UK GOVERNMENT FUTURE FUND FOR INNOVATIVE COMPANIES

April, 2020

On Monday 20 April, the UK Government announced a stimulus measure (the "**Future Fund**") aimed at supporting UK start-ups which will provide convertible loans of between £125,000 to £5,000,000 to eligible UK start-ups.

The announcement of the Future Fund is welcome support for the UK's start-up sector and will be of valuable assistance to some businesses which are being adversely affected by COVID-19. However, the terms (as currently published) are weighted in the Government's favour and therefore start-ups should consider all their options (in conjunction with their advisors) prior to accepting finance from the Future Fund.

The headline terms of the Future Fund, as well as points to note, are outlined below. Further details are available here.

Key Terms and Considerations

#	Item	Key Details	Baker Botts' points to note
1.	**Scheme Period**	May 2020 until September 2020	This is an initial period and may be extended.
2.	**Lending Partner**	The British Business Bank	As with the Business Interruption Loan Scheme (CBILS), it is anticipated that the Future Fund will be accessed via accredited lenders. To date, the accredited lenders under the CBILS scheme have been criticised for failing to meet demand and there is concern that this could also affect the Future Fund scheme.
3.	**Eligible Companies**	Initial eligibility criteria are as follows: a) private companies registered in the UK; b) company has historically raised at least £250,000 (in aggregate) from private third party investors in previous funding rounds in the last five	Clearly further clarification of the eligibility criteria is required, and we are expecting this to be provided in the coming weeks. It would be helpful for start-ups if a level of flexibility is included in the eligibility criteria (e.g. if a company has

		years; c) company has a substantive economic presence in the UK; and d) if company is part of a group, only the ultimate parent company is eligible to receive the loan	raised £250,000 funding during the past 5.5 years).
4.	**Size of Loan**	Between £125,000 and £5,000,000. The Government will initially make £250,000,000 available.	When accepting loans, companies should be mindful of the affect this will have on their balance sheet. Accepting high levels of debt can result in start-up companies becoming balance sheet insolvent (where a company's total liabilities outweigh its assets).
5.	**Interest**	8% per annum (non-compounding)	The interest rate for the loans is relatively high and could result in interest costs of up to £1,200,000 (assuming borrowing of £5,000,000 and a 3-year term). Notwithstanding the above, higher interest rates are common for early-stage companies as this reflects the investment risk.
6.	**Term**	Maximum term of 36 months	This is typical of a convertible loan.
7.	**Security**	Loans will be unsecured	This is typical of a convertible loan.
8.	**Matched Funding Requirement**	The Government will only provide loans alongside private third party investors. The Government loan shall constitute no more than 50% of the funding being provided to the company	This will require companies to source funding from private third-party investors, something which may currently be challenging. In practice, existing investors/ shareholders are likely to be the most practicable source of matched funding. It does not appear that matched investors are obliged to subscribe on the same terms as the Government. However, where a matched investor subscribes on more

			favourable terms, the general principle is that the Government will also be entitled to subscribe on those more favourable terms.
9.	**Use of proceeds**	The loan may only be used for working capital	This is typical of a convertible loan.
10.	**Conversion/ Repayment**	The loan shall automatically convert into equity upon the company's next Qualifying Fundraising Round at a minimum conversion discount of 20% to the price set at that funding round. A 'Qualifying Fundraising Round' is one where the company raises an amount of equity capital equal to at least the aggregate amount of the funding provided by the Government and the matched investor. The loan may also convert on a funding round which doesn't meet the Qualifying Fundraising Round threshold. Any such conversion will be at the discretion of the holders of the majority of the principal amount held by the matched investors. Upon a **sale** or **IPO**, the loan shall either: a) convert to equity at the discount rate to the price set by the most recent non-qualifying funding round; or b) be repaid with a redemption premium (the redemption premium being 100% of the principal amount), whichever will provide the higher amount for the lenders. On **maturity**, the loan shall: a) convert to equity at the discount rate to the price set by the most recent funding round; or b) be repaid by the company with a redemption premium (being 100% of the principal amount), at the election of the holders	Companies should be mindful that, subject to the principal amount of the loan, if the loan converts to equity, the Government (and matched investor) could have significant shareholdings in the company. This will impact governance and there may also be state ownership implications. Any repayment of the loan is subject to a repayment premium of 100% of the principal amount, which is financially onerous. Taking the example of a £5,000,000 loan which is repaid at the end of the three-year term, this would result in the company repaying £11,200,000 (i.e 224% of the principal amount).

		of the majority of the principal amount held by the matched investors. On a **sale, IPO** or **maturity**, if there has been no equity fundraising round since the issuance of the loan, the loan shall convert without a discount rate. Upon conversion, only the principal shall convert at the discount rate. Any interest shall convert without a discount rate.	
11.	**Share Class**	Upon conversion, the loan shall convert into the most senior class of shares in the company. For example, if preference shares are issued as part of a funding round the loan shall convert into preference shares. If a further funding round is completed within six months of conversion, the Government and matched investor shall be entitled to convert their shares into the shares issued as part of the subsequent round.	Although conversion into the most senior class of shares is common, the additional conversion right is uncommon.
12.	**Governance Rights**	The Government shall have limited corporate governance rights during the term of the loan and as a shareholder.	Companies should be mindful of the potential implications regarding state ownership and control over the business. Companies should seek to minimise governance rights where possible.
13.	**Transfer Rights**	The Government shall be entitled to transfer the loan (and following conversion any shares) without restriction to any institutional investor, provided such investor acquires an interest in at least ten Future Fund companies.	As either the loan or equity can be transferred without restriction, companies should be mindful that they will have no control over the lender/ shareholder. This could have significant implications going forwards, particularly if the loan coverts to a substantial percentage of the company's shareholding (per point #10).

For more information about our Corporate practice, click here.

Please feel free to contact Derek Jones, David Ramm, and Daniel Green.