



**ECHOING GREEN, INC.**  
**Q&A: SEED IMPACT INVESTMENT TEMPLATE NOTE**  
**May 2016**

The following is a selected list of questions and brief answers intended as a guide for users of the Seed Impact Investment Template Note (“SeedIIT”). These questions and answers are not meant to substitute for a thorough understanding of the SeedIIT’s provisions and are not intended to provide any legal, tax or accounting advice. Users of the SeedIIT are urged to consult legal and tax counsel concerning the consequences of issuing the SeedIIT. The SeedIIT should only be used in consultation with legal counsel.

- *Why was this template prepared?* The SeedIIT is meant to be a tool to assist a social enterprise (referred to in this Q&A as the “Company”) in raising financing at an early stage of its development. The SeedIIT was prepared at the direction of Echoing Green with input from Echoing Green social entrepreneur Fellows and is intended to facilitate funding of social enterprises.
- *Who is the SeedIIT designed for?*
  - The SeedIIT is designed to be used for investment into an early-stage social enterprise by institutions and individuals (“Holders”) who are principally concerned with assisting the social or environmental mission of the Company and not with earning a speculative financial return on their investment.
  - Echoing Green broadly defines social entrepreneurs as leaders driving positive social and environmental change all over the world. The SeedIIT is aimed at those leaders who drive positive change via for-profit companies with social and/or environmental missions. The SeedIIT has been prepared under New York law and is intended for U.S. business entities.
- *Why use debt instead of equity?* The use of debt allows the social entrepreneur to retain control of the Company, giving the entrepreneur time to develop the social or environmental goal of the Company. It also avoids the need to assign a value to the Company at an early stage of its development, given that many social entrepreneurs are creating new markets or working in markets with opaque information and few competitors, making it difficult to accurately value the Company. For Holders, the use of debt provides a clear right of repayment and possibly a priority in bankruptcy.
- *When is principal and interest paid?* Interest comes due quarterly but can be converted to principal at the Company’s discretion. This is called “payment in kind” or “PIK” interest.<sup>1</sup>

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<sup>1</sup> Because PIK interest may impose additional tax-related requirements on Holders, investors should consult tax counsel.

Principal is due at maturity, but outstanding principal and interest can be converted into equity prior to maturity, as described below.

- *Why does the template indicate that the maturity date of the SeedIIT should be up to five years after issuance?* This is in order to avoid classification as an applicable high yield discount obligation (“AHYDO”) under the U.S. federal tax code. If the SeedIIT were classified as an AHYDO, the Company’s ability to deduct interest payments made on the SeedIIT would generally be limited. Tax counsel should be consulted for a term of more than five years.
- *When can a Holder of a SeedIIT convert it into equity in the Company?* A Holder may convert the SeedIIT into equity whenever the Company raises financing by issuing equity interests to other investors, including through a “Series A” equity financing or an IPO (each, an “Equity Raise”). If a Holder chooses to convert, it will receive the same amount of equity as if it had participated in the Equity Raise itself by paying cash instead of converting outstanding principal and interest. The SeedIIT also allows for Holders to receive an additional premium over the new investors, which is set at 20% in the template.
- *What stockholder rights does a Holder receive after converting a SeedIIT into equity?* The Holder will receive the same stockholder rights as the equity investors in the Equity Raise in which the Holder chooses to participate.
- *Is the Holder of a SeedIIT required to convert it into equity?* No, there is no requirement for the Holder to convert. If the Holder chooses never to convert the SeedIIT, the Company must repay the Holder the outstanding principal and interest at the date of maturity.
- *Why is there no “valuation cap”?* Convertible debt instruments may include a “valuation cap”, which sets a maximum valuation of the Company for purposes of calculating the amount of equity a holder of the convertible debt will receive at conversion.

No valuation cap is included in the SeedIIT because the Holder will receive equity on the same terms, and is therefore subject to the same valuation, as the investors in the Equity Raise that the Holder chooses to participate in. The lack of a valuation cap allows the Company to defer valuation to a time when its business is more developed.

- *What ongoing obligations does a SeedIIT impose on the Company, other than the payment of interest and principal?* The Company is required to keep certain books and records which can be inspected by Holders, and the Company must deliver quarterly and annual financial information, an annual budget, as well as an annual impact report outlining the Company’s progress on its social and/or environmental mission.
- *Can the Company repay the SeedIIT ahead of schedule?* Yes, if the Company is able to repay the outstanding principal and interest on the SeedIIT ahead of schedule it can do so at its discretion. Principal is repaid at its face amount and no additional premium is payable.
- *What happens to a SeedIIT if the Company is acquired or experiences a change in its ownership?* In the event of a change of control in the Company, the Holder may require the

Company to repay the SeedIIT, or the Holder can keep the SeedIIT after the change of control. This process is separate from an Equity Raise for the purpose of obtaining financing, in which case the Holder would have the right to convert the SeedIIT as described above.

- *Can a Holder of a SeedIIT transfer it to anyone else?* No, the SeedIIT does not permit the Holder to transfer the SeedIIT to a third party without the Company's consent. The Holder may transfer the SeedIIT to a wholly-owned subsidiary without the Company's consent.
- *What happens if the Holder of a SeedIIT is acquired or experiences a change in its ownership?* If the Holder experiences a change in control, the Company has the option to remove the ability of the Holder to convert the SeedIIT into equity. This feature protects the Company from being forced to allow a future Holder that may not be motivated by the social and environmental goals of the Company from potentially owning an equity stake in the Company.
- *Can the Company issue multiple SeedIITs to different investors?* Yes, the SeedIIT permits the issuance of additional SeedIITs of the same series. The Company can issue SeedIITs as part of a single series even if their terms differ.

***The Seed Impact Investment Template Note ("SeedIIT") may not be the right means of financing for all persons and should only be used in consultation with legal counsel and tax, financial and accounting professionals. The SeedIIT and related material (including this Q&A) do not constitute legal, tax, financial or accounting advice.***