Cooley

Launch of the Future Fund

May 19, 2020

The UK government's Future Fund scheme, aimed at UK startups in response to the impact of COVID-19, officially launched on 18 May 2020. The UK government, partnering with the British Business Bank, will deliver an initial commitment of up to £250 million under the scheme, which will need to be matched by private investors (meaning an aggregate of £500 million of funding), and will be structured as unsecured convertible loans.

The scheme was first announced on 20 April 2020 with the publication of the scheme's proposed headline terms. Full details of the scheme are now published.

Future Fund eligibility

Companies

For a company to be eligible for the scheme:

- The company must have raised at least £250,000 in equity for cash from third-party investors in previous funding rounds in the last five years (from 1 April 2015 to 19 April 2020, inclusive)
- If the company is a member of a corporate group, it must be the ultimate parent company
- The company does not have any of its shares or other securities listed on a regulated market, a multilateral trading facility, a recognised investment exchange and/or any other similar market, stock exchange or listing venue
- The company must be a UK incorporated private limited company
- The company must have been incorporated on or before 31 December 2019
- At least one of the following must be true for the company:
    - Half or more employees are UK based
    - Half or more revenues are from UK sales

Companies that have received other types of UK government aid related to COVID-19 are not excluded from applying for the scheme.

Investors

For an investor to be eligible for the scheme they must fall within *any* of the following categories:

- An "investment professional" within the meaning given to that term in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO)
- A high-net-worth company, unincorporated associated or high value trust falling within article 49(2) of the FPO
- A "certified sophisticated investor" or a "self-certified sophisticated investor" within the meaning given in articles 50 and 50A respectively of the FPO
- A "certified high net worth individual" within the meaning of Article 48 of the FPO
- An equivalent professional, high-net-worth, institutional or sophisticated investor in accordance with applicable law and regulation in such investor's home jurisdiction
- An association of high-net-worth or sophisticated investors within the meaning of article 51 of the FPO
- Capable of being classified as a "professional client" within the meaning given in the glossary to the FCA Handbook.

Type of funding

To be eligible for the scheme, all scheme funding is required to be convertible loans on the same terms and on

the same prescribed form convertible loan agreement being used by the Future Fund on the scheme. This means that other investments being made at the same time as those pursuant to the scheme, whether a priced equity round or even another convertible note funding, will not count as part of the scheme and as such will not count towards the matched funding element, even if the terms are essentially the same as those for the scheme. Investments made prior to the scheme will also not be counted.

It is also now clear that the scheme is not going to be compliant for EIS purposes. The UK government has confirmed that existing EIS investments will not be affected where the convertible loan converts into shares, and in connection with potential redemption of the loans, the materials indicate that the UK government intends to make changes to the rules to clarify that this is compatible.

Matched and non-matched funding

The minimum amount of the loan provided by the Future Fund to each company under the scheme will be £125,000 (so a total matched loan funding of £250,000), with the maximum amount being £5 million (so a total matched funding of £10 million). All investment funds need to be in GBP.

There will be a period of 90 days after the main matched funding element with the Future Fund has closed (referred to in the loan agreement as the 'headroom period') whereby a company will be able to take on additional loans from additional lenders who will be required to be parties to the same loan agreement by entering into the subscription deed scheduled to the main loan agreement. It isn't clear whether the 'additional lenders' can also be investors who participated in the matched funding part of the loan. The amount of the loans that can be taken on during the headroom period is uncapped, although will not be matched by the Future Fund. There is a requirement that companies notify all investors in the scheme at the expiry of the headroom period of the total amount raised and the identity of the additional investors.

A solicitor's client account will be required to hold all the matched investors monies pursuant to the scheme.

Future Fund application process

Investor led, company checked

Applications will be investor led and processed on a "first come first served basis" through a special online application portal, which is due to open on Wednesday (20 May 2020) and which the 'lead investor' will get access to by creating an account on the British Business Bank's website. This lead investor (who has to be providing a minimum of £12,500 of the matched funding element) will be required to provide information regarding the investment and other matched investors, and confirm their own eligibility. Full details of the information required from the lead investor as part of the application can be found in the investor FAQs in the Future Fund section of the British Business Bank website.

The application is then submitted to the company in question, who will check the information and details provided by the lead investor, provide additional information and submit the application. See the company FAQs on the Future Fund section of the British Business Bank for full details of the company information required for the application. Once the application has been accepted, the Future Fund will send the company and the matched investors the convertible loan agreement for e-signing. In order to complete the funding under the scheme, the Future Fund requires receipt of:

- The convertible loan agreement signed by all other parties
- The signed director's certificate
- The solicitor's confirmation letter confirming receipt of and holding in its client account of the matched investor loan monies

Once all of this is in place, the Future Fund will circulate a fully executed copy of the convertible loan agreement, and shall pay its monies to the same solicitor's client account, all monies held may then be released to the company. Applications are expected to take a minimum of 21 days from initial application to funding being awarded.

Fair access

If an investor 'batch submits' multiple applications on the same day and there are a high number of other applications on that day then only one application made by that investor may be processed on that day. This approach is designed to reduce privileged access by more advanced investors, but without slowing investment by the Future Fund.

Diversity and inclusion

Questions on diversity and inclusion will be included as part of the application process to help monitor the diversity of the portfolio of loans backed by the scheme. There is also a statement that the Future Fund is a signatory to HM Treasury's Investing in Women Code and is encouraging other investors to become signatories also. It doesn't appear that any preference will be given to companies applying to participate in the scheme with diverse teams.

Right to change

The Future Fund retains its right to alter the application process, eligibility criteria and allocation criteria at any time, with details of any such changes posted on the British Business Bank website.

Use of proceeds

The loan monies received by a company cannot be used for the following things:

- To repay any borrowings from a shareholder of the company or a shareholder-related party (other than the repayment of any borrowings pursuant to any bank or venture debt facilities)
- Pay any dividends or other distributions
- For a period of 12 months from the date of the convertible loan agreement, make any bonus or other discretionary payment to any employee, consultant or director of the company other than as contracted prior to the date of the agreement and as paid by the company in the ordinary course of business
- Pay any advisory or placement fees or bonuses to any corporate finance entity or investment bank or similar service provider on monies advanced by the Future Fund

Convertible loan agreement

Most of the terms in the form convertible loan agreement are reflective of the initial headline terms, although there are a few differences. One thing that is clear is that other than the ability for the matched investors to increase the discount and interest rate above 20% and 8% respectively, and add a valuation cap, there is no scope for changing or negotiating anything on the agreement – it is to be entered into as is.

The key terms contained in the loan agreement are as follows:

- **Discount** – The loans will convert upon a next equity funding round at a 20% discount to the price to be paid by investors for shares in that equity funding round. The discount rate may be increased if agreed between the company and the matched private investors (it cannot be decreased below 20%), in which case such increased discount shall also apply to the loan made by the Future Fund. The discount rate shall not apply where the loan converts into the most recent funding round of the company where such round took place prior to the 'base date', being 20 April 2020
- **Valuation cap** – There will be no automatic valuation cap, although a valuation cap may be added if agreed between the company and the matched investors, in which case such valuation cap shall also apply to the loan made by the Future Fund
- **Interest** – The loans provided under the scheme will accrue interest at 8% per annum or any higher rate agreed between the company and the matched investors. On conversion of the loans, only the principal amount of the loans will convert at the discount rate; accrued interest converts without any discount. The company shall have the option of repaying the accrued interest rather than have the interest convert with the principal amount of the loans
- **Maturity date** – The loans provided under the scheme will have a maturity date of three years
- **Conversion/repayment events**
    - **Qualifying fundraising** – If there is an equity funding round at least equal to the aggregate amount of the loans

provided under the scheme (matched and unmatched), all loans provided to a company pursuant to the scheme will automatically convert into the same class of shares as issued to investors in that round at the agreed discount (or valuation cap, if there is one)

- **Non-qualifying fundraising** – At the election of the holders of a majority of the principal amount of the loans held by the other investors (i.e., not the Future Fund), referred to in the agreement as the 'lender majority', all loans provided to the company under the scheme will convert into the same class of shares as issued to investors in that funding round at the agreed discount (or valuation cap, if there is one), provided that if the amount being raised in the non-qualifying fundraising is equal to or less than 25% of the aggregate principal amount of all the loans a company has taken in pursuant to the scheme, then the consent of the Future Fund is also required (this additional consent is referred to in the agreement as a 'relevant majority')
- **Sale/IPO** – All loans provided under the scheme will either automatically convert into the most senior class of shares in issue at the time of the exit at the conversion price or be repaid with a redemption premium (being a premium equal to 100% of the principal of the bridge funding, i.e., 2x the loan), whichever provides the greater amount for the investors in respect of their loans under the scheme. If the consideration being provided as part of the exit contains any non-cash consideration, then the lender majority (in respect of all loans other than the loan made by the Future Fund) and/or the Future Fund (in respect of its loan only) can elect instead to be repaid with the redemption premium
- **Maturity date** – The loans will automatically convert into the most senior class of shares in the company in issue on the maturity date, or, the lender majority (in respect of all loans other than the loan made by the Future Fund) and/or the Future Fund (in respect of its loan only) can elect instead to be repaid with the redemption premium
- **Events of default** – On an event of default, each investor in the scheme can require repayment of its loan plus interest at the redemption premium. A breach of certain of the covenants in the agreement constitute events of default in favour of the Future Fund

- **Covenants** – There are a number of covenants given by the company to the investors in the scheme, but there are also some covenants that are given by the investors in favour of the company and each other investor. Investors looking to participate in the scheme should review these and be sure these are covenants they are each able to provide. Some of the key covenants are as follows –
  - **Information rights** – prescribed financial information is to be provided by the company to the Future Fund, and on written request from the Future Fund, the same information that is provided to the company's 'lead and/or major' investors pursuant to any shareholders' agreement that is in place between the company and such investors
  - **Negative pledge** – the company will not, without relevant majority approval, permit the creation of any indebtedness that is senior to the loans provided under the scheme, other than any bona fide senior indebtedness from a person that is not an existing shareholder or scheme investor or pursuant to any bona fide venture debt facilities
  - **Anti-abuse** – there a number of protections against abuse that have been built into the agreement
    - A trade-up right for investors in the scheme in the event of a preferential funding round in the six-month period following conversion of the loans
    - The right for investors in the scheme to enhanced consideration in the event of a sale/IPO in the six-month period following conversion of the loans in a non-qualified financing
    - The company and other investors in the scheme are required to act in good faith with respect to the Future Fund and must not act in any way, including by the entering into of any side arrangements, which would adversely affect the economic interests of the British Business Bank pursuant to the scheme, or treat it in a manner which is disproportionate to the manner in which other investors in the scheme and/or shareholders in the company are treated
    - There is also a £1 put-option in place to protect against potential reputational harm to either the Future Fund or the UK government
  - **Portfolio transfer right** – The Future Fund will be entitled to transfer its interests under this scheme without restriction to an 'institutional investor' that is acquiring a portfolio of the Future Funds' interest in at least 10 companies owned in respect of the scheme, other than any investor whom the board of the company reasonably determines is a competitor of the company. An institutional investor is an investor whose principal business is to make investments, or manage or advise upon investments for investors of the foregoing.
  - **Most-favoured nation** – in the event that prior to conversion the company issues further convertible loans or advance subscriptions to investors with more favourable terms than those provided to the investors on their loans under the scheme, those terms will apply to the loans provided under the scheme. There is a requirement on the company to

notify each investor in the scheme of such an arrangement and provide documents and details of such favourable rights.

- **Governance rights** – The Future Fund's governance rights will remain limited as expected from the scheme's headline terms, but the agreement provides a right for the Future Fund to request a meeting with an investee company once a conversion event is to take place in order to discuss in good faith governance rights that may be afforded to the Future Fund on conversion of its loan that are to be commensurate with its shareholding in the company
- **Warranties** – The company will provide limited warranties to the investors under the scheme, including satisfying the 'eligibility criteria', good standing, authority to enter into the agreement, compliance with laws and constitutional documents, conduct of the business in all material respects, and no litigation or proceeding likely to have a material adverse effect on the company. There is no scope here for any disclosures to be made against these warranties, which are in fact more limited than those set out in the scheme's headline terms. Investors will be required to warrant its eligible investor status, as set out in the eligibility criteria above

What should those looking to participate in the Future Fund scheme do now?

Companies and investors participating in the scheme should familiarise themselves with the company FAQs and investor FAQs and what will be required in making the application. Some of the information required for the application can take some time to get hold off, so the earlier this process can be started the better. In particular:

- Where there will be multiple matched investors participating in the scheme, identify and agree who is going to the lead investor. This lead investor will be required to provide details of the total amount of matched funding proposed to be raised under the scheme, along with contact details and amounts to be invested by all other matched investors, so make sure the lead investor has all this information as early as possible
- A copy of the ownership structure chart or supporting documentation showing all ultimate beneficial owners owning 25% or more of the company is required as well as all intermediary beneficial owners
- Be clear on the amount of matched funding being sought. It is not yet clear whether the matched investment can be changed once the application has been made.

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