Cooley

Future Fund to Assist UK Startups

April 27, 2020

The new Future Fund scheme, aimed at UK startups in response to the impact of COVID-19, will launch in May 2020 and is expected to remain open until the end of September 2020. The UK government, through the British Business Bank, will make up to £250 million available 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.

There is still a fair bit of detail yet to be announced, including full eligibility criteria, the application process, how to determine the amount of loans to specific companies, and when the scheme will officially launch, but here is what we currently know….

Eligibility

To be eligible for the scheme, companies must:

- be an unlisted UK registered company that is the ultimate parent company
- have previously raised at least £250,000 from private investors in previous funding rounds within the last five years
- have a substantive economic presence in the UK

What yet isn't clear is:

- Does the £250,000 need to be from one or more equity financings and/or convertibles?
- What is sufficient to constitute a "substantive economic presence"?
- Will there be any interaction between this scheme and the popular EIS and VCT incentive schemes?
- How does an individual applicant determine how much funding it is eligible for under this scheme?

Headline terms

The terms set out below are the headline terms of the scheme published by the UK government on its **website**. The expectation is that these will form the basis of a (still to be provided) prescribed form convertible loan agreement that each of the UK government, the company and the private matching investors will sign up to.

1. **Matched funding**: The UK government will require any loan it makes to a company to be matched by third-party private investors. It is unclear yet whether these matched investors will also be subject to any eligibility criteria, but the expectation is that the scheme will not be limited to UK-based investors.
2. **Loan size**: The minimum amount of the loan provided by the UK government to each company 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). There will be no cap on the amount that the matched investor(s) may invest pursuant to the convertible loan and therefore no cap on the aggregate funding being provided.
3. **Loan term**: The loans provided under the scheme will have a maturity date of a maximum of three years.

4. **Use of proceeds**: The loans provided under the scheme can be used solely for working capital purposes and cannot be used by the company to repay any borrowings, make any dividends or bonus payments to staff, management, shareholders or consultants or, in respect of the loan provided by the UK government, pay any advisory or placement fees or bonuses to external advisers. There are details still to be announced, but the expectation is that these limitations will not prevent companies operating in the ordinary course, and as such, they will be permitted to make contractual repayments under existing debt facility arrangements and adequately employ and incentivise talent.
5. **Discount**: The loan 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 UK government.
6. **Valuation cap**: There will be no valuation cap on conversion (as might be the case in early-stage convertible loan or advance subscription agreements), 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 UK government.
7. **Conversion/repayment events**
    a. *Qualifying fundraising:* If there is an equity funding round at least equal to the aggregate amount of the loans provided under the scheme, 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 rate.
    b. *Nonqualifying fundraising:* At the election of the holders of a majority of the principal amount of the loans held by the private investors (i.e., not the UK government), 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 discount rate.
    c. *Sale/IPO:* All loans provided under the scheme will either convert into shares issued in the most recent nonqualifying fundraising of the company 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 higher amount for the investors in respect of their loans under the scheme, with the discount rate being applied in the case of conversion into any nonqualifying fundraising that took place after the issuance of the convertible loans.
    d. *Maturity date*: On maturity of the loans, at the option of the holders of a majority of the principal amount of the loans held by the private investors (i.e., not the UK government), the loans shall either: (i) be repaid with the redemption premium; or (ii) convert into shares in the company at the discount rate to the price paid for shares in the most recent funding round of the company, provided that the UK government's loan shall convert into shares unless it requests repayment of its loan. It isn't clear whether the repayment will be at the redemption premium or just the principal amount of the loan. The discount rate shall not apply to the most recent funding round of the company where such round took place prior to the issuance of the scheme.
8. **Interest**: The loans provided under the scheme will accrue interest at 8% per annum or any higher rate agreed between the company and the private 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.
9. **Conversion equity/trade-up**: If after conversion of the loans, a further funding round is completed within six months of conversion where a more senior class of shares are issued, the investors pursuant to the scheme will be entitled to convert the shares in the company they received on conversion of their loans into such

senior class of shares. As the UK government is not able to set a qualifying funding round threshold that is specific for each company, it requires this trade-up right as a protection against the conversion of the loans into non-bona fide funding rounds.

10. **Decision making**: The UK government will have limited corporate governance rights during the term of the loans provided under the scheme and as a shareholder following conversion of the loans.
11. **Warranties**: The company will provide limited warranties to the investors under the scheme, including in respect of title and ownership, capacity, eligibility, compliance with law, the borrowing facilities of the company, litigation and insolvency events. We do not yet know the exact warranties required, but the expectation is that these will be suitably high-level and compliance-oriented not to require any disclosures.
12. **Covenants**: The company will provide limited covenants during the term of the loan and following conversion of the loan, including undertaking to treat the investors pursuant to the scheme, and the holders of the shares on conversion of the loans, fairly and equally, to provide the same information rights as other investors in the company and to comply with legal obligations.
13. **Most-favoured nation:** In the event that prior to conversion the company issues further convertible loans to investors with more favourable terms than those provided to the investors on their loans under the scheme (including the UK government), those terms shall apply to the loans provided under the scheme.
14. **Negative pledge**: The company will not 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 private investor having made a loan to the company under the scheme. While not yet explicit, the expectation is that this requirement would not prevent the company from taking such things as venture debt.
15. **Transfer rights**: The UK government will be entitled to transfer its interests under this scheme without restriction to an institutional investor that is acquiring a portfolio of the UK government's interest in at least 10 companies owned in respect of the scheme. In addition, the UK government shall be entitled to transfer any of its shares without restriction within UK government and to entities wholly owned by central government departments (similar to normal permitted transfer rights). The expectation is that this will be subject to certain protections for companies, such as the restriction on transfers to competitors.

What can companies do now?

We do not yet know some fundamentals on the scheme, such as the exact eligibility criteria, the application process or the date the scheme is expected to go live (other than the current expectation that this will be sometime in May). However, that doesn't mean companies should just wait for its formal launch. UK startups interested in participating in the scheme that meet the eligibility criteria that we know so far should consider taking the following steps so that they are prepared and ready to go as soon as the scheme opens and applications can be made:

- Consider with your board and investors how much you may want to raise from this scheme.
- Start discussions with the potential lead investors that will be matching under the scheme. This may be existing investors or new ones.
- Work with your advisors using the scheme's headline terms (as set out above) to set basic terms with your lead matching investors. Other than the variables on the discount, valuation cap and discount as explained above, you should assume that nothing else in the convertible loan agreement to be used in the scheme will change or be up for negotiation. You should assume you will not be able to get creative to give a different or clever deal to certain investors. Everyone will be signing up to the same documents.
- Consider what consents and approvals you'll need, and start to socialise with the relevant parties – in most cases these are likely to be the normal shareholder resolutions for disapplication of preemption rights and authority to allot shares, contractual investor

majority consents under your existing shareholder's agreement, and maybe those from any existing debt provider such as a venture debt lender.

- If you expect your next round to be a down round (or down, inclusive of the discount being provided under the convertible loans), consider the likely impact of any antidilution adjustments in your current articles of association. Whilst cash is king, raising more than you need, and having that convertible loan convert into a lower-priced equity round, will have dilutive consequences, including possibly antidilution for your current investors, that you'll want to think through. As an additional note of caution, if your lead/matched investors are expecting to add a valuation cap and/or increase the discount and/or interest rate, this could increase the chances of triggering antidilution in the next round.

Further updates to follow as soon as more information on the scheme is announced.

Key Contacts

Aaron Archer London	aarcher@cooley.com +44 (0) 20 7556 4366
Ryan Naftulin London	rnaftulin@cooley.com +44 (0) 20 7556 4540