

# Clients & Friends Memo

## COVID-19 Update: UK Government Launches Convertible Loan Scheme for Start-Ups; Announces Additional Funding for Innovate UK

22 April 2020

### Introduction

On 20 April 2020, the UK Treasury [announced](#) a support package aimed at helping start-ups whose businesses are facing financial difficulties due to the COVID-19 pandemic. “Future Fund” is being created, pursuant to which the government will offer convertible bridging loans of £125,000 - £5 million to eligible high-growth companies, provided the government investment is matched by private money. The total size of the government’s initial commitment to Future Fund is £250 million. It will initially be open from May until the end of September, and the scale of the fund will be kept under review. In addition, £750 million is being added to the existing Innovate UK program, which is a scheme providing grants and loans to small and medium-sized firms focused on R&D.

This follows pressure from many in the start-up community urging the government to focus on the needs of businesses in this important sector of the economy, many of whom have found themselves ineligible to participate in the COVID-related lending schemes previously announced in the UK (*see* our memo [here](#)).

### The Future Fund

The Future Fund is to comprise an initial £250 million of funding from the UK Government, with private investors (excluding angel investors), at least matching that commitment. The initial commitment will be open from May until the end of September. Certain details as to the mechanism for accessing the Future Fund are as yet unclear, but the Treasury has published a [partial term sheet](#), highlighting the following features of loans granted under the scheme:

**Eligibility.** To be eligible for a Future Fund bridging loan, a company must:

- a. be an unlisted UK registered company;
- b. have raised at least £250,000 in aggregate from private third party investors in previous funding rounds in the last five years; and
- c. have a substantive economic presence in the UK.

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Note that if a company is a member of a corporate group, only the ultimate parent company, if a UK registered company, is eligible to receive the loan. Further, the Government's guidance on the Future Fund (accessible [here](#)) provides that full eligibility criteria will be published shortly, and therefore additional criteria may apply.

**Loan Size.** The amount of the Bridge Funding provided by the Future Fund will be:

- a. a minimum of £125,000; and
- b. a maximum of £5 million.

The amount contributed by the Future Fund must be at least matched by private investors (the “**matched investors**”), though there is no upper limit on the amount that may be provided by private investors, so even larger bridge financings can take advantage of this scheme.

**Use of Proceeds.** The Bridge Funding must be used solely for working capital purposes and cannot be used by companies to repay any borrowings, make any dividends or bonus payments to staff, management, shareholders or consultants, or, in respect of the Government loan, pay any advisory or placement fees or bonuses to external advisers.

**Conversion.** The Bridge Funding will be convertible into equity in the following circumstances:

- a. *Automatic Conversion on a Qualifying Funding Round.* The Bridge Funding will automatically convert into equity in the debtor's next funding round equal to or exceeding the total amount of the Funding excluding shares issued on conversion of the Bridge Funding and any shares issued upon exercise of employees/consultants' options (a “**Qualifying Funding Round**”). The lenders will benefit from a conversion price for outstanding principal with at least a 20% discount (the “**Discount Rate**”) to the equity price set by that round (unless a higher discount rate is agreed). In all conversions, the Discount Rate will apply only to the conversion of principal, and any unpaid accrued interest will be converted without the Discount Rate.
- b. *Optional Conversion on a Non-Qualifying Funding Round.* The Bridge Funding may also be converted into equity on a funding round that does not meet the size test to be a Qualifying Funding Round, at the option of the holders of a majority in principal amount held by the matched investors. The conversion price will reflect the Discount Rate to the price set by that non-qualifying round.
- c. *Conversion or Repayment on a Sale or IPO.* If the Bridge Funding has not been converted prior to a sale or IPO, it will either:
  - i. convert into equity at the price set by the most recent non-qualifying funding round after the issuance of the Bridge Funding discounted by the Discount Rate<sup>1</sup>; or
  - ii. be repaid with a 100% redemption premium (being a premium equal to 100% of the principal of the bridge funding) (the “**Redemption Premium**”),

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<sup>1</sup> If no such funding round has occurred, the conversion price will not include a Discount Rate.

whichever will provide the higher amount for the lenders.

- d. *Conversion or Repayment on Maturity.* At maturity, the Bridge Funding will either:
- i. convert into equity at the price set by the most recent non-qualifying funding round after the issuance of the Bridge Funding discounted by the Discount Rate<sup>2</sup>; or
  - ii. be repaid with a Redemption Premium,

at the option of the holders of a majority of the principal amount held by the matched investors.

**Interest Rate.** The interest rate on any loan will be 8% *per annum* (non-compounding) unless a higher rate is agreed upon between a company and matched investors.

**Term.** Each loan under the Future Fund will mature after a maximum of 36 months.

**Warranties.** Companies will provide limited, standard warranties (including those relating to title and ownership, capacity, loan eligibility in accordance with the Government eligibility criteria, compliance with laws, the borrowing facilities of said company, litigation and insolvency events to the lenders on closing of the loan).

**Covenants.** Companies will provide limited covenants to the Government during the term of the loan (and as a shareholder following conversion of the loan), including undertaking to treat the lenders and the holders of the conversion equity fairly and equally and to provide the Government with the same information rights as other investors in said company, and to comply with legal obligations.

**Most Favoured Nation.** Where a company issues further convertible loan instruments to investors (including any new or existing investors which are not matched investors) with more favourable terms, those terms will apply to the bridge funding provided under the Future Fund.

**Negative Pledge.** Companies will not be permitted to create any indebtedness that is senior to the Future Fund loan other than any *bona fide* senior indebtedness from a person that is not an existing shareholder or matched investor.

**Transfer Rights.** The Government will be entitled to transfer the loan and any conversion shares to any institutional investor which is acquiring a portfolio of the Government's interest in at least ten companies owned in respect of the Future Fund. The Government will also be entitled to transfer any of its shares within the Government and to entities wholly owned by central government departments.

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<sup>2</sup> If no such funding round has occurred, the conversion price will not include a Discount Rate.

Note that the full terms of the Future Fund have yet to be finalised, and will be published by the Government in due course.

### Targeted Development Support

In addition to the Future Fund convertible loan program, the Treasury have also announced £750 million will be available for grants and loans to R&D-intensive small and medium-sizes firms through Innovate UK.<sup>3</sup> Of that amount, £200 million will be used by Innovate UK to assist its 2,500 existing customers (on an opt-in basis), with the additional £550 million to be made available to fund R&D activity by additional businesses. It is understood that £175,000 of support will be offered to around 1,200 firms not currently in receipt of Innovate UK funding. The first payments under this scheme are anticipated to be made by mid-May.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Joanna Valentine	+44 (0) 20 7170 8640	<a href="mailto:joanna.valentine@cwt.com">joanna.valentine@cwt.com</a>
Michael Sholem	+44 (0) 20 7170 8545	<a href="mailto:michael.sholem@cwt.com">michael.sholem@cwt.com</a>
Christopher Smith	+44 (0) 20 7170 8736	<a href="mailto:christopher.smith@cwt.com">christopher.smith@cwt.com</a>

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<sup>3</sup> Innovate UK is the UK's national innovation agency, a non-departmental public body operating at arm's-length from the Government as part of the United Kingdom Research and Innovation organisation.