

UK Announces Full Details of Future Fund Scheme to Support Startups in COVID-19 Era

The scheme opens on 20 May 2020 and is available on a “first come, first served” basis.

On 18 May 2020, the UK government released a draft of its convertible loan note agreement and details of the application process for the Future Fund scheme, having announced the headline terms of such scheme on 20 April 2020. (See [UK Announces New Funds to Support Startups in the COVID-19 Era](#)).

This *Client Alert* addresses some of the questions that investors and companies are likely to have in relation to the Future Fund scheme.

Eligibility (Company)

To be eligible for the Future Fund, a startup company must:

- Be an unlisted UK-registered company (if the company is a member of a group, only the ultimate parent company, if a UK registered company, is eligible to receive the loan)
- Have been incorporated in the UK on or before 31 December 2019
- Attract the equivalent funding from third-party private investors and institutions, such that the funding from the UK government is no more than 50% of the aggregate bridge funding
- Have previously raised at least £250,000 in equity investment from third-party investors in the last five years (1 April 2015 to 19 April 2020 (inclusive))
- Ensure that either half or more of the company's: (i) employees are UK-based; or (ii) revenues are from UK sales (this was previously the requirement for the startup company to have a “substantive economic presence in the UK”)

Eligibility (Investor)

To be eligible for the Future Fund to co-invest alongside the UK government, each such investor in a startup company must be one of the following:

- An “investment professional” within the meaning given to that term in article 19 of the 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 “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
- An entity capable of being classified as a “professional client” within the meaning given in the glossary to the FCA Rules

How much funding can be accessed?

The loan provided through the Future Fund to startup companies will be from £125,000 to £5 million, and must be at least matched by investors. Overall, the UK government has made £250 million available under the scheme (although it is reviewing the aggregate amount available and timeline of the Future Fund in case of excessive demand).

How do companies apply?

The Future Fund opens on 20 May 2020 and will continue until the end of September 2020. Applications are available on a “first come, first served” basis, with no amounts reserved for companies in a particular sector or companies in particularly difficult circumstances.

Applications can be submitted online via the Future Fund’s portal at www.uk-futurefund.co.uk (which is due to open on 20 May 2020). The application process is investor-led, and the lead investor will need to apply on behalf of itself, the other investors, and the company, with the company verifying the information submitted later in the process (the information requirements to submit the application and which are to be verified can be found [here](#)). Companies can, however, still register their interest in the scheme. Once the application is approved, the parties will enter into the convertible loan note agreement.

An investor with investments in multiple companies that qualify for the scheme will need to submit separate applications for each company.

How much funding must the lead investor provide?

The lead investor must fund at least £12,500.

How long will the application process take?

It is estimated to take a minimum of three weeks from the time the application is submitted to the company receiving the funds, but this may vary depending on a variety of factors, including the speed at which information is provided.

Is the Future Fund eligible for SEIS and EIS? Will it affect the SEIS or EIS compatibility of previous investments?

No, the Future Fund is not eligible for SEIS and EIS, therefore such relief is not available. The scheme is not expected to affect previous SEIS or EIS investments where the loan converts into equity. Where the loan is to be redeemed, emergency legislation is expected to be passed to clarify that such redemption is compatible with SEIS and EIS.

Should investors seeking to benefit from SEIS and EIS wish to participate in this funding round, an alternative is an advance subscription agreement, however, companies and investors should note that the convertible loan note agreement contains a most-favoured nation provision (see below for further details).

Do advance subscriptions qualify as matched funding?

No, nor do they count towards the eligibility requirement of the company having raised £250,000 in the previous five years.

Does founder finance count as investment from third-party investors?

No, funding from founders, officers, employees, consultants, or any of their connected persons will not count towards the eligibility requirement of the company having raised £250,000 in the previous five years; however, investment from a non-executive director or an investment director (in their personal capacity) will count towards this threshold.

Are there any other requirements on the part of the company or investors?

Investors are encouraged to become signatories of the Investing in Women Code, and the British Business Bank is expected to monitor investors' commitment to this Code.

Companies will need to appoint solicitors to act for them as the funds will be distributed directly to the company's solicitors for onward payment to the company. This provides for the funding to be released faster as it avoids the need to conduct thorough KYC checks on the recipient.

Is the convertible loan note agreement negotiable?

No, the form of the convertible loan note agreement is non-negotiable, save for the interest rate, conversion discount, headroom amount, and valuation cap, which are negotiable between the investors (other than the Future Fund) and the company. However, the parties should note that the interest and discount rates cannot be lower than 8% and 20%, respectively. If no headroom amount or valuation cap is agreed, they will default to zero and none, respectively.

The non-negotiable status of the majority of terms was designed with speed in mind — to reduce the time spent negotiating the terms with a variety of parties and allowing funds to be released earlier.

What are the key terms of the convertible loan note agreement?

- **Simultaneous funding:** The amount to be provided by the UK government is to be matched on completion by investors; however, the company is able to raise additional financing for a further 90 days after completion, subject to such additional investors adhering to the terms of the convertible loan note. Such additional financing, however, will not be matched by the Future Fund.
- **Discount rate:** The principal amount of the loan will convert into the most senior class of shares on the next qualifying funding round (being a round at which proceeds raised equal at least the aggregate bridge funding provided) at a minimum discount rate of 20% (the Discount Rate) (subject

to any valuation cap), with a repayment right in respect of the accrued interest. If the matched investors agree a deeper discount with the company, the UK government would have the benefit of a larger discount.

- **Non-qualifying round conversion:** On a non-qualifying round, at the election of the holders of a majority of the principal amount held by the matched investors (excluding the Future Fund) (the Lender Majority), the loans shall convert into the most senior class of shares issued at the Discount Rate, subject to any valuation cap, provided that the Lender Majority and the Future Fund (the Relevant Majority) may jointly elect to so convert if the amount raised on such non-qualifying round is equal to or less than 25% of the loans outstanding.
- **Exit events:** On a sale or IPO of the company (an Exit Event), the loan shall either convert into the most senior class of shares issued at the Discount Rate (subject to any valuation cap) or be repaid with a redemption premium (being a premium equal to 100% of the principal of the bridge funding (the Redemption Premium)), whichever shall provide the higher amount for the lenders. A new anti-embarrassment right has also been included providing protection if an Exit Event occurs within six months of a non-qualifying round in which the lenders have converted into equity, pursuant to which they shall be entitled to receive the higher of: (i) the consideration for the sale of their shares and (ii) the principal of the loan plus accrued interest and the Redemption Premium.
- **Maturity:** On maturity of the loan, at the option of the Lender Majority, the loan shall either: (i) be repaid with the Redemption Premium or (ii) convert into equity at the Discount Rate, provided that the Future Fund's loan shall convert into equity unless it requests repayment of its loan. The loan will mature after 36 months and cannot be repaid; it is likely, therefore, that the Future Fund will eventually become a shareholder in the company, and companies should consider any future impact having the Future Fund as a shareholder may have on prospective investors.
- **Interest-bearing loan:** The loan shall accrue interest of at least 8% per annum (non-compounding) unless the matched investors agree to a higher interest rate, with the accrued interest payable on conversion (either wholly or partially in cash or in shares, at the board's discretion) or on an event of default (in cash).
- **Use of proceeds:** The funding cannot be used to: (i) repay any shareholder debt, (ii) pay any dividends or other distributions, (iii) pay, within 12 months of the agreement, any bonus or other discretionary payment to employees, consultants, or directors of the company other than those which have been contracted prior to the date of the agreement and which are paid in the ordinary course of business, or (iv) pay any advisory or other similar corporate finance fees in relation to obtaining funding under the Future Fund scheme.
- **Limited governance rights:** The UK government shall, during the term of the loan, be entitled to receive quarterly reporting information (e.g., revenue, EBITA, cash flow, performance against budget, etc. — see schedule 4 of the convertible loan note agreement, available [here](#)), and at its request, such other information provided to the company's investors. Prior to the loan converting, the company and the Future Fund shall discuss in good faith the scope of any shareholder governance rights to be afforded to the Future Fund which shall be commensurate with its shareholding, although it is expressly stated that no such rights need to be agreed by the company. In addition, each of the company and the other lenders covenant to the Future Fund that they will not, among other things, enter into any side agreement or arrangement that would be adverse to the economic interests of the Future Fund, and will treat the Future Fund equally with other lenders and shareholders.

- **No valuation cap:** The default position is that there is no valuation cap; however, if agreed by the matched investors and the company, then such a cap would apply.
- **Most-favoured nation:** The Future Fund will automatically benefit from any favourable terms contained in convertible loan note instruments or advance subscriptions issued subsequently to any lender or subscriber relating to security, interest, conversion, repayment, and/or undertakings — companies should be mindful of this provision when seeking additional bridge financing during the term of the loan. If the loans convert into equity and within six months of the date of conversion a new round is raised in which new senior ranking shares are issued, the shares held by the lenders shall be deemed to convert into such senior ranking shares unless they decline.
- **Warranties:** The UK government requires warranties from the company relating to the company's eligibility under the scheme, compliance with laws, borrowing facilities, litigation, insolvency, authority, and capacity — these go beyond current market practice for convertible loan note instruments and are absolute in nature with limited materiality, awareness or reasonableness qualifications, and with no ability to disclose against these. Companies should carefully review these warranties to ensure that they can give such warranties, especially in light of the impact the COVID-19 pandemic is having on its business. Warranties are also required from matched investors that they are a qualifying investor and have the authority and capacity to enter into the convertible loan note agreement.
- **Other debt:** No senior ranking indebtedness to the loan shall be permitted without the consent of the Relevant Majority, other than bona fide senior indebtedness from a person (including any bona fide venture debt facilities) that is not an existing shareholder (or a connected person) or lender. In practice, a company is unlikely to seek secured debt financing from its shareholder base (the norm is to achieve this through convertible loan note instruments), so this is unlikely to be a real restriction on companies.
- **Transferability:** The Future Fund shall be permitted to transfer the: (i) loan as though the permitted transfer regime applicable to the most senior ranking class of shares applies to such loan and (ii) shares to an institutional investor (other than one which the board reasonably determines is a competitor) that is acquiring a portfolio of the UK government's interest in at least 10 companies owned in respect of the scheme. This may result in an undesirable institutional investor acquiring an interest in the company, and founders and existing shareholders should be aware of this possibility, although the addition of the competitor carve out addresses some of the initial concerns.

Next steps

Companies and their investors should carefully review the eligibility requirements and terms of the convertible loan note agreement to determine whether or not to apply for assistance under the Future Fund scheme. Prior to filing an application, investors should begin to compile the required information, while companies should assist the investors by making sure the required information is ready and available, to avoid delays in the submission of the application. Companies interested in applying for the scheme should have already commenced discussions with investors, and if they have not, they should do so as a matter of expediency.

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If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Robbie McLaren

robbie.mclaren@lw.com
+44.20.7710.1880
London

Mike Turner

Mike.Turner@lw.com
+44.20.7710.4642
London

Shing Yui Lo

shing.lo@lw.com
+44.20.7710.1817
London

Terry Charalambous

terry.charalambous@lw.com
+44.20.7710.3095
London

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