

# UK Government Releases Full Details of its Future Fund Scheme to Support Innovative Companies Facing Financial Difficulties Due to COVID-19

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UK Corporate

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The UK Government has released the full details of its Future Fund scheme, including the application process, together with the template convertible loan agreement. The Future Fund, the headline terms of which were announced on 20 April 2020 (see our [Alert of 22 April](#)), launched on 20 May 2020 and will initially be open until the end of September 2020.

The purpose of this briefing is to summarise the key terms of the Future Fund now that full details have been released and to provide insights into the guidance provided that will be of interest to investors and companies who may consider participating in the scheme.

## COVID-19 Package to Protect UK Businesses

The Future Fund scheme forms part of a wider £1.25 billion COVID-19 package to protect businesses driving innovation in the UK. The remaining £750 million is being made available through the UK's national innovation agency, Innovate UK, and is targeted at small and medium-sized businesses that are focused on research and development. Whilst existing customers of Innovate UK will receive the majority of this funding in the form of grants and loans, the Government announced that £175,000 of support will be offered to each of around 1,200 customers that do not currently receive Innovate UK funding, equating to just under 30% of the total funding. This scheme launched on 15 May 2020.

Companies that have received other types of Government aid related to COVID-19 are not excluded from applying to the Future Fund. This briefing focuses on the Future Fund only.

## Future Fund

Under the new Future Fund scheme the Government will offer funding to innovative UK registered companies facing financial difficulties due to the COVID-19 outbreak. The Government has committed an initial £250 million to the Future Fund, which is being delivered via the British Business Bank, with this amount subject to review.

## Application Process

A lead investor, on behalf of itself or an investor syndicate, has to make the application to the Government, although companies are still able to register their interest. Applications are expected to take a minimum of 21 days from initial application to funding being awarded.

Eligible companies will be offered convertible loans of between £125,000 and £5 million, provided that this amount is matched by private investors such that the funding from the Government is no more than 50% of the aggregate funding. The private investors and the Future Fund must both invest in the Company using the template convertible loan agreement, to ensure the investments are made on standardised terms. The convertible loans will have a maximum term of three years.

## Eligibility

The eligibility requirements have now been published. Companies need to meet the following criteria to access the loan:

1. be an unlisted UK registered company, incorporated on or before 31 December 2019;
2. if the company is a member of a corporate group, it must be the ultimate parent company;
3. have a substantive economic presence in the UK—the test being, either (i) half or more of the employees are based in the UK, or (ii) half or more of the revenue is from UK sales;
4. have previously raised at least £250,000 in equity investment from third-party investors in the last five years; and
5. crucially, must obtain at least equal match funding from third-party private investors and institutions.

## Key Terms

A form of the convertible loan agreement has been made available [here](#) (the **Agreement**) and sets out the key terms and conditions, the most important of these being summarised below.

The Agreement is a fixed, non-negotiable standard form document. However, certain terms, including the interest rate, conversion discount, headroom amount and valuation cap are (in certain cases between specified bands) negotiable between the investors (other than the Government) and the investee company in advance of application. The same terms are applicable to both the Government and the private investors and everyone invests pursuant to the same agreement.

## Conversion/Repayment

*Conversion:* On a conversion, the principal amount of the loan will convert into the most senior class of shares issued by the company at a minimum discount rate of 20% to the price per share paid by investors in that funding round (the **Discount Rate**) (the Discount Rate being higher if the matched investor(s) agree a higher rate than 20% with the company). On a “qualifying funding round”—being a round at which proceeds raised equal at least the aggregate

amount of the bridge funding provided—that conversion will occur automatically. On any other funding round, the matched investor(s) can elect to (but do not have to) convert.

If companies issue a further senior class of shares in the six months following conversion, the matched investor(s) and Government will be able to convert their shares into that senior class. Generally, the loan will always convert other than where the company either: (i) raises no further funds; or (ii) does not achieve an exit prior to the maturity date—which gives the matched investor(s) and Government the option to request repayment (plus the Redemption Premium).

*Exit events:* On a sale or IPO of the company, based on whichever provides the higher return for the matched investor(s) and Government, the loan will either:

- (i) convert into equity at the Discount Rate to the price set at the most recent non-qualifying funding round; or
- (ii) be repaid with a redemption premium equal to 100% of the principal of the bridge funding (the **Redemption Premium**).

*Maturity:* On maturity (being after a maximum of 36 months), the matched investor(s) can choose to either:

- (i) be repaid with the Redemption Premium; or
- (ii) convert into equity at the Discount Rate.

*Interest:* The Government's loan will accrue a minimum non-compounding interest of 8% per annum, or any higher rate agreed by the matched investor(s). Accrued interest is payable on conversion of the loan into shares (other than if an event of default occurs in relation to the company where the loan and accrued interest becomes repayable), at the option of the company the interest will either (i) convert into shares without the Discount Rate applying or (ii) be repaid in cash.

### Other Key Terms

*Rights of the Future Fund/covenants:* There are a number of covenants given by the company to the investors under the Agreement, along with some covenants that are given by the investors in favour of the company. Some of the key covenants include, but are not limited to the following:

- (i) *Information rights:* The company will provide and submit prescribed information quarterly to the Future Fund via an online portal (the information required is set out in schedule 4 of the Agreement). Additionally and on written request, any information that is provided to the company's shareholders, should also be shared with the Future Fund;
- (ii) *Negative pledge:* The company will not, without the relevant majority approval, permit the creation of any indebtedness that is senior to the loan provided under the Future Fund scheme (other than in respect of any bona fide senior indebtedness from a person that is not an existing shareholder or an investor under the scheme or pursuant to any bona fide venture debt facilities);

- (iii) *Transferability*: The Government will be entitled (without restriction) to transfer the loan and, following conversion, shares to an institutional investor (other than a competitor of the company) that is acquiring a portfolio of the Government's interest in at least ten companies owned in respect of the scheme;
- (iv) *Most-favoured nation*: In the event that, prior to repayment or conversion, the company issues any further convertible loans or advance subscriptions to investors that include more favourable terms than those included in the loan under the scheme, the investors under the Future Fund will also benefit from such favourable terms. The company will be required to notify each investor in the scheme of any such arrangements and provide relevant documentation. Companies should be mindful of this provision when seeking additional bridge financing during the term of the loan;
- (v) *Put-option*: There is a £1 put-option in place to protect against potential reputational harm to the Future Fund and/or the Government, where the company is to repay the loan or purchase all of the shares in the capital of the company held by the Future Fund, in the event that the Future Fund determine (in its absolute discretion) that it would be prejudicial to their reputation to continue holding its loan and/or shares in the company; and
- (vi) *Acting in good faith*: The company and other investors in the scheme are required to act in good faith with respect to the Future Fund and do all things reasonably within their power which are necessary to give effect to the spirit and intent of the Agreement, including not acting in any way which would adversely affect the economic interests of the British Business Bank pursuant to the scheme, or treating 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.

*Government restrictions*: The Government will have limited corporate governance rights during the term of the loan.

*Use of funds*: The loan must be used solely for working capital purposes. Specifically it must not be used to repay any borrowings from a shareholder 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 12 months from the date of completion of the loan, make any bonus payments other discretionary payment to any employee, consultant or director of the company (other than as contracted prior to the date of the loan and paid in the ordinary course), or to pay any advisory or placement fees or bonuses to any corporate finance entity or investment bank or similar service provider.

## **Conclusions and Considerations**

We have the following thoughts on the updated terms of the Future Fund:

- *Applicant eligibility*: The scheme has been pitched in certain media as support for start-ups—but the requirements to have already raised £250,000 and have investors willing to put in at least £125,000 more means that it is targeted at the more established companies along the emerging company chain, including those that have received backing from venture capital investors. Usual venture capital deal terms will mean that the company will need buy-in and support from those investors before applying for the

scheme. It is also worth noting that while the scheme is only open to UK-registered companies, there is no requirement for the existing shareholders to be based in the UK.

- *EIS funding:* The British Bank advise that HM Treasury and HMRC are responsible for all decisions on tax reliefs, including on SEIS and EIS, and that their understanding is that the structure of the Agreement does not meet existing rules for SEIS or EIS eligibility. This may narrow the pool of willing lenders.
- *Funding allocation:* The Government have confirmed that applications will be processed on a “first come, first served” basis. Companies who have not yet submitted an application are strongly encouraged to do so.
- *Simultaneous funding:* The Government proportion of the loan will be invested at the same time as the investors’ proportion of the loan. Once the Agreement has been signed, there is a 90 day window in which additional investors can make further loans to the company on the same basis as the Agreement, up to an agreed headroom amount specified in the Agreement. These additional loans do not qualify for matched funding from the Future Fund.
- *Decision-making:* The nature and extent of rights of the Government following conversion of the loan are unclear. It is also unclear how the Government will make decisions—and with a potential portfolio of 2,000 companies, this process may not be fast.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our UK Corporate practice:

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