Goodwin Alerts

May 04, 2020

Answers to FAQ about the UK Government's 'Future Fund' Financing Package

by Adrian Rainey, Sophie C. McGrath, Robert Young, Adam Thatcher

On 20 April 2020, the UK government ("Government") announced the Future Fund, providing financing to UK companies (including to start-ups and scale-ups in the technology and life sciences sectors) in the form of a convertible loan which is invested directly by the Government alongside private investors.

Goodwin assembled and led the legal task force advising the Government on this groundbreaking scheme, and we wanted to share the most frequently asked questions and our thoughts, based on the currently available terms.

The proposed detailed terms of the Future Fund can be found in a term sheet available here. The term sheet states these are 'Headline Terms' and full and final details, including in respect of eligibility criteria, will be published shortly.

ECONOMIC TERMS

What is the Future Fund?

It is a pot of money to be invested directly by the Government including into UK start-ups and scale-ups in the technology and life sciences sectors. It is not a grant – it is a financial investment in the form of a convertible loan, and is similar in form and substance to that which companies would receive from a private investor or a venture capital fund on a bridge funding round. As a convertible loan, it is convertible into shares.

What are the key economics?

- *Government Loan*: minimum loan of £125,000 and a maximum loan of £5,000,000, matched by one or more private investors, but with no limit on matched investor amount(s) above that matched funding amount.
- *Loan Length*: maximum 36 months.
- *Discount Rate*: 20%, unless a higher rate agreed by the company and matched investors.
- *Interest*: 8% non-compounding, unless a higher rate agreed by the company and matched investors. On conversion of the principal, there is a repayment right, in the company's discretion, of the interest i.e., although the principal amount of the loan will convert at the 20% discount rate, the company can elect to repay the accrued interest. Any interest not repaid converts but not at the discount rate.
- *Valuation Cap*: none, unless agreed by the company and matched investors.
- *Conversion Share Class*: always the most senior share class issued in the converting round.
- *Repayment*: cannot be repaid at the election of the company but it is repayable in some circumstances (sale, IPO or at maturity) with a 100% redemption premium.

Would the Government receive different economic terms than matched investors?

Based on the Headline Terms, the Future Fund convertible loan would set the minimum economic terms, which would be adjusted and aligned with matched investors if they agreed better terms with the company. In addition, the Headline Terms refer to a 'most favoured nation' clause in the event that further convertible loan instruments are issued by the company following the date of the issue of the Future Fund convertible loan on more favourable terms – in that scenario, those more favourable terms would apply to the convertible loans under the Future Fund.

Does the Government receive the same redemption premium as matched investors?

Yes. Based on the Headline Terms, when the loan is repaid to investors, a 100% redemption premium would be payable to all such investors.

ELIGIBILITY AND USE OF FUND

What are the eligibility criteria to participate in the Future Fund?

The Headline Terms set out the following eligibility criteria:

1. The company is an unlisted UK registered company;
2. The company has a substantive economic presence in UK;
3. The company has raised at least £250k from private investors in the last five years; and
4. If the company is part of a corporate group, it must be the ultimate parent company of that group.

The Government states in the Headline Terms that full eligibility criteria will be published shortly and so these criteria may be subject to further modification. We expect further details will be published in order for companies to ascertain how these eligibility criteria will apply in practice.

Can companies use the funds to pay existing debt?

According to the Headline Terms, a convertible loan issued under the Future Fund cannot be used to repay any borrowings. However, this does not prevent the company using other funds to repay debt. It is also possible for a company to have existing venture debt and / or to take subsequent venture debt.

MATCHED FUNDING

Can the matched funding be invested as normal equity?

Based on the Headline Terms, the Future Fund requires the matched investment from private investors to be in the same form as the Government's investment, i.e. a convertible loan on the Government's minimum terms. Equity would not count towards the matched funding requirement but we cannot see anything that would prevent the company completing an equity fundraise *alongside* the convertible loan(s), albeit the equity component would not count towards the matched funding requirement.

Can companies include recently raised capital towards the matched funding?

The Headline Terms imply that the matched funding needs to be 'fresh cash'. If an equity or a convertible round has already closed and the cash has been received by the company, it appears that the Future Fund will not be available for that cash. If this remains the case once full details have been announced, companies could consider whether the structure of the round can be adjusted to meet the criteria of the Future Fund in the event that they are currently:

1. Negotiating a new funding round;
2. Midway through an existing funding round that has a "follow-on" component; or
3. Midway through an existing funding round that is subject to a tranched investment, where not all tranches have been drawn down.

Does the loan only apply to matched funds raised after the launch date?

Based on our interpretation of the Headline Terms, this appears to be the case, subject to the company satisfying the final eligibility criteria and ensuring the terms of those matched funds are consistent with the Government's minimum terms.

SEIS AND EIS RELIEF

Will the convertible loan qualify for SEIS or EIS relief?

Based on the Headline Terms, as is the case generally, convertible debt instruments would not meet current SEIS or EIS qualifying requirements. As a result, investors that wish to make a matched investment alongside the Future Fund would not be entitled to the relevant tax relief that would be applicable on an SEIS or EIS qualifying equity investment. However, investors would receive the benefit of the conversion discount, interest and redemption premium as set out in the Headline Terms.

Is there another option for SEIS or EIS investors?

The convertible loan itself would not preclude the company from obtaining equity investment in the ordinary course, separate from matched investment alongside the Future Fund. Companies could therefore complete both a convertible round (using the Future Fund) and an equity round, with SEIS or EIS investors participating in the latter and obtaining reliefs, subject to the investor and the company satisfying the relevant qualifying conditions.

How would the convertible loan interact with existing and future SEIS or EIS relief?

If an investor held shares with existing SEIS or EIS relief and they wanted to participate in a convertible loan, the convertible loan would not of itself compromise that existing relief, subject to the investor and the company satisfying other qualifying conditions. However, if the convertible loan converts into shares (which do not qualify for SEIS or EIS relief), based on the current law that shareholder could not claim SEIS or EIS relief for a subsequent equity investment. This is because a shareholder cannot receive EIS or SEIS relief on a future investment if they hold any shares that did not qualify for EIS or SEIS relief.

CORPORATE GOVERNANCE

What other rights and consents will the Government have under the Future Fund?

The Headline Terms state that the Government will have “limited corporate governance rights” and companies will provide “limited covenants to the Government” during the term of the loan and, in the event the loan converts into shares, following conversion as a shareholder. The Future Fund therefore contemplates a ‘light touch’ approach, with minimal input required from the Government. The Government will be entitled to limited transfer rights: (1) within Government (2) to entities wholly owned by central government departments and (3) to an institutional investor that acquires a portfolio of the Government’s interest in at least 10 companies under the Future Fund.

PRACTICALITIES

Is there a restriction on the total number of loans under the Future Fund?

The Headline Terms do not express a maximum number of loans or companies that can access the Future Fund. However, based on the currently announced numbers (a minimum Government loan amount of £125,000 and an initial total fund of £250,000,000), it would mean no more than 2,000 companies could access the Future Fund. In practice we would expect different companies to take different amounts and so this number would likely be lower.

When will the product be available?

According to the Government’s website, the Future Fund will launch in May 2020 and it will initially be available until the end of September 2020. Beyond that, the current guidance is unclear as to how and when delivery takes place and on what timescales.

Will applications be determined on a first-come, first-served basis?

The Headline Terms do not currently provide details of how the application process will be carried out in respect of eligible companies. We expect further details on how applications will be made to be available shortly and the delivery mechanism will be an important part of the success of the Future Fund.

How can companies get ready?

Companies should monitor the Government's website for further guidance on the terms and eligibility criteria, when released. In the meantime, if the Future Fund is potentially of interest, companies can start having discussions with potential investors to try and build a syndicate around these terms, noting that the current Headline Terms indicate matched funding can only be fresh capital. To the extent companies are going to need shareholder and board approval for the convertible loan (which would normally be the case for this type of investment), companies should start thinking about how they will obtain it in short order.

* * *

This is a general presentation about rapidly-changing issues. It should not be construed as legal or tax advice, which may vary depending on relevant facts and circumstances. Anyone contemplating applying for a Future Fund convertible loan or participating in matched investment should take their own legal and tax advice in relation to the implications of so doing.

If you have a particular situation on which you need advice, please reach out to your Goodwin contact and we can make sure to connect you with the Goodwin task force addressing these issues.

Please also look out for additional resources and webinars on this topic from Goodwin.

* * *

Visit Goodwin's **Coronavirus Knowledge Center**, where lawyers from across the firm are issuing new guidance and insights to help clients fully understand and assess the ramifications of COVID-19 and navigate the potential effects of the outbreak on their businesses.

CONTACTS:

Adrian Rainey
Partner
+44 (0)20 7667 3550
+44 (0)1223 738801
arainey@goodwinlaw.com

Sophie C. McGrath
Partner
+44 (0)20 7447 4821
smcgrath@goodwinlaw.com

Robert Young
Partner
+44 (0)20 7447 4282
ryoung@goodwinlaw.com

Adam Thatcher
Associate
+44 (0)1223 738805
athatcher@goodwinlaw.com
