

# Claims Chat

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## “Safe” Investors Found to Hold Claims, Not Equity Interests



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On an issue of first impression, the bankruptcy court in *Rhodium Encore*<sup>1</sup> found that holders of a simple agreement for future equity (Safe) held claims, rather than equity interests, providing such holders recoveries ahead of common stockholders, under the bankruptcy priority scheme. The court's decision was driven by two features of the Safes in *Rhodium*: (1) upon certain events, the Safe-holders were entitled to receive back the amount that they had initially paid for the Safes;<sup>2</sup> and (2) the Safe-holders' right to receive the payment had a liquidation priority junior to outstanding indebtedness and creditor claims but senior to common stock. Notably, various equity-like features of the *Rhodium* Safes, such as the absence of a fixed maturity date and regular interest payments and the holders' entitlement to dividends, did not weigh heavily in the court's decision.

As a broader takeaway, the *Rhodium* Safes were drafted using the Y Combinator Safe form as a baseline, which is the standard form of a Safe agreement used by companies utilizing such financing. However, given the deviations made in the *Rhodium* Safes, particularly the removal of references to preferred stock in the liquidation priority provision, *Rhodium* should not be read as a blanket ruling that all Safes will provide holders a claim in a bankruptcy proceeding. Instead, *Rhodium* should be read to provide guidance that courts will pay particular attention to the waterfall provisions of Safes when interpreting such agreements as either equity or debt, even more so than other factors that courts have weighed in prior decisions on the issue.

### Safes' Rise in Popularity Is Presenting a Challenge for Bankruptcy Practitioners

A Safe is an agreement under which an investor, in exchange for a payment to the company, is entitled to receive equity in the company at a future date, typically upon the occurrence of an equity financing. Safes emerged as an alternative to con-

vertible notes in the early 2000s,<sup>3</sup> and in 2013, Y Combinator, a startup accelerator and venture capital firm, created a form of Safe, which today serves as the standard template for startups obtaining early-stage financing.<sup>4</sup>

Unlike debt, Safes typically do not accrue interest and have no maturity date, making them attractive for early-stage companies. Upon an equity financing by the company, the Safe converts to equity, allowing investors to receive shares at a reduced cost.<sup>5</sup> Safe-holders might be entitled to dividends, but until the Safe converts to equity, investors have no voting rights.

The Y Combinator form provides that upon certain liquidity events, such as a merger or an initial public offering, or upon a dissolution of the company, the Safe-holder will be entitled to receive back at least the amount it initially paid for the Safe (the “cash-out amount”). Under its terms, the Safe-holder's right to receive the cash-out amount is junior to payment of all outstanding indebtedness and creditor claims, is on par with payments for other Safes and/or preferred stock, and is senior to payments for common stock.

Airbnb, Dropbox and Uber are a few of the thousands of companies that utilized Safes in their early stages of fundraising.<sup>6</sup> Startups and investors alike prefer Safes over other instruments due to the simplicity and equity/debt hybrid nature of Safes.

Despite their popularity, there had been no clear guidance prior to *Rhodium* from courts on how to classify the rights of Safe-holders. Are they creditors holding claims with priority over the equity interests of equity security-holders, or are they to be treated on par with other equity interests? Chapter 11 plans confirmed by bankruptcy courts have differed in their treatment of

3 Adam Janofsky & Angus Loten, “Startups Offer Unusual Reward for Investing,” *Wall St. Journal* (April 1, 2015), [wsj.com/articles/startups-offer-unusual-reward-for-investing-1427944095](https://www.wsj.com/articles/startups-offer-unusual-reward-for-investing-1427944095) (unless otherwise specified, all links in this article were last visited on Oct. 30, 2025).

4 See Carolyn Levy, “Safe Financing Documents,” Y Combinator, [ycombinator.com/documents](https://ycombinator.com/documents) (various Safe forms and additional information).

5 *Id.*

6 See “What Is a Safe? Startup Financing 101,” *Capboard*, [capboard.io/en/captable/safe-convertible](https://capboard.io/en/captable/safe-convertible).

7 *Compare Local Eateries Inc.*, Case No. 3:25-bk-01131, Docket No. 133 (Bankr. M.D. Tenn. June 16, 2025) (confirming plan that classifies Class 8 Safe claims above Class 9 equity interests), with *Millennial Benefit Mgmt. Corp.*, Docket No. 109, Case No. 23-12083 (Bankr. D. Del. March 7, 2023) (confirming plan treating holders of Safes *pari passu* with common equity).

1 *In re Rhodium Encore LLC, et al.*, Case No. 24-90448, 2025 WL 2501132 (Bankr. S.D. Tex. Aug. 30, 2025).

2 Capitalized terms not otherwise defined in this article shall have the meanings ascribed to them in the *Rhodium* opinion. Unless otherwise stated, all references to docket numbers shall mean the *Rhodium* docket.

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Safes.<sup>7</sup> While bankruptcy courts have developed a list of factors to analyze whether an instrument is debt or equity,<sup>8</sup> its applicability to hybrid instruments like Safes is inherently challenging.

On this issue of first impression, the *Rhodium* court held that the Rhodium Safe-holders were creditors with contingent claims and therefore had priority over common stockholders pursuant to the terms of the Rhodium Safes. Although the terms of the Rhodium Safes differed from the Y Combinator form in a few important respects, the bankruptcy court’s decision will likely influence future analyses regarding the treatment of Safes in bankruptcy cases.

## Rhodium Background

In 2021, Rhodium Enterprises Inc. entered into Safes with various investors.<sup>9</sup> The parties utilized the Y Combinator form as a baseline but removed all references to preferred stock, as Rhodium had no preferred equity.<sup>10</sup> Paragraph 1(d) of the Rhodium Safes, which set forth the Safe-holders’ priority of payment in the event of a liquidation or other events, is compared to the Y Combinator form in the exhibit.<sup>11</sup>

### Exhibit 1

(d) **Liquidation Priority.** In a Liquidity Event or Dissolution Event, this Safe is intended to operate like standard ~~non-participating-Preferred~~ Common Stock. The Investor’s right to receive its Cash-Out Amount is:

(i) Junior to payment of outstanding indebtedness and creditor claims, including contractual claims for payment and convertible promissory notes (to the extent such convertible promissory notes are not actually or notionally converted into Capital Stock); and

(ii) On par with payments for other Safes ~~and/or Preferred Stock~~, and if the applicable Proceeds are insufficient to permit full payments to the Investor and such other Safes ~~and/or Preferred Stock~~, the applicable Proceeds will be distributed pro rata to the Investor and such other Safes ~~and/or Preferred Stock~~ in proportion to the full payments that would otherwise be due; and

(iii) **Senior to payments for Common Stock.**  
The Investor’s right to receive its Conversion Amount is (A) on par with payments for Common Stock and other Safes ~~and/or Preferred Stock~~ who are also receiving Conversion Amounts or Proceeds on a similar as-converted to Common Stock basis, and (B) junior to payments described in clauses (i) and (ii) above (in the latter case, to the extent such payments are Cash-Out Amounts or similar liquidation preferences).

On Aug. 24, 2024, Rhodium and certain of its affiliates filed for bankruptcy in the U.S. Bankruptcy Court for the Southern District of Texas.<sup>12</sup> The Safe-holders filed proofs of claim in the bankruptcy proceeding asserting claims of more than \$70 million, including Celsius Holdings LLC, which asserted claims of more than \$50 million.<sup>13</sup>

The debtors objected to the Safe-holders’ proofs of claim on the grounds that the Rhodium Safes were equi-

ty security instruments, and therefore, the Safe-holders held mere equity interests that should recover on par with common stock. The debtors pointed to language in paragraph 1(d) of the Rhodium Safes stating that they were “intended to operate like standard Common Stock” upon the occurrence of a liquidity or dissolution event.<sup>14</sup> The debtors also argued that the parties’ deletion of the references to preferred stock in the description of priorities indicated that they intended for the Safes to sit on par with common stock.

The debtors also emphasized that other features of the Rhodium Safes demonstrated that the parties intended for the agreements to be treated as equity, including that the Safe-holders were entitled to dividends.<sup>15</sup> In support of their arguments, the debtors drew parallels to a series of bankruptcy court decisions<sup>16</sup> that considered whether warrants were deemed equity interests rather than debt claims.<sup>17</sup> Similar to warrants, the debtors argued, the Rhodium Safes lacked a fixed maturity date and did not accrue interest, among other features of equity.

## The Bankruptcy Court’s Ruling

After analyzing the Rhodium Safes and noting that the dispute was an issue of first impression, the bankruptcy court overruled the debtors’ objection to the Safe-holders’ claims and held that the Safe-holders held contingent claims, not equity interests, and that pursuant to the Rhodium Safes, such claims were senior to common stock. The court first explained that the definition of “claim” under 11 U.S.C. § 101(5)(A) includes a “right to payment, whether or not such right is reduced to judgment, liquidated, fixed, *contingent*, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.”<sup>18</sup>

Under the Rhodium Safes, upon either a liquidity or dissolution event, the Safe-holders were entitled to elect to recover at least their cash-out amount, which is the amount they initially paid for the Safes.<sup>19</sup> This entitlement to the cash-out amount provided the Safe-holders with a “right to payment” that was “contingent” upon a triggering event, such as a dissolution or liquidation. Therefore, the Safe-holders clearly held “claims” as defined in the Bankruptcy Code.<sup>20</sup>

14 *Id.* at 2. Under the Rhodium Safes, “liquidity event” referred to various events, such as mergers, sales of substantially all assets and initial public offerings. “Dissolution event” referred to various other events, such as a voluntary termination of operations, a liquidation, dissolution or winding up of the company.

15 *Id.*

16 *Carrieri v. Jobs.com Inc.*, 393 F.3d 508 (5th Cir. 2004); *In re Washington Mut. Inc.*, 464 B.R. 656 (Bankr. D. Del. 2012).

17 Docket No. 1401, p. 13.

18 *Id.* at 13 (emphasis in original).

19 *Id.*

20 While the parties extensively briefed on whether a dissolution event or liquidity event occurred, the court summarily found that the confirmation of the liquidating plan would constitute either a liquidity event or dissolution event, thus providing for a triggering event giving rise to a Safe-holder’s entitlement to the cash-out amount. *Id.* at 18.

8 See, e.g., *In re Washington Mut. Inc.*, 464 B.R. 656 (Bankr. D. Del. 2012) (providing list of factors that courts consider in determining whether an instrument is equity, including (1) whether the holder’s right is guaranteed; (2) the name of the instrument; (3) the parties’ intent; (4) the presence or absence of a fixed maturity date; (5) the right to enforce principal and interest payments; (6) the presence or absence of voting rights; and (7) the holder’s priority in payment).

9 *Rhodium Encore*, 2025 WL 2501132, at \*1.

10 *Id.* at 2, 16 (discussing that Rhodium was not permitted to issue preferred stock under their articles of incorporation).

11 Docket No. 1356-25, Ex. 76.

12 *Rhodium Encore*, 2025 WL 2501132 at 1.

13 *Id.* at 1, 4.

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The court rejected the debtors’ argument that the opening sentence of paragraph 1(d) of the Rhodium Safes, which stated that the Safes were “intended to operate like standard Common Stock,” established that the Safe-holders held equity interests, not claims, in the event of a liquidity or dissolution event. Based on the interpretation principle that the “general does not detract from the specific,”<sup>21</sup> the court found the opening sentence of paragraph 1(d) to be “general language without much explanation,” and thus could not override the more specific language in paragraph 1(d) providing that the cash-out amount is “[j]unior to payment of outstanding indebtedness and creditor claims” and “[o]n par with payments for other [Safes],” and that the conversion amount (which is a different amount payable upon certain triggering events) is “on par with payments for Common Stock” but junior to payment of outstanding indebtedness and creditor claims and payment of cash-out amounts.

According to the court, the fact that the title of the paragraph was “Liquidation Priority” and provided that the conversion amount was on par with common stock and junior to cash-out amounts, and that the cash-out amount was junior to payments of outstanding indebtedness and creditor claims, the only reasonable conclusion was that the cash-out amount was senior to common stock. Those specific clauses overrode the general language cited by the debtors about the Safes operating like common stock.<sup>22</sup>

The court also distinguished the Rhodium Safe-holders from typical stockholders. Whereas stockholders “place their money at the risk of the business” and are not protected if the company fails, the Rhodium Safe-holders were, to some extent, protected because upon a liquidity event or a dissolution event, the Safe-holders were entitled to receive at least their cash-out amounts (or their *pro rata* share of proceeds after all creditors are paid). Even though a liquidity event or a dissolution event might never occur, the Safe-holders’ rights to receive the cash-out amount if such an event were to occur was, according to the court, “the essence of the description of a contingent claim.”<sup>23</sup>

The court was not swayed by the fact that the Rhodium Safes included equity-like features, including that the Safe-holders were entitled to dividend payments to the extent any dividends were provided to holders of common stock.<sup>24</sup> While acknowledging that potentially receiving a dividend “may provide some support for the notion of an equity interest,” that fact did not change the reality that the Rhodium Safes provided the holders with a contingent claim for the potential cash payout.<sup>25</sup> The court’s decision did not address other equity-like features of the Rhodium

Safes, such as the absence of a fixed maturity date and interest payments, but it did add that the Safe-holders’ lack of voting rights supported the conclusion that they held contingent claims.

The bankruptcy court also found the case law presented by the debtors regarding warrants and other types of instruments to be distinguishable from the Rhodium Safes. Unlike those other cases, which “were all about receiving stock” upon certain events, the Rhodium Safes are “more than an agreement for potential equity but are also an agreement that if there is a Liquidity or Dissolution Event, the [cash-out] Amount (at a minimum) will be returned to the investor.”

The bankruptcy court found the debtors’ remaining arguments unpersuasive and ultimately overruled the debtors’ objections to the Rhodium Safe-holders’ claims.<sup>26</sup> The bankruptcy court also held that paragraph 1(d) of the Rhodium Safes constituted a subordination agreement, pursuant to which the Safe-holders’ claims were junior to payment of outstanding indebtedness and creditor claims, but not to common stock.

However, the *Rhodium* decision is not yet “safe.” On Sept. 15, 2025, the debtors appealed the bankruptcy court’s decision to the U.S. District Court for the Southern District of Texas. As a matter of first impression, it will be interesting to see whether the district court will agree with the bankruptcy court’s conclusions and/or provide further guidance on the treatment of Safes.

### A New Standard for Safes?

Although the terms of a Safe may differ from case to case, the *Rhodium* decision will likely impact future analyses regarding the treatment of Safes in bankruptcy cases. Notably, the court seemed to give little weight to the factors courts have traditionally employed in determining whether an instrument is debt or equity. Rather, the court seemed to be most persuaded by the Rhodium Safes’ cash-out amount provisions, including that the Safe-holder enjoyed priority of payment over equityholders.

An open question remains as to whether the *Rhodium* court would have reached a different conclusion — namely, that the Safe-holders held equity interests rather than claims — if the Y Combinator form was used without alteration. The Y Combinator form provides that a Safe-holder’s entitlement to the cash-out amount is on par with other Safes *and/or* preferred stock. In the Rhodium Safes, the references

26 The court also rejected the debtors’ argument that even if the Safe-holders held claims, such claims were subordinated to all other general unsecured creditors and on par with common equity. Section 510(b) of the Bankruptcy Code subordinates “a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security.” The court found § 510(b) inapplicable because the Safe-holders sought neither “damages” nor “rescission” of the Rhodium Safes. As stated by their counsel, the Safe-holders sought “exactly the opposite. The SAFE parties are arguing that the SAFE contracts are valid and enforceable and should be enforced... The SAFE parties are merely arguing ... that they’re creditors and that their right to payment of [the] cash-out amount has to be satisfied before equity is entitled to annual [sic] recovery, exactly as the contracts provide.” *Rhodium Encore*, 2025 WL 2501132 at 18.

21 *Thompson Street Capital Partners IV LP v. Sonova United States Hearing Instruments LLC*, No. 166, 2024, 2025 WL 1213667, at \*8 (Del. April 28, 2025).

22 *Rhodium Encore*, 2025 WL 2501132 at 14-15.

23 *Id.* at 15.

24 The court cited, but did not discuss in detail, the nonexhaustive list of factors courts have considered in determining whether an instrument is equity or debt. See *In re Washington Mut. Inc.*, 464 B.R. 656 (Bankr. D. Del. 2012).

25 *Id.* at 16.

to preferred stock were removed, and as a result, the Safe-holders' right to payment of the cash-out amount was senior to the holders of equity interests.

Following *Rhodium*, the Y Combinator form's position that the Safe-holder's right to the cash-out amount is "on par" with preferred stock (*i.e.*, equity securities) could change

a court's view as to the nature of the Safe-holder's rights. Startups and investors may avoid ambiguity by clearly stating in the Safe how the cash-out amount and other potential payment rights should be treated relative to equity-holders in a bankruptcy case. **abi**