

When making investments through the Angel Cofund or the Delta Fund, ACF Investors, as a co-investment fund manager, will generally look to adhere to existing legal documentation (Articles of Association of the Company, Shareholders Agreement or Subscription Agreements etc.), providing that documentation meets the minimum standards required by the Fund. The terms set out below provide an indication of the types of rights and protections that the Funds would generally expect to see in order to invest in a Company. Most of the items below are industry standard protections for minority investors, or reflect industry best practice for governance; however a small number are specific to ACF Investors in order to support its internal governance.

All decisions to invest are subject to approval by the Funds independent Investment Committee.

Investment Structure

Investment

The Funds can invest in any combination of shares and loans (repayable or convertible), providing that other investors are investing on the same or largely the same terms; however, the Funds will not provide solely debt. The majority of investments made by the Funds are into ordinary shares or shares with basic liquidation preferences.

Valuation and Price per Share

The Funds will invest at the same price as other investors in the round but retains the right to refuse investment if it believes the price proposed does not reflect the demonstrable value of the Company. Where it is desirable to use a convertible loan or other such instrument which delays the pricing of an investment until a future event, the Fund may consider this.

Amount

The Funds will invest between £100k and £1m in its initial investment but will not provide more than 49% of the investment in a funding round and will not acquire more than 30% of the issued equity in any company receiving investment.

Multiple or Tranched Investments

In certain circumstances investors may wish to invest in a series of pre-determined amounts over a period of time and based on pre-agreed milestones. The Funds will generally support this type of structure where it is commercially appropriate to do so and the milestones set are satisfactory.

EIS

ACF Investors are a private sector institutional investor and therefore cannot benefit from any current investment tax reliefs in the UK, however it is accepted that business angel co-investors may benefit from the reliefs offered by the Enterprise Investment Scheme (EIS). In all investments a clear alignment of interest with co-investors is fundamental to any decision by the Funds.

Purpose of Funding

It is normal practice to specify the use of funds being raised in a funding round. Although this can be done at quite a high level, it should be clear how the Company intends to use the monies it is raising.

Follow-on Investment

Subsequent to its initial investment the Funds may provide further investment in future follow-on funding rounds, but this will remain subject to Investment Committee approval. Any decision to invest will be based on the performance of the Company at the time.

Process and Timing

Both Funds aims to complete investments as quickly as it reasonably can and key to this is ensuring that management and other investors are able to focus on and approve any changes required to the documentation. Where unforeseen delays happen, it is usually because key individuals are unavailable or conditions precedent to investment are not yet met. However the relative complexity of existing or proposed legal structures can also add to the time it takes to close.

The Funds Investment Committee must approve all investments it makes, therefore this approval kicks off the process of preparing legal documentation.

Documentation

Once an investment has been approved by the Funds Investment Committee the Funds will begin working with the Company and other investors to agree legal documentation. It is expected that the Company will engage solicitors, who specialise in private equity transactions, to draft the legal documentation. Only following a full review of the existing documentation will the Fund's legal counsel be able to confirm the detail of any changes required.

Conditions Precedent

The co-investors and the Funds Investment Committee may have imposed certain conditions precedent to completing an investment (e.g. raising a minimum amount of funding in the round), these will be discussed and must be satisfied before the Funds's investment completes.

The Funds always require an update on the Company's trading immediately prior to the completion. It also requires proof that monies committed by other investors in the round have been received.

Anti-Money Laundering

It is essential that all companies receiving investment from the Funds are compliant with the prevailing law around the anti-money laundering and the proceeds of crime. The Company should be comfortable that it can confirm the identity of all investors on its share register. The Funds will require specific proof of identity (in the form of certified copies of a utility bill (which confirms the address and which is less than 3 months old) and photo ID or FCA register checks) from major investors in the Company as well as from key members of the management team. If an investor is based in what is considered a high risk jurisdiction they may also require separate proof of identity.

Co-Investment Agreement

It is expected that syndicates have the capacity (either individually or collectively) to form the counterparty to legal documentation including a formal co-investment agreement. This document sets the parameters for the co-investment relationship between the Fund and the syndicate.

Investor Representation and Information Rights

Board Representation - Directors

Having a strong and balanced Board is often a key enabler of success for a small business and as such the Fund is very focussed on ensuring management have the right support around them. In many cases, but by no means all, the Fund's lead angel investor will become a non-executive director or chairman and join the Board of the

Company following investment. This arrangement allows the Company to benefit from the experience of the non-exec director and gives investors comfort on matters of governance and reporting.

In certain circumstance the Fund may seek the right to directly appoint a Board member, and would look to provide someone with the right depth of industry experience to perform this role.

Board Representation - Observer

Given the Fund's co-investment model it requires an enduring right to provide an observer at Board meetings, enabling it to get up to speed with events at a company rapidly if needed. This right is rarely exercised and observers do not have the right to vote on Board matters. To support this role the Fund will require notice of all Board meetings and Board papers at the same time as the Board directors irrespective of whether the Fund has appointed an observer to the Board.

Information for Investors

There is a strong correlation between the strength of a company's reporting on its own performance and its ultimate success and therefore the Funds require standard, regular reporting on the performance of the companies it invests in. Usually this takes the form of a monthly Board or management information pack covering, at least at a high level, all key financial and non-financial aspects of the business.

For internal reporting the Funds also require information on an annual basis on the number of people employed by the Company. The Fund is obliged to provide this information to its investors, including the Regional Growth Fund, Department for Business Innovations and Skills and the British Business Bank.

The investors, along with the Fund, will usually retain the right to appoint accountants to produce this information in rare cases when it is not forthcoming.

Important Decisions

It is a standard practice for investors to require the Company seek their approval on certain key business decisions. Appendix 1 illustrates typical matters expected to be subject to investor consent.

Option Scheme

In order to align the interests of the employees with those of shareholders, it may make sense to set up an employee share option scheme as part of the funding round. This would typically be a tax efficient EMI share option scheme which grants participating employees options to acquire shares in the Company at a certain point in the future (usually, at exit) for a price fixed at the date the option is granted. The Fund generally supports such schemes but will require full details on how they operate.

The Fund will generally support other appropriate and reasonable management and employee incentive programmes in the event an EMI scheme is not desirable or effective. These will need to be disclosed in full.

Directors' Emoluments

In accordance with good governance, and to ensure an alignment of interest behind growing the value of the business, the Fund will commonly look to see a remuneration committee put in place to provide oversight of the compensation for key employees and other personnel.

Directors' Service Contracts

In alignment with good practice the Fund expects that all key individuals in the business will already have in place service contracts containing provisions of their engagement (such as compensation, time commitment, confidentiality, restrictive covenants, assignment of both current and future intellectual property, notice periods etc.)

In the event contracts are not already in place, they will need to be agreed prior to investment.

Management Obligations

Warranties

Having received information and representations during the investment process, the Fund will want to see that the business “stands behind” the information provided and as such both the management and the Company will be expected to provide basic warranties. The extent and scope of warranties will vary depending on the nature of the business and the size of investment.

Disclosures

In the process of providing warranties it is common for the management of the Company to wish to disclose certain matters which may either be ambiguous or should fall outside the warranty provisions. e.g. to disclose an outstanding insurance claim which is still to be settled. The Fund will accept reasonable specific disclosures.

Restrictive Covenants

Every business has information that it considers both integral and invaluable to its success. If any of the founders or key employees were to leave the Company they would normally be prevented from using this information through the usual restrictive covenants included in their service contracts. Such covenants will need to be included in the investment documentation, as standard.

Executive Directors Holding Other Investments

If key management team members have any other business interests the Fund will need comfort that there is no potential for a conflict of interest to arise that could undermine the value of the Company. In some cases this may mean a restriction on employees making certain types of investment.

Good Leaver and Bad Leaver

The strength of a small company is often concentrated in a handful of key employees, and therefore it is essential that investors have comfort that should any one of these individuals leave, there is the capacity to reward new members of the team. The good leaver/bad leaver provisions are used in the investment documentation to set out the precise mechanism for managing this.

In the case of employee shareholders this generally means that, on leaving without prior agreement or mitigating circumstances, they should return any shares to the Company. The usual position is that a good leaver receives market value for shares and a bad leaver receives the lesser of market value or nominal value.

Where an individual has clearly made a considerable contribution to establish the value of those shares, it may be more equitable that they retain the economic value of the shares, but may be relieved of the voting rights attached to them.

Investor Protections

Tag Along and Drag Along Rights

Drag along and tag along provisions are often widely drafted, but perhaps rarely exercised. They are a way of giving all investors comfort that no party or minority group can prevent the majority of investors from realising the value of their investment when the time comes.

A “drag along” right sets out a mechanism whereby a specified majority of shareholders, commonly 75%, can force the minority to sell their shares to the proposed buyer (providing the majority are also doing the same). This provision is generally accompanied by a “tag along” right, commonly requiring a 50% threshold, to give the minority the ability to demand that any offer to buy shares from a certain investor group is also extended to them.

The Fund requires that these provisions are in place and that the thresholds are set at appropriate levels.

Pre-emption Rights

The issue of new shares, or sale of existing shares, will normally follow standard pre-emption rights and be offered first to existing shareholders on a pro-rata basis, thus enabling both investors as well as founder-shareholders to maintain their relative shareholding in any future funding rounds.

Transfer Rights

Due to its structure the Fund requires reasonable freedoms to be able to transfer ownership of its investments, whether internally within its group of companies or to be able to transfer assets to any investors or funds whose business comprises to a material extent the holding for investment purposes securities, debt or other financial facilities in unlisted UK companies in the unlikely event that the Fund is wound up. The example of the wording the Fund requires on transfers is available on request.

In addition the Fund expects that any rights the Fund benefits from in connection with its investment in the Company will be assignable to whoever it can transfer its investment.

The Fund cannot invest without these freedoms.

Company Expansion

To ensure investors remain entitled to all earnings of the Company, any expansion, development or evolution of the business must be carried out within the same company or through a wholly owned subsidiary, unless agreed otherwise.

Warranties on Sale or Listing

The Fund will not, under normal circumstances, provide any warranties to a purchaser (or other party), other than to confirm its ownership, when the time comes for its shares to be sold or transferred.

Investment Horizon

Most investors have an investment horizon, i.e. a set period of time after which they would seek to realise the investment. It is therefore standard for management to provide for an undertaking to assist investors in achieving an exit within an agreed period. The Fund will support such provisions where appropriate, but any exit decision should always be based on the facts at the time.

Anti-dilution

Venture capital investors sometimes request anti-dilution protection rights to safeguard the value of their shareholding in cases where new shares are issued at a lower price (a “down round”). There are a number of ways in which this protection may operate and the Fund will take a “most favoured nation” position (that is to say it will require the same rights as other investors if it believes not taking them would place it at a disadvantage) if anti-dilution is required by other investors.

Listing

It is standard practice for investors to convert their shares into ordinary shares prior to a company listing on a publicly traded stock exchange. Therefore investment documentation should contain an automatic conversion mechanism for all share classes, effective immediately prior to an IPO.

“Phoenix” Protection

The Fund may, in certain circumstances, ask for an anti-embarrassment type protection in case the business in which it invests is replicated in another vehicle in which it is not invested and which is connected to some or all of the founders/management.

General Matters

Address for Communication

Investment documentation should specify the Company address for formal notices to be sent to. The registered address of the Fund is – Foundry House, 3 Millsands, Sheffield S3 8NH.

Health and Safety, Environmental obligations

The investee company will be expected to meet or exceed minimum legal standards and this may be specified in the investment documentation if it is felt this represents a significant risk to the Company.

Confidentiality

Given the commercially sensitive nature of the discussions, it is important that terms and details of the proposed investment are kept confidential to protect the interests of the Company, the angels and the entrepreneurs. The Fund would anticipate that an industry standard confidentiality clause is included in the investment documentation to provide for a legally binding undertaking from all parties to keep information relating to the proposed investment confidential. The Fund will however require the freedom to be able to disclose information relating to its investment in the Company and the business affairs of the Company to governmental or regulatory bodies, their successor organisations and as is required by law or regulation.

Fees & Costs

Both Funds, as a general principle, are keen to see as much of the money raised by the Company retained within the Company to advance its growth with investors, founders and management benefiting from the growth in value of the Company. It is however accepted that it may be necessary to meet certain, limited, costs of investors.

Where the Angel CoFund chooses to invest, a one off fee of 2.5% of the amount the funds invests will be payable to the Syndicate. This is considered reasonable as a payment for the investment preparation, monitoring and reporting activities that the syndicate is required to carry out on behalf of the CoFund.

If the CoFund believes fees being paid are excessive it will not invest.

Arrangement Fees

The Funds do not make charges to a company, except in exceptional circumstances, when making an investment. If other investors wish to make such a charge to the Company the Fund will consider agreeing to this if the level of fee is proportionate and reasonable given the work undertaken.

The Fund will not accept any third party fees being paid to advisors contingent on or in relation to its investment, however if other investors have agreed to pay such fees (directly or indirectly) the Fund will generally accept them provided they are in line with market norms.

Due Diligence Fees

The Fund will generally accept the payment of genuine third party due diligence fees, where all investors benefit from such work.

Monitoring Fees

Depending on the size of the investment and percentage shareholding, it may be acceptable for certain investors to benefit from monitoring fees paid by the investee company. The Fund will generally accept these where they are reasonable and demonstrably proportionate to monitoring activity being undertaken.

Non-Executive Director and Advisor Fees

Non-executives often provide invaluable support to help the growth of a company and will often be asked to commit a considerable amount of time to providing that support. The Fund is therefore happy to see reasonable compensation being paid to directors and a chairman, but prefers to see such compensation being provided in the form of equity rather than cash, as this provides a strong alignment of interest with investors.

Legal Fees

Where investors choose to pass on legal costs to the investee company then the Fund is obliged to do the same. In general, the Funds legal costs are usually capped at (c.£4,000+VAT) per investment.

APPENDIX 1 - TYPICAL INVESTOR CONSENTS

The matters below may be subject to the consent of an investor majority (at either 51% or another pre-determined level), require explicit consent of the Fund or reside with the Board or investor director(s) as appropriate. The Fund prefers that companies have the support of a balanced and experienced Board with independent members. If such a Board is present it will limit the matters requiring investor consents.

1. Changing the Articles of Association of the Company.
2. Changing the share capital/share rights of issued shares.
3. Creating new shares, and the rights attached to those shares, or granting of any options
4. A decision by the Company to purchase its own shares.
5. External borrowing above certain limits which would not restrict the normal operation of the business.
6. Declaring any dividends.
7. Founders shall require investor majority consent to sell shares.
8. Offering new service contracts for senior staff, where compensation is above an agreed level.
9. Amending the service contracts of existing senior staff.
10. Changing Board members, other than where investors have the right to appoint representatives.
11. Making any loan/payment to any director other than in accordance with the terms of the investment agreement or director service contract.
12. Creating a subsidiary.
13. Entering into any consortium, joint venture or profit sharing arrangement with any other person (other than as part of a solvent reconstruction).
14. Creating any charges over assets, incl. guarantees, etc.
15. Acquiring another company or the assets of another company.
16. Signing other contracts e.g. leases, where the obligations incurred are above a certain level.
17. Spending on capital items above a certain pre-agreed limit or outside the expectations of an agreed business plan.
18. Any disposal of a subsidiary, undertaking or majority of assets (including IP).
19. Instigating, defending, settling or compromising any litigation (other than debt collection in the ordinary course of business).
20. Winding up or deciding to appoint an administrator.
21. Changing the Company's auditors/accounting date.
22. Transferring of control/exit.
23. Seeking publicity (if it includes disclosing the identity of the investors).

APPENDIX 2 – PRE-COMPLETION CHECKLIST

Although not exhaustive, the below is a list of matters that will commonly need to be resolved prior to the completion of any investment:

Pre-completion checks

Item	
Syndicate and other investment will meet the minimum investment round?	
Are other investors ready to complete and their funds available?	
Are all due diligence points cleared?	
All outstanding legal points cleared?	
All lead investors other Conditions Precedent (see Offer Letter) are cleared?	
Warranties/Indemnities/disclosures satisfactory?	
Directors and other senior management have appropriate service contracts in place?	
All IP is confirmed as vested in the business?	
Any changes to the options scheme or other incentives have been approved?	
Any changes to the Board have been approved?	
Latest audited/management accounts received?	
Has a trading update been provided?	
Syndicate has signed the Fund Co-investment Agreement?	
Anti-money laundering checks carried out?	
Is there a plan for publicity, press or PR in place?	