that, Mr. Crockett said the manufacturer required a hefty investment in high-pressure dying equipment. "So we lost more money," he said. Still, shirts made in early production runs at the China plant are hand-wash only, according to the label.

When an advance run of 3,000 shirts came through that December, Mr. Crockett said he and an assistant hand labeled and shipped orders through the U.S. Postal Service.

Now, more than a year later, about one-third of 30,000 orders from the Kickstarter campaign haven't shipped, said Mr. Crockett, whose co-founder left the business earlier this year. "Demand crushed our supply capability," said Mr. Crockett, adding that he could have been better prepared.

The problem mushroomed into a public relations fiasco after angry Kickstarter backers, posted complaints on Facebook, Twitter and other websites. In the past 30 days alone, nearly 250 messages about Radiate have been posted on Twitter, nearly all complaints, according to Topsy, a social-media search tool.

Mr. Crockett said he fully understands "that waiting a year for a purchase is unacceptable," promising to ship the remaining orders within the next few weeks.

Until this week, a product fulfillment center, hired in February, was withholding the last 30% of the orders until Radiate settled its bill of roughly \$40,000, said Mr. Crockett, who now expects orders to be shipped soon. "The whole thing has been a nightmare," he said.

Ethan Mollick, who teaches management at the Wharton School of the University of Pennsylvania, said Radiate's struggles are fairly typical of startups that overshoot their crowdfunding goals.

In an analysis of more than 471 fundraising projects on Kickstarter that promised goods, Mr. Mollick found that only 25% deliver them on time: "There's a direct relation between how much money you raise over your goal and how late you're going to deliver" to backers, he said. "Startups are killed by growth all the time," he added.

"We see this type of backlash and scramble regularly in our research," said Liz Gerber, a design professor at Northwestern University, who studies crowdfunding platforms. Ms. Gerber said startup founders often "grossly underestimate" demand, and have little or no experience with supply chains or manufacturing to ramp up production quickly.

As crowdfunding becomes more commonplace, consumers are starting to treat it like a service, rather than a fundraising tool, Ms. Gerber said. As such, they expect the same level of service from an early-stage venture, as they do from Amazon or eBay, she said.

Kickstarter, which takes a 5% cut of raised funds when a project meets its target, leaves it to fundraisers to settle any conflicts with their contributors. The site itself doesn't offer refunds.

"While Kickstarter is not a store, after five years and 175,000 projects, creators have an incredible track record of bringing new and untested ideas to life," said Justin Kazmark, a Kickstarter spokesman.

Mr. Kazmark said there's risk inherent in creating anything new, but that the system overall works remarkably well.

That's little consolation to Bruce Fisher, a Kingsport, Tenn., church administrator who contributed \$250 to Radiate's Kickstarter campaign in April 2013, and is still waiting for five shirts and a hoodie from Radiate.

"I appreciate that they're snowed in," said Mr. Fisher. "But it's been one excuse after another. Where are my shirts?"

CONVERTIBLE PROMISSORY NOTE PURCHASE AGREEMENT

This CONVERTIBLE PROMISSORY NOTE PURCHASE AGREEMENT (this “Agreement”) is made and entered into as of September ____, 2014, by and among ____, **Inc.** a Delaware corporation (the “Company”) and the individuals and entities whose names and addresses are set forth on Exhibit A hereto (collectively, the “Investors” and, each individually, an “Investor”). Exhibit A shall be updated as necessary to reflect Investors who become a party to this Agreement after the date first written above.

For good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Company and the Investors hereby agree as follows:

1. Authorization of the Notes. The Company has authorized the issuance and sale to the Investors of convertible promissory notes, in substantially in the form attached hereto as Exhibit B (each a “Note” and, collectively, the “Notes”, which terms also include any notes delivered in exchange or replacement therefor), for an aggregate purchase price not to exceed Five Hundred Thousand Dollars (\$500,000).

2. Purchase and Sale of the Notes.

2.1. Subject to the terms and conditions hereof, the Company agrees to issue and sell to the Investors, and each of the Investors, severally and not jointly, agrees to purchase from the Company a Note in the principal amount set forth opposite such Investor’s name on Exhibit A hereto (the “Purchase Commitment”).

3. Closing.

3.1. The purchase and sale of the Notes shall take place remotely via the exchange of documents and signatures at one or more closings (each, a “Closing”). The date of each such Closing shall be referred to herein as a “Closing Date” and the first such Closing (the “Initial Closing”) shall occur on the date first written above. Any Closing that occurs after the date of this Agreement (each, a “Subsequent Closing”) shall require the mutual approval of ____ Seed Fund LLC (the “Lead Investor”) and the Company. The last Subsequent Closing shall occur no later than September 30, 2014.

3.2. At the Initial Closing, the Lead Investor shall purchase a Note for a purchase price of Two Hundred Fifty Thousand Dollars (\$250,000).

3.3. On the applicable Closing Date, (i) the Company shall deliver to each Investor a Note, dated as of the applicable Closing Date, payable to the order of the Investor in the principal amount set forth opposite such Investor’s name on Exhibit A hereto, and (ii) each of the Investors shall pay to the Company such amount, either via certified check or wire transfer pursuant to written instructions provided to the Investor by the Company.

4. Registration, etc. The Company shall maintain at its principal office a register of the Notes and shall record therein the names and addresses of the registered holders of the Notes, the address to which notices are to be sent and the address to which payments are to be made as

designated by the registered holder if other than the address of the holder, and the particulars of all transfers, exchanges and replacements of Notes. No transfer of a Note shall be valid unless made on such register for the registered holder or his, her or its executors or administrators or his, her, its or their duly appointed attorney, upon surrender therefor for exchange as hereinafter provided, accompanied by an instrument in writing, in form and execution reasonably satisfactory to the Company. Each Note issued hereunder, whether originally or upon transfer, exchange or replacement of a Note or Notes, shall be registered on the date of execution thereof by the Company and shall be dated the date to which interest has been paid on such Notes or Note. The registered holder of a Note shall be that person in whose name the Note has been so registered by the Company. A registered holder shall be deemed the owner of a Note for all purposes of this Agreement and, subject to the provisions hereof, shall be entitled to the principal, premium, if any, and interest evidenced by such Note free from all equities or rights of set-off or counterclaim among the Company and the transferor of such registered holder or any previous registered holder of such Note.

5. Replacement of Notes. Upon receipt of evidence satisfactory to the Company of the loss, theft, destruction or mutilation of any Note and, if requested in the case of any such loss, theft or destruction, upon delivery of an indemnity bond or other agreement or security reasonably satisfactory to the Company, or, in the case of any such mutilation, upon surrender and cancellation of such Note, the Company will issue a new Note, of like tenor and amount and dated the date to which interest has been paid, in lieu of such lost, stolen, destroyed or mutilated Note; provided, however, that if any Note of which an Investor, its nominee, or any of its partners or affiliates is the registered holder is lost, stolen or destroyed, the affidavit of the registered holder, in a form reasonably acceptable to the Company and setting forth the circumstances with respect to such loss, theft or destruction, shall be accepted as satisfactory evidence thereof, and no indemnification bond or other security shall be required as a condition to the execution and delivery by the Company of a new Note in replacement of such lost, stolen or destroyed Note other than the registered holder's unsecured written agreement to indemnify the Company.

6. Use of Proceeds. The Company shall use the proceeds from the transactions contemplated hereby as working capital to support the growth of the Company and for other general corporate purposes.

7. Representations and Warranties by the Company. To induce each Investor to enter into this Agreement and to purchase the Notes hereunder, the Company hereby represents and warrants to each Investor that, as of the applicable Closing Date, the statements in this Article 7 are all true and correct:

7.1. Organization, Standing, Etc. The Company is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and has the requisite corporate and authority to own, lease or operate its properties and to carry on its business as it is now being conducted and as proposed to be conducted.

7.2. Company Acts and Proceedings. This Agreement has been duly authorized by all necessary corporate action on behalf of the Company, has been duly executed and delivered by authorized officers of the Company, is a valid and binding agreement on the

part of the Company and is enforceable against the Company in accordance with its terms, except as the enforceability hereof may be limited by bankruptcy, insolvency, moratorium, reorganization or other similar laws affecting the enforcement of creditors' rights generally and to judicial limitations on the enforcement of the remedy of specific performance and other equitable remedies. All corporate actions necessary for the authorization, creation, issuance and delivery of the Notes have been taken by the Company.

7.3. Valid Issuance. The Company has the requisite corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder, and to issue the Notes.

8. Representations and Warranties of the Investors. Each Investor, severally and not jointly, hereby represents and warrants to the Company that, as of the applicable Closing Date, the statements in this Article 8 are all true and correct:

8.1. Organization. In the event that the Investor is a corporation, limited liability company, limited partnership or trust, it is duly organized or incorporated (as applicable), validly existing and in good standing (as applicable) under the laws of its jurisdiction of organization or incorporation.

8.2. Authorization. The Investor has all necessary power and authority and has taken all appropriate action required to enter into and perform under this Agreement. This Agreement constitutes valid and legally binding obligations of the Investor, enforceable in accordance with its terms, except as the enforceability hereof may be limited by bankruptcy, insolvency, moratorium, reorganization or other similar laws affecting the enforcement of creditors' rights generally and to judicial limitations on the enforcement of the remedy of specific performance and other equitable remedies.

8.3. Investigation; Economic Risk. The Investor acknowledges that the Investor has had an opportunity to discuss the business, affairs and current prospects of the Company with the Company's officers. The Investor acknowledges that it is able to fend for itself in the transactions contemplated by this Agreement and has the ability to bear the economic risks of its investment pursuant to this Agreement.

8.4. Purchase for Own Account. The Notes and the equity securities into which they may be converted (the "Shares") shall be acquired for the Investor's own account, and the Investor is not acting and will not act as a nominee or agent for another party with respect to the Notes or the Shares, and is not acquiring the Notes and will not acquire the Shares with a view to or in connection with the sale or distribution of any part thereof. The Investor has no current plan or intention to engage in any sale, exchange, transfer, distribution, redemption, reduction in any way of the Investor's risk of ownership by short sale or otherwise, or other disposition, directly or indirectly, of the Notes being acquired by the Investor pursuant to this Agreement or the Shares.

8.5. Accredited Investor. The Investor is either an “accredited investor” under Rule 501 of the Securities Act of 1933, as amended (the “Securities Act”).¹

8.6. Exempt from Registration; Restricted Securities. The Investor acknowledges that the Notes have not been registered under the Securities Act or any state securities laws by reason of their contemplated issuance in transactions exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof or Rule 504, 505 or 506 promulgated thereunder and applicable state securities laws, and that the reliance of the Company and others upon these exemptions is predicated in part upon this representation by the Investor. The Investor further acknowledges that the Notes may not be transferred or resold without (i) registration under the Securities Act and any applicable state securities laws, or (ii) an exemption from the requirements of the Securities Act and applicable state securities laws. The Investor also acknowledges that the Shares (and any other securities issued by the Company pursuant to this Agreement or the Notes) will be issued without prior registration thereof under the Securities Act or applicable state securities laws in reliance upon Section 4(2) of the Securities Act and transactional exemptions from registration under applicable state securities laws based upon appropriate representations of the Investor. Accordingly, the Shares will be subject to transfer restrictions similar to the restrictions applicable to the Notes. The Investor acknowledges that (i) an exemption from such registration requirements that would permit transfer of the Shares or other securities is not presently available pursuant to Rule 144 promulgated under the Securities Act (“Rule 144”), (ii) the Company has made no commitment undertake such actions as may be necessary to make the Shares or other securities eligible for transfer pursuant to Rule 144 and (iii) in any event, the Investor may not transfer the Shares or any securities acquired hereunder pursuant to Rule 144 prior to the expiration of a one-year period (or such shorter period as the United States Securities and Exchange Commission (the “Commission”) may hereafter adopt) after the Investor has acquired such Shares or other securities. The Investor understands that any transfers pursuant to Rule 144 can be made only in full compliance with the provisions of Rule 144.

8.7. Restrictive Legends. The Investor acknowledges that each Note, any certificate representing the Shares, and any other instruments representing securities issued in respect of the any of the foregoing upon any stock split, stock dividend, recapitalization, merger or similar event shall bear a legend substantially in the following form (unless no longer required pursuant to the opinion of counsel, which opinion and counsel shall be reasonably satisfactory to the Company):

THIS NOTE AND THE SECURITIES INTO WHICH IT MAY BE CONVERTED HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “ACT”), OR UNDER THE SECURITIES LAWS OF ANY STATE. THESE SECURITIES ARE SUBJECT TO

¹ Need to know if non-US persons are involved and if this offering needs to be a (partial) Reg S offering.

RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE ACT AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. INVESTORS SHOULD BE AWARE THAT THEY MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME. THE ISSUER OF THIS NOTE AND THE SECURITIES INTO WHICH IT MAY BE CONVERTED MAY REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE REASONABLY SATISFACTORY TO THE ISSUER TO THE EFFECT THAT ANY PROPOSED TRANSFER OR RESALE IS IN COMPLIANCE WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS.

8.8. Additional Acknowledgments. The Investor further acknowledges that:

8.8.1. The Notes and the Shares into which they may convert involve a high degree of risk. The Investor is of adequate financial means and has no need for liquidity with respect to the investment contemplated by this Agreement. The Investor considers the investment contemplated by this Agreement as a long-term investment. The Investor can bear the economic risks of its investment pursuant to this Agreement for an indefinite period of time. There is no trading market for this Note or the Shares. Neither the Notes nor the Shares have been registered under federal or state securities laws. The ability of the Investor to sell or otherwise dispose of any of such securities in the future will be limited by, among other things, the federal and state securities laws. Consequently, the Investor may not be able to liquidate his, her, or its investment, or may be able to do so only at a significant discount. The investment contemplated by this Agreement is speculative and subject to a 100% loss.

8.8.2. The Company may issue additional equity interests (including rights and options to purchase equity interests) in the Company after the date hereof. Any such issuances will result in dilution to the then existing holders of equity interests (including holders that received such interests through the conversion of convertible notes prior to such issuance). To attract additional funding, the Company may need to offer potential investors interests in the Company that have rights superior to those of the Investors.

8.8.3. The net proceeds from this financing contemplated by this Agreement may not be sufficient to meet all of the Company's current and long term capital needs relating to the operation and expansion of the business. If the Company is unable to generate sufficient cash flow from operations, it will need to raise additional funds through the offering of private debt or equity securities in order to affect the Company's business strategy. At this time, the Company does not have any firm commitments for any additional financing and there can be no assurance that any additional financing will be available when needed or on terms and conditions acceptable to the Company. The inability to obtain additional financing, when needed, could have a material adverse effect on the Company's operations and business.

8.8.4. The Company's growth is largely dependent on the successful implementation of its business strategy. The Investor acknowledges that there can be no

assurance that the Company will be able to successfully implement its business strategy or that, if implemented, such strategy will be successful. If the Company is unable to implement its business strategy, the Company's results of operations and financial condition could be materially adversely affected.

8.8.5. The Company is at a very early stage of development in light of its expansion objectives, has a very short operating history and may need substantial additional investments of capital to support expansion and achieve its business objectives. The Company may face intense market competition. There can be no assurance that the Company will be successful, and there is no assurance that additional capital, if needed, will be available to Company.

9. Covenants.

9.1. Participation. If, while the Notes remain outstanding, the Company proposes to offer or sell any equity or debt securities (the "New Securities") in a financing transaction other than pursuant to this Agreement and other than in connection with a line of credit extended by a bank or other institutional lender (the "Next Financing"), the Company shall offer each Investor holding Notes with an aggregate principal amount equal to or greater than \$100,000 (each, a "Major Investor") the opportunity to purchase New Securities with an aggregate dollar value equal to the aggregate principal amount of all Notes held by such Major Investor. Either prior to or within thirty (30) days after the first issuance of New Securities, the Company shall give notice (the "Offer Notice") to each Major Investor stating the terms of the Next Financing, including the type and price of securities to be issued, and any purchase of New Securities by any Major Investor shall occur at such price and on such terms as are set forth in the Offer Notice. As a condition precedent to the issuance of any New Securities to a Major Investor, such Major Investor shall be required to execute and deliver to the Company such documents and other instruments as are executed and delivered by other investors in the Next Financing, together with such other documents and instruments as the Company may reasonably request.

9.2. Subsequent Debt Financing. If, while the Notes remain outstanding, the Company sells debt securities (the "New Notes") in a financing transaction other than pursuant to this Agreement and other than in connection with any credit facility extended by a bank or other institutional lender (the "Debt Financing") and terms and conditions of which are deemed by the Requisite Holders (as defined below) to be more favorable to the holders of such New Notes than those contained in this Note, then the terms of the Notes shall automatically be amended to include such terms of the New Notes. The Company shall be required to give the holders of the Notes notice immediately upon the issuance of the New Notes.

9.3. Additional Indebtedness. Without the prior written consent of the holders of a majority of the aggregate outstanding principal amount under all of the Notes, which consent must include the Lead Investor (the "Requisite Holders") but shall not be unreasonably withheld, the Company shall not (A) sell any debt securities ("Subsequent Debt") other than pursuant to this Agreement or in connection with any credit facility extended by a bank or other institutional lender and (B) grant any security interest in any assets of the Company other than in connection with any credit facility extended by a bank or other institutional lender or an equipment lease. If,

prior to the conversion or discharge of the Notes, the Company issues Subsequent Debt and corresponding promissory notes ("New Notes") on terms and conditions more favorable to the holders of such Subsequent Debt than those contained in this Agreement and the applicable Note, then, at the election of the Lead Investor, the Outstanding Amount (as defined in the Notes) of such Investor's Note shall be converted into the principal amount of a New Note; provided, however, that as a condition precedent to the conversion of any Note issued pursuant to this Agreement into a New Note, the Investor holding such Note shall be required to execute and deliver to the Company such documents and other instruments as are executed and delivered by other investors in the Subsequent Debt financing, together with such other documents and instruments as the Company may reasonably request.

9.4. Information. Within forty-five (45) days after the end of each fiscal quarter, the Company shall provide each Major Investor with an update as to the Company's cash balances as of the end of such fiscal quarter, the Company's spending during such fiscal quarter, and the Company's progress towards attaining significant Company milestones.

10. Conversion of Notes. The Notes shall be convertible into Shares in accordance with the terms and conditions set forth in Section 4 of the Notes. All Shares that may be issued will be, upon issuance in accordance with the terms of this Agreement, fully paid and nonassessable and free from all taxes, liens and charges (except for taxes, if any, upon the income of the holder and applicable transfer taxes) with respect to the issue thereof, and the issuance thereof shall not give rise to any preemptive rights on the part of any person. The issuance of the Shares or other securities of the Company in the event of conversion may be further subject to the holders of the Notes entering into one or more agreements relating to the voting and constraints on transfer of such Shares or other securities.

11. Miscellaneous.

11.1. Written Changes, Waivers, Etc. This Agreement and the Notes may only be changed, modified, waived, or discharged with the express written consent of the Company and the Requisite Holders; provided, however, that Exhibit A may be amended by the Company to reflect Investor information upon the issuance of any Note without the consent of the holders of the Notes then outstanding. Any such change, modification, waiver, or discharge shall apply similarly to all of the Investors and/or the holders of the Notes.

11.2. Notices. All notices, requests, consents and other communications required or permitted hereunder shall be in writing and shall be delivered, or mailed first-class postage prepaid, registered or certified mail, as follows:

(a) to the Investors, to: the names and addresses set forth on Exhibit A.

(b) to the Company, to:

Attn: _____

with a copy to:

Such notices and other communications shall for all purposes of this Agreement be treated as being effective or having been given if delivered personally, or, if sent by mail, when received. Any party may change its address for such communications by giving notice thereof to the other parties in conformity with this Section 10.2.

11.3. Delays or Omissions. Except as expressly provided herein, no delay or omission to exercise any right, power or remedy accruing to any party under this Agreement shall impair any such right, power or remedy of such party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence thereto, or of a similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party hereto of any breach or default under this Agreement, or any waiver on the part of any party of any provisions or conditions of this Agreement, must be in writing and shall be effective only to the extent specifically set forth in such writing.

11.4. Other Remedies. Any and all remedies herein expressly conferred upon a party shall be deemed cumulative with, and not exclusive of, any other remedy conferred hereby or by law on such party, and the exercise of any one remedy shall not preclude the exercise of any other.

11.5. Entire Agreement. This Agreement, the exhibits and schedules hereto, the documents referenced herein and the exhibits and schedules thereto, constitute the entire understanding and agreement of the parties hereto with respect to the subject matter hereof and thereof and supersede all prior and contemporaneous agreements or understandings, inducements or conditions, express or implied, written or oral, between the parties with respect hereto and thereto. The express terms hereof control and supersede any course of performance or usage of the trade inconsistent with any of the terms hereof.

11.6. Severability. Should any one or more of the provisions of this Agreement or of any agreement entered into pursuant to this Agreement be determined to be illegal or unenforceable, all other provisions of this Agreement and of each other agreement entered into pursuant to this Agreement, shall be given effect separately from the provision or provisions determined to be illegal or unenforceable and shall not be affected thereby. The parties further agree to replace such void or unenforceable provision of this Agreement with a valid and

enforceable provision which will achieve, to the extent possible, the economic, business and other purposes of the void or unenforceable provision.

11.7. Pronouns. Whenever the context may require, any pronouns used in this Agreement shall include the corresponding masculine, feminine or neuter forms, and the singular form of nouns and pronouns shall include the plural, and vice-versa.

11.8. Successors and Assigns. The terms and conditions of this Agreement shall inure to the benefit of and be binding upon and be enforceable by the successors and assigns of the parties hereto, including the holder or holders from time to time of any of the Notes or Shares.

11.9. Governing Law. This Agreement shall be governed by and construed under the laws of the Commonwealth of Massachusetts, without regard to its choice of law principles.

11.10. Counterparts. This Agreement may be executed concurrently in two (2) or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

11.11. Payment of Fees and Expenses. At the Closing, the Company shall pay the reasonable legal fees and expenses of the Lead Investor, up to a maximum amount of \$12,500.

[Signature Page to Follow]

[Convertible Promissory Note Purchase Agreement]

IN WITNESS WHEREOF, this Agreement is hereby executed as of the date first written above.

_____, CEO

[Signature page to Convertible Promissory Note Purchase Agreement]

INVESTOR:

(Print Name of Investor – if entity, print entity
name; if individual, print your name)

Sign: _____

If entity, complete the following:

Name of Person Signing: _____

Title of Person Signing: _____

Date: _____

[Convertible Promissory Note Purchase Agreement]

Exhibit A

Investors

Name and Address

Purchase Commitment

Exhibit BForm of Note

THIS NOTE AND THE SECURITIES INTO WHICH IT MAY BE CONVERTED HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “**ACT**”), OR UNDER THE SECURITIES LAWS OF ANY STATE. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE ACT AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. INVESTORS SHOULD BE AWARE THAT THEY MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME. THE ISSUER OF THIS NOTE AND THE SECURITIES INTO WHICH IT MAY BE CONVERTED MAY REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE REASONABLY SATISFACTORY TO THE ISSUER TO THE EFFECT THAT ANY PROPOSED TRANSFER OR RESALE IS IN COMPLIANCE WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS.

_____, INC.

CONVERTIBLE PROMISSORY NOTE

\$ _____, 2014

FOR VALUE RECEIVED, _____, **Inc.**, a Delaware corporation (the “**Borrower**”), hereby promises to pay to _____ (the “**Lender**”), on or after _____, 2016² (“**Maturity Date**”), ON DEMAND (but subject to the approval of the Requisite Holders (defined below) and to Sections 4, 5 and 6 herein) the principal sum of \$ _____ together with simple interest on the principal accruing on and from the date hereof at an annual rate equal to seven percent (7%). Interest shall be calculated based on a 360-day year of twelve 30-day months. Notwithstanding any other provision of this convertible promissory note (the “**Note**”), the Lender does not intend to charge and the Borrower shall not be required to pay any interest or other fees or charges in excess of the maximum permitted by applicable law; any

² Insert date that is 18 mos after date of note

payments in excess of such maximum shall be refunded to the Borrower or credited to reduce principal hereunder. Principal and all accrued interest thereon shall be payable in immediately available funds only following an Event of Default (as defined below) in accordance with the terms of this Note, subject to Section 6 herein. This Note is one of a series of Convertible Promissory Notes (collectively, the “Notes”) issued pursuant to that certain Note Purchase Agreement (the “Note Purchase Agreement”), dated as of September __, 2014, between the Borrower and the Investors (as defined therein) and is subject to the terms and conditions of the Note Purchase Agreement. The Notes rank *pari passu* in right of payment, and all payments on the Notes shall be paid to the holders thereof pro rata based on the respective principal balances of the Notes. For the avoidance of doubt, in the event of any migratory merger, reincorporation or similar reorganization of the Borrower in which the shareholders of the Borrower immediately prior to such event continue to own, directly or indirectly, at least a majority of the equity interests in the successor entity following such event (a “Migratory Transaction”), this Note shall become an obligation of such successor entity of the Borrower and such successor entity shall be deemed to be the “Borrower” for all purposes under this Note.

1. Payment. The principal amount of this Note and all accrued and unpaid interest thereon shall be immediately due and payable to the Lender upon the occurrence of an Event of Default (as defined below), subject to the approval of the holders of a majority of the principal amount outstanding of all of the Notes (the “Requisite Holders”) and to Section 6 herein, and unless previously converted into equity securities of the Borrower pursuant to the terms of Section 4 hereof. All cash payments on account of principal and interest shall be made in lawful money of the United States of America at the principal office of the Lender, or such other place as the holder hereof may from time to time designate in writing to the Borrower. The principal and accrued but unpaid interest on this Note (and all of the Notes) shall not be prepaid unless approved in writing by the Requisite Holders.

2. Transfer and Exchange. Subject to the terms set forth below and to the restrictions on transfer contained in the Note Purchase Agreement, the holder of this Note may, prior to maturity thereof, surrender such Note at the principal office of the Borrower for transfer or exchange. Within a reasonable time after notice to the Borrower from such holder of its intention to make such exchange and without expense to such holder, except for any transfer or similar tax which may be imposed on the transfer or exchange, the Borrower shall issue in exchange therefor another note or notes (each also a “Note”) for the same aggregate principal amount as the unpaid principal amount of the Note so surrendered, having the same maturity and rate of interest, containing the same provisions and subject to the same terms and conditions as the Note so surrendered. Each new Note shall be made payable to such person or persons, or transferees, as the holder of such surrendered Note may designate, and such transfer or exchange shall be made in such a manner that no gain or loss of principal or interest shall result therefrom. The Borrower may elect not to permit a transfer of the Note if it has not obtained satisfactory assurance that such transfer: (a) is exempt from the registration requirements of, or covered by an effective registration statement under, the Securities Act of 1933, as amended, and the rules and regulations thereunder, (b) is in compliance with all applicable state securities laws, including without limitation, upon the request of Borrower, receipt of an opinion of counsel reasonably satisfactory to the Borrower; provided, however, that no opinion of counsel shall be required in the event of a transfer to an “affiliate” as defined in Rule 12b-2 of the Securities

Exchange Act of 1934, as amended; and (c) is in compliance with the restrictions on transfer contained in the Note Purchase Agreement.

3. New Note. Upon receipt of evidence reasonably satisfactory to the Borrower of the loss, theft, destruction or mutilation of this Note, including, without limitation, an affidavit of lost, stolen, mutilated or destroyed note, the Borrower will issue a new Note, of like tenor and amount in lieu of such lost, stolen, destroyed or mutilated Note, and in such event the Lender agrees to indemnify and hold harmless the Borrower in respect of any such lost, stolen, destroyed or mutilated Note.

4. Conversion of Note.

(a) Mandatory Conversion of Note Upon Closing of a Qualified Financing. If this Note remains outstanding upon the closing of a Qualified Financing (as defined below) and an Event of Default has not occurred or has otherwise been waived, interest shall stop accruing as of the date of such closing and the entire outstanding amount of principal and accrued but unpaid interest of this Note (the "Outstanding Amount") shall automatically (with no further action required on the part of the Borrower or the lender) be converted into such number of shares of the identical equity security issued to the investors in the Qualified Financing (the "Financing Shares") equal to the quotient obtained by dividing (i) the Outstanding Amount by (ii) the lesser of (y) the Cap Price, or (z) the product obtained by multiplying the price per share at which Financing Shares are sold in the Qualified Financing by **0.80**. At the request of the Borrower and as a condition to receiving such Financing Shares, the holder of this Note shall become a party to all other documents and agreements entered into by the investors in the Qualified Financing; provided, however, that the holder shall be entitled to the same general rights, privileges, powers and benefits afforded to other investors in the Qualified Financing (including, without limitation, registration rights, preemptive rights, tag along rights, come along rights, rights of first and second refusal and the like) but excluding (A) rights that may be afforded to "Major Investors" or similar concepts that may be used in such Qualified Financing (unless the Note holder otherwise meets the qualifications therefore as such concepts may be defined in the definitive documents to be executed in connection with the Qualified Financing) or (B) board rights or observer that are negotiated by certain investors.

(i) Qualified Financing. The term "Qualified Financing" shall mean any equity security financing for the account of the Borrower consummated in one or a series of related transactions (1) which occurs on or before the Maturity Date, and (2) pursuant to which the aggregate gross proceeds received by the Borrower (excluding all of the principal and interest amounts of Notes and any other indebtedness issued by Borrower that are converted in such Qualified Financing) equals or exceeds **\$1,000,000**.

(ii) Cap Price. The applicable "Cap Price" at any point in time shall be equal to the quotient obtained by dividing **\$5,000,000** by the number of shares of common stock in the Company (or ordinary units or its equivalent, "Common Shares") then issued and outstanding, assuming conversion and/or exercise of all stock options and other securities that are convertible into, or exercisable for, shares of the Borrower's Common Shares at such time (excluding any Common Shares or other equity issuable

upon conversion of the Notes issued pursuant to the Note Purchase Agreement or any subsequent note purchase agreement and any Common Shares exercisable upon conversion of the Financing Shares).

(iii) Financing Conversion Procedures. The Borrower shall give notice of the Qualified Financing by mail, postage prepaid, to the holder of this Note as soon as is practicable prior to the closing of said Qualified Financing, but in any event the Borrower shall use commercially reasonable efforts to provide such notice no later than five business days prior to such closing. Such notice shall specify the date of such closing and the price per share at which the Financing Shares shall be issued to the investors in the Qualified Financing. The conversion of the Notes into Financing Shares shall be automatic and without regard to whether or not such notice is given.

(b) Issuance of Financing Shares. Upon the occurrence of the conversion specified in Section 4(a), the holder of this Note shall surrender the Note at the office of the Borrower or of its transfer agent for the applicable number of Financing Shares. Thereupon, there shall be issued and delivered to such holder the Financing Shares to which such holder is entitled pursuant to the terms hereof. The issuance of Financing Shares may be further subject to the holder of this Note entering into one or more agreements relating to the voting and constraints on transfer of such Financing Shares or such other agreements that have been entered into by other holders of the same class or series of equity securities as the holder of this Note shall receive. Furthermore, any certificates representing the Financing Shares of the Borrower that are issued upon conversion may have fixed on them legends restricting the transferability of the Financing Shares.

(d) Cash in Lieu of Fractional Shares. No fractional Financing Shares of the Borrower, or scrip representing any such fractional shares, shall be issued upon conversion of this Note. Instead of any fractional Financing Shares which would otherwise be issuable upon conversion of this Note, the Borrower shall pay to the holder of this Note an amount in cash equal to the fair market value of such fractional Financing Shares determined upon the price per Financing Share paid for the Financing Shares by investors in the Qualified Financing or the applicable Cap Price, as applicable.

(e) Cancellation of Note. Upon the conversion of the entire principal amount of this Note, or the payment of the entire principal amount of this Note and all interest accrued thereon, this Note shall be cancelled.

(e) THE LENDER HAS HAD AN OPPORTUNITY TO OBTAIN THE ADVICE OF THE LENDER'S OWN TAX AND LEGAL ADVISORS REGARDING THE TERMS OF THIS NOTE PRIOR TO ENTERING INTO THE NOTE PURCHASE AGREEMENT AND FULLY UNDERSTANDS AND AGREES TO THE PROVISIONS HEREOF.

5. Default. Any of the following shall constitute an “Event of Default” under this Note:

- (a) The dissolution or termination of business of Borrower;
- (b) Any petition in bankruptcy being filed by or against Borrower or any proceedings in bankruptcy, insolvency or under any other laws relating to the relief of debtors, being commenced for the relief or readjustment of any indebtedness of Borrower, either through reorganization, composition, extension or otherwise, and which, in the case of any involuntary proceedings shall be acquiesced to by Borrower or shall continue for a period of 60 days undismissed, undischarged or unbonded;
- (c) The making by Borrower of an assignment for the benefit of its creditors;
- (d) The appointment of a receiver of any property of Borrower which shall not be vacated or removed within 90 days after appointment;
- (e) Any seizure, vesting of rights of or intervention by or under any authority of any government; or
- (f) The closing or consummation of a sale of the Borrower, whether by merger, transfer of more than fifty percent (50%) of its capital stock (but excluding a Migratory Transaction), or sale of all or substantially all of its assets (a “Sale Event”).

At any time after the occurrence of an Event of Default, and subject to the approval of the Requisite Holders, the entire outstanding amount of principal and interest of this Note shall become immediately due and payable, without presentment, demand, protest or other notice of any kind, all of which are hereby expressly waived.

6. Sale Event. Notwithstanding the foregoing, immediately prior to the closing of a Sale Event, and subject to the approval of the Requisite Holders, the holder of this Note may instead elect to (i) convert all Outstanding Amounts into such number of Common Shares equal to the quotient obtained by dividing the Outstanding Amounts by the Cap Price, or (ii) receive from the Borrower an amount equal to two times (2x) the Outstanding Amount, in either case, in full satisfaction of all obligations due by the Borrower under this Note. The Borrower shall give notice of the Sale Event by mail, postage prepaid, to the holder of this Note as soon as is practicable prior to the closing of said Sale Event, but in any event the Borrower shall use commercially reasonable efforts to provide such notice no later than seven business days prior to such closing.

7. Governing Law. This Note shall be governed by and construed in accordance with the internal laws of the Commonwealth of Massachusetts without giving effect to the principles of conflicts of laws thereof.

[SIGNATURE PAGE TO FOLLOW]

[Signature Page To Convertible Promissory Note]

IN WITNESS WHEREOF, the undersigned has caused this instrument to be executed by its duly authorized officer as of the date first above written.

_____, INC.

_____, CEO

