# An introduction to UK Venture Capital Investments: A guide for US Investors

The UK venture investing landscape has many attractive features, including a wealth of technological innovation from outstanding universities and research institutions, and centres of excellence in a range of areas such as AI and fintech. US investors continue to look towards the UK for investment targets as they face increased competition for the best opportunities at home.

This note provides an introduction to venture capital transactions in the UK, with a particular emphasis on the differences in approach between transactions in the UK and in the US.

## Structure

A venture investor in the UK will typically invest in preferred shares (unless the investor is able to take advantage of the favourable SEIS/EIS tax reliefs available for individual investors). The preferred shares will ordinarily have the same rights as ordinary shares (equivalent to common stock in the US) but will usually have a number of additional rights including enhanced entitlements to any returns of value (including a liquidation preference).

Convertible debt instruments and share warrants are seen much less frequently in UK venture deals, as compared with US venture transactions, although they are becoming more common.

## Transaction Documents

The key documents for any UK venture capital investment will be the subscription and shareholders' agreement and the target company's articles of association.

A summary of some of the key terms found in UK venture capital transaction documents is appended to this guide at Appendix 1.

## Subscription and Shareholders' Agreement ("SSA")

- Often referred to as an investment agreement, this document is a private agreement between the investor, the company, management and any other shareholders of the company.
- The SSA will usually fulfil the roles of both the stock purchase agreement and stockholder's agreement seen in a typical US venture equity transaction.
- The SSA sets out the basic terms of the investor's subscription for shares and any loan stock. The company, the management and sometimes existing shareholders will give warranties to the investor, qualified by a disclosure letter identifying matters of fact that are inconsistent with the warranties.
- The SSA will also include provisions governing the relationship between the company and the shareholders and how the company is to be operated, such as information rights, investor consent matters and the composition of the board.

## Articles of Association

- The articles of association are the constitution of the investee company. The articles will set out the rights attaching to the shares for which the investor is subscribing, including as to dividends, voting and any liquidation preference. The articles of association will also typically contain any anti-dilution, drag and tag/co-sale rights.
- Investors will generally require the adoption of new articles. This is especially the case in first round venture capital investments where existing articles are likely to require significant amendment.
- Once adopted, the new articles of association must be filed with Companies House and placed on the public record. It is therefore important to consider which investor protections should be contained within the SSA (which will remain confidential), and which are appropriate for inclusion in the investee company's articles of association. The advantage of including provisions in the investee company's articles of association is that they automatically become binding on any person who acquires shares in the target, regardless of whether or not they have become a party to the SSA.
- A UK company's articles of association are functionally similar to a US company's certificate or articles of incorporation, albeit articles of association typically contain a greater number of provisions dealing with a company's general corporate governance.

## Employee Incentives

In the UK, the most common form of employee incentivisation is through employee share option schemes. There are a number of tax-favourable schemes which allow employees to obtain capital treatment in respect of any gains at a lower rate than income tax. At seed and series A investment stage, employee share option pools typically represent between 7.5%-12.5% of the investee company's fully diluted share capital.

## Model Documents

There is less widespread use of standardised documentation for early-stage deals in the UK than in the US markets. However, the British Private Equity and Venture Capital association (BVCA) has produced a model Term Sheet, Subscription and Shareholders' Agreement and Articles of Association intended for use in a series A round. These are often used as a starting point for more tailored investment documentation on larger transactions. The BVCA model documents can be found here.

## Investment Process

A high-level outline of the structure of a typical venture capital transaction in the UK is appended to this guide at Appendix 2.

**For more information please contact:**


**Marek Petecki**
**Partner**
marek.petecki@bristows.com
Direct: +44 (0)20 7400 8442

**Nick Cross**
**Associate**
nick.cross@bristows.com
Direct: +44 (0)20 7400 8397

Bristows LLP
100 Victoria Embankment
London EC4Y 0DH
T +44(0)20 7400 8000

www.bristows.com

## Appendix 1 - Key Terms in Venture Capital Investments

Many of the investor protections seen in US venture transactions are also common to the UK. A summary of the typical investor protections in a UK venture capital transaction is set out below.

| Protection | Used in UK | Document | Notes |
|---|---|---|---|
| Anti-dilution/down round protection | Yes | Articles | *Commonly a "broad based weighted average" formula is used, as opposed to full ratchet protection.* |
| Right of first refusal on new issuances of shares | Yes | Articles | *Will not be applicable to a defined number of shares issued under employee option schemes and, in certain instances, for the purpose of using shares as consideration in commercial transactions/partnering deals.* |
| Right of first refusal on transfer | Yes | Articles | *Often the VC investor's shares will not be subject to restrictions on transfer.* |
| Drag-along | Yes | Articles | *The threshold for triggering these provisions is commonly between 51-75%.* |
| Tag-along/Co-sale | Yes | Articles | *The threshold for triggering these provisions is generally > 50%.* |
| Founder Vesting | Yes | Articles | *The target's articles will contain good/bad leaver provisions applicable to the shares held by founders. A 3-4 year reverse vesting period with a 1 year cliff is typical. Shares in a UK company cannot easily be cancelled, therefore 'unvested' shares will generally convert to a valueless class liable to redemption for a nominal sum.* |
| Veto rights over company action | Yes | SSA | *Usually these matters require the consent of a specified investor majority (e.g. 50% of investors participating in the round), although investors with a high shareholding may have specific vetoes.* |
| Information rights | Yes | SSA | *Monthly management accounts are generally provided and investors granted reasonable access to the company's financial information in order to monitor their investment.* |
| Right to appoint director | Yes | SSA | *Investors (either individually, or together) holding at least 10-15% of the company's issued shares will often have a board appointment right.* |
| Right to appoint board observer | Yes | SSA | *Smaller investors may have the ability to appoint a board observer, rather than a director. Often the ownership threshold is half that for a full board appointment right. Investors who have a right to appoint a director will often also have a right to appoint a board observer in lieu of a director.* |
| Restrictive covenants | Yes | SSA | *Founders usually give non-competes which are enforceable provided that they are reasonable as to term, geographic scope and field.* |
| Company/management warranties | Yes | SSA | *Liability under the warranties is typically limited in a number of ways:*<br>*(i) the investee company's maximum liability is generally capped at the invested amount;*<br>*(ii) the founders'/ management's liability is generally capped at 1-3 times salary;*<br>*(iii) there is a time limit of 1-2 years within which warranty claims can be brought; and*<br>*(iv) there is a generally a basket or threshold requirement.* |
| Redemption rights | Rare | SSA/Articles | *There are strict legal requirements that must be satisfied before a company can redeem any of its shares. These are rarely met by companies which are receiving venture investment, and so redemption rights are unusual.* |
| Registration rights | No | n/a | *There is no registration procedure in the UK equivalent to that in the US. Registration rights agreements would usually only be entered into if a US listing is contemplated.* |

## Appendix 2 - Venture Capital Investment Process