The pursuit of a company's interest over the life of a company

Corporate Acquisition and Joint Ventures Commission

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A. Interest of equity holders

1. Start-up phase

In the start-up phase, an entrepreneur or third parties may wish to invest in a business idea as equity holders in a business association. In this context:

1.1 In your opinion, what is an entrepreneur's typical reasoning for setting up a specific business association? Attract investments by third parties? Avoidance of personal liability? Tax reasons? Protect IP rights and technology?

The main reasons for setting up a business association include: (i) setting up a structure that is tax efficient, (ii) limiting investors' liability, (iii) making it easier to raise finance and attract new investors and (iv) protecting the entrepreneur's assets. These reasons are discussed further below.

1.2 What kind of business association structures does your jurisdiction offer to equity holders (e.g., partnerships, corporation, LLC, etc.)?

The different structures offered include:

a. General partnerships;

b. Limited partnerships;

c. LLPs; and

d. Companies limited by shares.

- ***What are the most crucial differences between these business association structures from an equity holder's perspective?***

a. General partnerships – these are formed by at least two people carrying on a business in common with a view to profit. The partners will have unlimited joint liability for the partnership's debts. The general partnership does not have a legal personality so it cannot own assets in its own right. It does not have to file any accounts with Companies House.

b. Limited partnerships – these are governed by the Limited Partnership Act 1907. They have two types of partner: (a) a general partner (the entrepreneur) who has responsibility for managing the business and has unlimited liability for the partnership's debts and (b) a limited partner (the investor) who provides funding and receives limited liability up to the amount of capital it has contributed. A limited partner cannot become involved in the management of the business, otherwise it loses its limited liability status. The limited partnership does not have a separate legal personality so it cannot own assets in its own right. It does not have to file any accounts with Companies House.

c. LLPs - these are governed by the Limited Liability Partnerships Act 2000. Its members have limited liability up to the amount of their interest in the LLP, which has its own legal personality, so it can own assets in its own right. Every member has the right to participate in the management of the LLP. LLPs must file their accounts with Companies House.

d. Companies – these are governed by the Companies Act 2006. There are three types of company: a company limited by shares, a company limited by guarantee and an unlimited company, however, a company limited by shares is the most common form. Its shareholders have limited liability up to the amount which remains unpaid on their shares. A company has a legal personality, so it can own assets in its own right. Shareholders do not have to be involved in the management of the company. Instead, that is left to the directors. Shares will be issued in return for funds. Attached to the shares can be different rights, for example voting rights and rights to dividends. Companies must file their accounts with Companies House. They are also subject to more onerous filing and disclosure obligations than the structures described above.

- ***If statistics on the use of business association structures are available in your jurisdiction: which are the most commonly used business association structures for start-ups? Do you see a particular reason for the dominance of one specific structure?***

The most commonly used business structure is a company limited by shares because:

a. Each shareholder's liability for the company's debts is limited to the outstanding amount (if any) on its shares;

b. It should be easier to raise finance as the company should be able to attract investment under the Enterprise Investment Scheme ("EIS") and Seed Enterprise Investment Scheme ("SEIS"), which allow investors to claim income tax and capital gains tax relief;

c. It can own its assets in its own right. This makes it easier to raise finance where a lender may want to take security over the assets of the business;

d. It can take advantage of lower rates of tax. Companies pay corporate tax on their profits and gains at 21% (unlike partnerships where the partners' profits and gains are charged to income and capital gains tax at 40% and 28% respectively (if they are higher rate tax payers). Companies also enjoy numerous tax reliefs; and

e. It can incentivize employees by offering them shares in the company. Such shares can have favourable tax incentives if they are held in particular ways.

- ***In case of a corporation or LLC (in the following we simply refer to the "company"): are there any equity instruments other than common shares that are typically used for equity investments? Non-voting shares? Other forms of participation rights?***

Different classes of shares are available. These include:

a. Preference shares – these shares usually provide a dividend. They also give priority if the company becomes insolvent and distributions are to be made by the liquidator. These shares are often non-voting shares;

b. Non-voting shares – these do not entitle the shareholder to participate in meetings, however, they can be used to provide dividends. These are often issued, for example, to employees to enable a tax efficient payment;

c. Redeemable shares – these shares give the company the right to buy back shares in the future. This could be useful where the company wants to be able to buy back the shares from the investor where they are able to repay the money given. However, the company can only redeem the shares when they have enough distributable profits; and

d. Ordinary shares – these are the most common form of shares. The company may issue different classes of ordinary shares to attract venture capital investment (e.g. "A" and "B ordinary shares). These would have voting rights but each class could have different rights depending on the investor's requirement. For example, enhanced voting rights, the right to appoint a director, or the right receive a preferential dividend.

- ***Can equity investors remain anonymous (for example by the use of bearer shares)? Anonymous towards the company, other investors, the public? In the event equity investors cannot remain anonymous when holding shares, is there any alternative scheme that can be implemented to participate on an anonymous basis (for example, silent partnership schemes)?***

There are two types of ownership: registered (or legal) and beneficial (or equitable). The company is required to file an annual return which sets out the registered owners of the company's share capital. This does not show who the beneficial owners are of those shares.

An equity investor can remain anonymous to the public by using a nominee company or person to hold his shares. There would then be a declaration of trust between the nominee and the equity investor.

The company is likely to know the identity of its investors at this phase, otherwise it may not wish to issue shares to them. However, other investors may not have the same visibility, especially where pre-emption rights on new issues or transfers have been disapplied.

Proposals are in place to require companies to keep a register of people who have significant control over the company (the "PSC Register"). This would keep a public record of persons who hold, directly or indirectly, more than 25% of the shares in the company. The proposals are expected to come into force later in January 2016.

A company can issue bearer shares (or share warrants to bearer). The holder (or bearer) of the warrant is absolutely entitled to the underlying shares, so it allows the holder to remain anonymous. They are fairly uncommon, however, there are proposals in place to abolish them.

1.3 Once the entrepreneur has set up a company: what could be a typical focus of third party equity investors when they invest in a company in this phase?

- ***What could typically be the friends', family's and fools' ("FFF") focus? Helping the entrepreneur to get his / her business going?***

The focus of the FFF is generally on:

a. Getting the business going;

b. Evaluating whether the business has good investment prospects; and

c. Potential job opportunities within the business.

- ***What could typically be the professional investor's focus?***

The focus of professional investors is generally on:

a. Carrying out legal and financial due diligence and obtaining a full suite of warranty protection from the company;

b. Protecting the business by ensuring all IP is protected and key management have restrictive covenants in place;

c. Protecting their investment by ensuring the articles of association contain drag and tag along provisions and they have pre-emptions rights on new shares issues and share transfers; and

d. Ensuring they have sufficient information rights so they can keep up-to-date with the company's progress.

- ***If there is a difference in focus among the various equity investors, how is this typically reflected in the legal relationship (be it corporate or contract law)? Are there legal instruments that are only used by certain investors (e.g., only by professional investors)?***

Professional investors will seek to document the rights and protections described above through a mixture of enshrining them in the company's articles of association and entering into a shareholders' agreement between the company and other shareholders.

Ideally, the rights and protections set out in the shareholders' agreement will be mirrored in the company's articles. This is preferable because the rights of a shareholder are entrenched in the shares, whereas the rights in a shareholders' agreement are personable and made on a contractual basis. As the articles of association are publicly available, some investors are sensitive about what rights are set out in this document.

2. Growth phase

In the start-up phase a business idea comes into existence: the idea is put into a business plan, a company is set up, first steps relating to production, service, distribution, sales etc. are made. The growth phase allows potential new investors to better assess not only the viability of business idea, but also the commitment of the people involved. In this phase, the new investors are usually not FFF, but professional investors. As a result, the FFF who invested in the start-up phase are faced with more demanding and skilled potential new co-investors. Against this background:

2.1 In your opinion, does the focus of the equity holders (e.g., the FFF or professional investors) shift in the growth phase (as compared to the start-up phase)?

- ***If so, what could be a particular focus for equity holders in the growth phase? Protection from dilution?***

In our experience, the focus of professional investors does not change between the start-up phase and the growth phase.

- ***In your experience, do the equity investors from the start-up phase participate in further capital rounds in the growth phase? Do they***

usually accept dilution? Do they usually cash out at this point in time?

In our experience, the FFF do not generally participate in further capital rounds in the growth phase. This is because the size of the rounds is generally too large for them. We find that the FFF accept dilution and seek to maintain their holding until there is a better opportunity to cash out (usually on a sale or listing).

Professional investors who joined the start-up phase will usually seek to participate in further capital rounds in the growth phase. The protections put in place in the start-up phase should ensure that they have the right not to be diluted. They will try to avoid dilution unless the size of the funding round is too large for them to participate fully.

2.2 In your jurisdiction, does company law provide existing equity holders protection from being diluted in further financing rounds in the growth phase? If so, how are they protected? Is there a need for equity holders to seek protection on a contractual basis?

The Companies Act 2006 provides that all shareholders have pre-emption rights. This means that, unless such rights have been disapplied, if the company wishes to issue new shares for cash consideration, it must first offer them to existing shareholders pro rata to the number of shares they currently hold. This protects shareholders from being diluted.

The directors of a private company can disapply pre-emption rights either by obtaining shareholder approval (which requires 75% of the votes cast in favour) or incorporating this right in the company's articles of association.

Pre-emption rights do not apply if the shares are being issued for non-cash consideration.

2.3 When new potential investors offer to come on board during the growth phase, the existing equity holders may be reluctant to provide the information required to satisfy the potential new investor's need for valuation. The reason for the existing shareholders' reluctance may be, for example, that the required information contains (still) unprotected intellectual concepts, knowledge or ideas. In your experience, which legal instruments are used to find a balance between the potential new investor's need for information and the existing equity holders' wish to keep such information confidential? Do existing equity holders have legal means to prevent management from disclosing such information?

Well advised existing shareholders would be expected to have a shareholders' agreement in place. This agreement would typically contain a confidentiality clause which prevents all shareholders from divulging confidential information to third parties, unless there is prior approval.

In addition, the company will normally ask the potential investor to enter into a confidentiality agreement which would prevent them from disclosing the company's confidential information to third parties.

3. Maturity

During the various capital rounds in the growth phase, the circle of equity investors in a company typically becomes larger and the atmosphere may become less familiar. Also, in the maturity phase the management of the company may become more professional in the sense that there is a management in place which is not, or not significantly, invested in the company (i.e., intensification of the principal-agent-conflict). As a consequence, legal concepts that govern the relationship between equity holders (such as fiduciary duties of majority equity holders) as well as legal concepts that govern the relationship between management and equity holders (such as fiduciary duties of the board members / management, duty of loyalty, principle of equal treatment) may become more important. In other words, corporate governance may become more important. Against this background:

3.1 In your opinion, how does the equity holder base change between the start-up phase, the growth phase and the maturity phase? How does the focus of the equity holders change? Focus on fair distributions of earnings?

In general, the shareholder base should become more sophisticated as the company moves through the different phases. Once the company has reached the maturity phase, the focus changes to maintaining a successful company and preparing the company for an eventual exit: either an IPO or a sale. Investors may seek a return on their investment and encourage the company to make regular distributions.

3.2 In your jurisdiction, does the law provide for stricter corporate governance rules for large (privately-held) companies as compared to small companies? If so, what exactly triggers the application of the stricter corporate governance rules? In which sense are the corporate governance rules different / stricter?

For private companies, the level of corporate governance is the same, regardless of whether the company is large or small. Companies and directors are subject to the Companies Act 2006. In particular, the Companies Act 2006 imposes certain duties on the directors, such as a duty to promote the success of the company for the benefit of its members as a whole.

The company's articles will also set out governance rules, such as what powers the directors have.

Stricter corporate governance rules apply in the case of listed public companies. For example, premium listed companies on the main market of the London Stock Exchange must comply (or give reasons for non-compliance) with the UK Corporate Governance Code.

3.3 In your jurisdiction, do (certain) equity holders (e.g., majority shareholders) have obligations towards (certain) other shareholders or the company (e.g., duty of loyalty)? Please explain such obligations.

No, majority shareholders do not have a duty of loyalty to the minority shareholders. However, a (minority) shareholder can petition to the courts for relief if it thinks the affairs of the company are being conducted in a manner which is unfairly prejudicial to shareholders' interests as members. This right can be used to cover situations where shareholders are exerting greater influence over the company than they are entitled to, or where decisions by management are not in the interests of the company's members as a whole.

The company's articles of association may also contain tag along rights. These enable minority shareholders to force other shareholders (who wish to sell their shares) to procure an offer for the shares benefitting from such rights. These rights act as a protection for minority shareholders in case the majority shareholder chooses not to exercise its drag along rights (which can be used to force the minority to sell).

3.4 Does the company have any means to control the circle of its equity holders (i.e., can the articles of incorporation prevent competitors from holding shares in the company?) or have such restrictions to be agreed among the other equity holders (e.g., shareholders' agreement)?

Private companies will generally have pre-emption rights on transfers, which prevent a shareholder from selling its shares to a new investor, unless it has offered such shares to existing shareholders first, pro rata to their existing holdings.

In addition, the shareholders' agreement could contain a restriction which would prevent shareholders from transferring their shares to certain types of investors, such as a competitor, although this is relatively unusual. The shareholders' agreement can also be used to prevent existing shareholders from investing in the company's competitors, although again, this is relatively unusual.

4. IPO / Listed phase

Following the IPO, a company enters into a new phase of being listed. The listing has potentially a great influence on the equity holder: the sale of their interest becomes easier. Against this background:

4.1 How does the focus of the shareholders change through the going public as compared to the maturity phase? Does the fact that a shareholder may at any time sell the residual value in its share (ideally) at a fair price in your opinion soften the focus on distribution of earnings? Does the focus shift from long term to short term?

The focus depends on the type of investor. Investors like pension funds will focus on long-term growth and regular dividends. However, an investor like a hedge fund may focus on short-term growth or negative growth if it has taken a short position.

Shareholders will be concerned about market conditions, as the company will become susceptible to conditions outside of the company's control, which could affect the share price.

4.2 In your jurisdiction, are there publicly available records on the identity of (certain of) the shareholders in a listed company? If so, does this in your opinion influence the shareholders' focus?

Under the Disclosure and Transparency Rules (the "DTRs"), shareholders of AIM and Main Market companies must notify the company when their voting rights reach, exceed or fall below 3% of the company's voting rights, and each 1% threshold thereafter (assuming the company is UK incorporated, otherwise different thresholds apply). The company must then publish these notifications to the market. This allows the market to build up a picture of whether the company has long-term investors (such as pension funds), short-term investors (such as hedge funds) or a mixture of both.

In addition, the Short Selling Regulations (which apply to AIM and Main Market companies) require a shareholder to notify the Financial Conduct Authority ("FCA") of a net short position it has in respect of such shares when the position reaches or falls below 0.2% of the company's issued share capital and at each additional 0.1%.

The Regulations also require a shareholder to notify the public of a net short position it has in respect of such shares when the position reaches or falls below 0.5% of the company's issued share capital and at each additional 0.1%.

4.3 An efficient allocation of resources requires a most accurate pricing of the shares.

- ***In this regard, are companies that are listed in your jurisdiction under an obligation to publish price-relevant information (ad hoc publicity)? If so, please provide a short overview of the respective rules including the exemptions from such obligation.***

The DTRs require Main Market companies to publish inside information as soon as possible. Similar rules apply to AIM companies. Information is "inside information" if it is precise, not generally available and would have a significant effect on the price of the company's securities if it was available. Whether the information will have a "significant effect" depends on whether it is something that a reasonable investor would be likely to use as part of the basis of his investment decision. Companies are permitted to delay disclosure if it would otherwise prejudice their legitimate interests. For example, if the company is negotiating the acquisition of a company, whilst that may be inside information, such disclosure could jeopardize its negotiations with the seller. The company is also permitted to disclose inside information to those on a need to know basis, such as its legal advisers, provided the other party is under a confidentiality obligation.

- ***It can be assumed that no jurisdiction requires listed companies to publish all price sensitive information. If this is correct in your***

jurisdiction, how does the law protect the market and its participants (including, the equity holders in the company) from market abuse? Are there insider trading and market manipulation prohibitions? If so, please provide a short overview and, if you can, provide certain peculiarities about them?

Section 118 of the Financial Services and Markets Act 2000 ("FSMA") provides for a civil regime relating to "market abuse". A breach of this regime permits the FCA to take action against certain persons, as referred to below. Market abuse, in essence, is market manipulation or information abuse. Specifically, market abuse consists of behaviour which occurs in relation to securities admitted to trading on AIM or the Main Market.

There are seven types of behavior, including:

a. Insider dealing – where an insider deals, or attempts to deal, in securities on the basis of inside information relating to the securities in question;

b. Tipping off – where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties;

c. Misleading transactions – where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or secure the price of one or more such investments at an abnormal or artificial level; and

d. Dissemination of information –where the behaviour consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew, or could reasonably be expected to have known, that the information was false or misleading.

Where a person's behaviour amounts to market abuse, the FCA may impose an unlimited civil fine; make a public statement that the person has engaged in market abuse; apply to the court for an injunction to restrain threatened or continued market abuse, an injunction requiring a person to take steps to remedy market abuse or a freezing order; apply to the court for a restitution order; and/or require the payment of compensation to victims.

The civil market abuse regime supplements the criminal regime for insider dealing under the Criminal Justice Act 1993. The FCA has a choice as to whether to pursue a criminal prosecution or take civil action in respect of the same behaviour.

5. Acquisition

In its life cycle, the company may itself become the object of an acquisition and integration into the acquirer's structure. At this point the life cycle of the company ends. For the purpose of the remainder of this questionnaire, we assume the acquirer proceeds via a public tender offer. Against this background:

5.1 In case a listed company (target) is approached by another company (bidder), the board of the target will have to decide whether it supports the offer (friendly offer) or not (unfriendly offer). What are the interests that the board of directors needs to take into consideration for this decision? Shareholders' interests only (e.g., offer price only)? The interests of other stakeholders (employees, community etc.)?

The board of directors is under a duty to promote the success of the company for the benefit of its members as a whole, but in doing so, it must have regard (among other matters) to the following:

a. The likely consequences of any decision in the long-term;

b. The interests of the company's employees;

c. The need to foster the company's business relationships with suppliers and customers;

d. The impact of the company's operations on the community and the environment;

e. The desirability of the company maintaining a reputation for high standard of business conduct; and

f. The need to act fairly as between the company's shareholders.

5.2 In case of an acquisition of the listed company (target) by another company (bidder), the shareholders' are at a disadvantage as they cannot communicate efficiently or act in concert (for example, regarding the rejection of a low offer). A rational bidder should try to use this disadvantage of the shareholders to his benefit. In your jurisdiction, how does the law protect shareholders of the target in case of public tender offers? (for example, is there a specific process for public takeover offers which provides protection? Does the bidder need to treat target

shareholders equally? Are there, for example, minimum price rules and/or best price rules?)

Takeovers of public companies are governed by the City Code on Takeovers and Mergers (the "Code") which is regulated by the Panel on Takeovers and Mergers (the "Panel").

The Code contains general principles which include (i) all shareholders must be treated equally, (ii) shareholders must have sufficient time and information to enable them to reach an informed decision and (iii) shareholders cannot be denied the opportunity to decide on a bid's merits. Although it may not be in the directors' interest (as they may lose their jobs) the shareholders must be involved.

The FCA may take enforcement action at the request of the Panel. The Panel may also impose sanctions on persons who have acted in breach of the Code or have failed to comply with a direction given by the Panel to secure compliance with the Code. The Panel also has power to apply to the court to make orders to secure compliance with the Code where a person has contravened, or is reasonably likely to contravene, the Code.

If the bidder or its concert parties acquire securities in the target in the three months prior to the offer being made (or longer in certain circumstances) or during the offer period (which commences on a leak announcement or on the announcement of a proposed or possible offer), the offer itself must be on no less favourable terms.

Where cash purchases in the 12 months prior to the offer by the bidder and its concert parties exceed 10 per cent of any class of securities or where any cash purchases are made by the bidder during the offer period, a cash offer for securities of that class or a cash alternative offer of at least the highest price paid must be made available.

Under the Companies Act 2006, once the bidder has acquired 90% of the voting rights in the target, the minority shareholders have the right to be bought out at the same offer price.

5.3 As mentioned above, a listing provides (ideally) liquidity for the company's shares and ensures a high level of information for a potential new investor. In fact, equity investors may invest in listed companies exactly for these reasons. In your jurisdiction, how is an equity investor protected from a delisting? Does the delisting require (qualified) shareholder consent? What are the deadlines for the delisting? Do issuers need to provide for an off-exchange trading for a certain period following delisting?

Under the Listing Rules, Main Market companies can only request to delist if they obtain shareholder approval, with at least 75% of votes in favour.

The circular convening the shareholders' meeting must include the anticipated date of cancellation which must not be less than 20 business days following the passing of the resolution.

AIM companies are subject to similar rules.

The company will normally offer an off-exchange trading platform for a limited period to allow investors to trade their shares. However, there is no obligation to provide this.

B. Interest of debt holders

1. Start-up phase

In the start-up phase, the entrepreneur may ask the so called "FFF" (friends, family and fools) for a loan. In other words the entrepreneur asks them to invest in a business idea as debt holders. In this context:

1.1 In your experience, what could be the typical focus of the FFF in this phase? Helping the entrepreneur to get his / her business going? How is this focus reflected in the legal relationship? For example, will such debt holders be likely to refrain from asking for security? Is the agreed interest rate likely to correctly reflect the risks for the debt investor?

In our experience, the FFF rarely provide debt capital because if they do, they are not able to obtain tax reliefs under the Enterprise Investment Scheme and Seed Enterprise Investment Scheme, which allow investors to claim relief against income and capital gains tax.

If they do provide debt finance, the loans are often not documented or simple loan agreements are entered into, usually with relatively low interest rates.

It is becoming more common for start-ups to seek finance from peer-to-peer lenders such as Lending Club and Zopa, or reward-based crowdfunding platforms such as Crowdfunder.

1.2 In your experience, is it common for professional investors to act as debt holders in this phase? If so, how is the different focus of professional investors typically reflected in the legal relationship? What are the legal instruments commonly used in your jurisdiction to protect their interests? For example, is it common for the professional investors to request a personal security by the entrepreneur in case the company does not yet have (a lot of) assets to secure a loan?

In our experience, professional investors prefer to act as equity holders in this phase due to the level of risk involved and the enhanced returns that can be achieved through equity.

2. Growth phase

2.1 In your experience, who provides debt in this phase and what could typically be their focus (e.g., high return on investment)?

- ***Are the debt holders and their focus in the growth phase typically different from the ones in the start-up phase? Is it now mostly professional investors (and no FFF)?***

The FFF do not typically provide debt in this phase, as the company's funding requirements are usually substantial.

Professional investors in this phase focus on:

a. High interest rates (usually 10% or higher) and initial fees (usually 3% or higher);

b. Carrying out legal and financial due diligence and obtaining a full suite of warranty protection from the company;

c. Protecting their investment by taking security over the company's assets;

d. Ensuring they have sufficient information rights so they can keep up-to-date with the company's progress;

e. Enhancing their investment by structuring the loan so that they have the right to convert it into equity.

- ***If there is a difference, how could this be reflected in the contractual relationship? For example, do the interest rates or the security for the debt change?***

N/A.

2.2 What kind of security is commonly request by debt holders in this phase? For example, rather collateral (pledge, etc.) or personal guarantees by the entrepreneur? What is the reason for the preference of a specific kind of security?

Professional investors will seek to take security over the business, usually by way of a fixed and floating charge over its assets.

It is rare for investors to seek personal guarantees from the entrepreneur.

If the debt is convertible into equity, then the debt is usually unsecured to reflect the potential upside that the investor has through the conversion right.

2.3 During the growth phase, the burn rate of the company may be quite high and the company may continuously be at the verge of over-indebtedness. Will investors usually be willing to subordinate their debt? Usually only the entrepreneur / FFF from the start-up phase or also professional investors?

We would not expect professional investors to be willing to subordinate their debt in these circumstances.

2.4 Investors providing debt in this phase may wish to keep the possibility to participate in the potential valuation upside. How could this wish be accommodated in your jurisdiction? For example, are profit-participating loans or convertible loans commonly used instruments?

Investors typically provide debt capital in this phase using loan note instruments. Loan notes are a type of debt instrument, however, loan notes can be structured so that they are convertible into equity. Usually, the conversion into equity is linked to a listing or sale. There will usually be anti-dilution protection for the investor.

3. Maturity

After having reached maturity, the structure of debt holders may change fundamentally. Against this background:

3.1 In your jurisdiction, who is usually the debt holder in the maturity phase (e.g., banks)?

The debt holder is usually a commercial bank at this stage. The company will normally have an overdraft facility in place and may have a term loan or revolving credit facility with a bank or a syndicate of banks. These facilities help the company with its working capital. If the company requires finance for capital expenditure, then it may have a term loan in place.

- ***Are the debt holders and their focus in the maturity phase typically different from the ones in the start-up or growth phase?***

As the debt holders are major financial institutions, they are normally more risk averse than the debt providers in the growth phase.

- ***If there is a difference, how may this be reflected in the contractual relationship?***

This may be reflected by the security package that the major bank(s) seek from the company, which would typically be more extensive. The loan and security documentation will usually follow the form set out by the Loan Market Association, so there is limited scope for negotiation. This helps the commercial banks minimize transaction costs and control their risk exposure.

3.2 Before providing debt to a company, the potential debt holder may require information about the company's financial status to assess the default risk. What financial information is publicly available for potential new investors who wish to invest in a privately-held company? Are financial statements available from public registers? Excerpt from the debt enforcement register? Tax returns? Do companies have means to influence the amount of publicly available financial information?

Publicly available financial information is limited to the company's last audited annual accounts. As private companies have up to nine months after their year-end in which to file their accounts, this means that the financial information which is publicly available could be significantly out of date. Private companies do not have an obligation to make any other financial information publicly available. The debt holder will request the company's management accounts, as well as its financial plans and projections. The debt holder may also review the company's corporate records (such as board minutes) and investigate its key assets (such as property or IP)

3.3 In your jurisdiction, is it common for privately-held companies to issue notes? Could you provide a short overview of the requirements and the procedure relating to the issuance of notes? Is the focus of note-holders any different from other debt holders?

Private companies can issue corporate bonds, however, it is relatively uncommon. Private companies are prohibited from offering debt securities to the public, so any debt issue is usually distributed as a private placement or to wholesale or professional investors only.

If the private company wanted to attract retail investors, then it could incorporate a public company subsidiary, which would issue the bonds, and guarantee that subsidiary's obligations under the bond documents. This structure has been used by private companies that wanted to issue debt securities on the Main Market through its Order book for Retail Bonds.

4. IPO / Listed

4.1 Once a company is listed, the debt holders have a considerably higher level of information regarding the company's financial situation. One could expect that this reduces the risk for the debt holder. Thus, in your jurisdiction, do listed companies usually have to pay lower interests?

We would normally expect a listed company to pay lower interest rates than a private company because (a) it is seen as a more secure investment and (b) it is more likely to have been rated by one of the credit rating agencies.

4.2 In your jurisdiction, is it possible to list notes? Could you provide a short overview of the requirements and the procedure relating to the listing of notes? In your opinion, is the focus of holders of listed notes any different from the focus of other debt holders?

It has become increasingly common for listed companies to list bonds on the London Stock Exchange. There are two principal markets: the Main Market and the Professional Securities Market.

The procedure for listing bonds or loan notes is similar to listing equity on the relevant stock exchange. For example, in order to list bonds on the London Stock Exchange, the company has to prepare a prospectus which has to be approved by the Financial Conduct Authority. The prospectus must comply with the Prospectus Rules.

As the bonds can be easily traded, the focus of investors can be different as some investors do not intend to hold the bonds for the duration of the redemption period.

5. Acquisition

5.1 In your jurisdiction, what is commonly the effect of a public tender offer

on listed notes. Do they have to be redeemed? Can holders of listed notes interfere in the process of a public tender offer? If so, by which means?

The bond instrument will usually contain provisions setting out what happens if there is a takeover offer for the company. Typically, the bondholders will have the right to force the company to repay the bonds. If the bonds are convertible, then the takeover offer will normally trigger the conversion (with, usually, enhanced rights) and the bidder will have to make an appropriate offer to the bond holders to ensure that they get equality of treatment, although the offer does not have to be on identical terms.

5.2 In your jurisdiction, what is the typical influence of a public tender offer on existing credit facilities?

The takeover offer will normally give the bank the right to call in the loan, so the offeror will normally seek bank consent as part of the negotiations. The bank may charge a fee if it decides to grant consent. Alternatively, the bank may want the loan repaid if it does not to be exposed to the offeror's plans for the business going forward.

C. Interest of management / employees

1. Start-up phase

In the start-up phase, it is essential that the key management is committed towards the development of the business idea or project. In this context:

1.1 Which are the most commonly used means to ensure that the management / key employees will not leave the company until the company reaches the growth or maturity phase? Are warrants or similar incentives granted during this stage?

In a very early start-up phase there are often very little formal mechanisms either to ensure that mangers/key employees do not leave the company, or to incentivise them. At this stage, it is usual for a small core number of founders to take equity (and in our experience founders and key management are very focused on having an equity stake) but in many cases that grant of equity is not accompanied by formal documents dealing with future entitlements – either for them or for the remainder of management / key employees. Warrants and options are possible but are little used and, where they are, they do not tend to be accompanied by much formal documentation.

It is likely that at this stage, there are not sufficient funds for remuneration of management / key employees. Is it common to grant warrant or stock incentive schemes in your jurisdiction? Is there any other scheme to liaise with this issue?

Certain option schemes are approved by HM Revenue & Customs and therefore give tax advantages to the employee, for example the Enterprise Management Incentive Scheme (**EMI Scheme**) which is a very well used route and provides significant tax advantages to option holders. EMI Schemes are subject to qualifying criteria – for the company and the individual, and they will not therefore apply to all circumstances – and it is usual to agree a company valuation with HMRC. There is a degree of complexity in relation to option schemes – and therefore the need for professional advice – and early stage companies usually do not have the financial resources to take this advice. It is possible to grant warrants but in our experience they are not commonly used in purely domestic transactions.

2. Growth phase

The management plays a crucial part in order that a company achieves going from a start-up phase to a growth phase and tend to assumes considerable risks by devoting to such project. Therefore, it would seem reasonable to protect the management in further financing rounds during the growth phase.

2.1 In case new investors come on board in the growth phase and such investors request replacement of the current management: in such replacement, does the current management usually lose rights granted under an incentive plan? How broad are "bad leaver" provisions usually formulated?

It is reasonably common in the growth phase as part of a substantial external investment for more complex agreements to be put in place, and for these to address the circumstances when management are forced to sell shares if they are bad leavers. The breadth of the definition of a bad leaver is for negotiation in each case but with investors in a growth phase it is usually not very broad, as otherwise this acts as a disincentive for management. The position is different in larger, private equity transactions where bad leaver provisions will be less favourable to management. It is usual at this stage for bad leaver provisions to cover voluntary resignation by the employee and termination of employment in circumstances justifying summary dismissal of the employee (including fraud).

A bad leaver is usually forced to sell shares for nominal value and they may be disenfranchised from voting pending a sale of their shares. A good leaver is usually forced to sell shares at market value, which is either agreed or determined by an accountant acting as an expert. In some, usually rare, circumstances good leavers might be entitled to retain their shares but this is often subject to the discretion of the board or with the consent of the majority investor(s).

2.2 Upon implementation of an incentive plan, the rights related to the shares that the management will be entitled to receive are usually subject to vesting. Is there any specific vesting period that is applied in your jurisdiction or is the vesting period usually linked to a liquidation event (such as an IPO)?

The more usual approach is for shares to vest (and therefore gain value) in tranches over a number of years, for example 20% of the options vest every year over five years. The intention is for options to incentivise employees in the medium to long term. Vesting is usually subject to performance criteria (personal and/or corporate), although this is not strictly necessary. EMI Schemes must be capable of being exercised within 10 years of the date of grant. Larger, more mature companies - where the option scheme is available to a wide range of employees - or companies anticipating an IPO are more likely to link vesting to an IPO or a sale.

2.3 In certain jurisdictions the management may fall out of labor relationship since it is developing executive duties for the company and/or may hold certain stock of the company (it might fall in a special labor relationship or corporate relationship). Is this the case in your jurisdiction? If so, is the loss of labor rights compensated by special laws or by contractual means?

Employee shareholder status is a relatively new scheme: an employee may voluntarily agree to give up certain employment rights – such as unfair dismissal - in return for shares worth at least £2,000. There are also tax advantages for the employee shareholder in respect of the shares issued to them under this scheme.

Other than in this circumstance, the positions of shareholder, employee and director are distinct positions and each aspect will need to be recorded by separate documentation.

3. Maturity

After having reached maturity, the business activity and the relationship between the shareholders and the management / key employees tend to become more complex (in particular, intensification of the principal-agent-conflict). The increasing complexity triggers certain hindrances or deterrents for the ongoing activity of the company. In this context:

3.1 In your jurisdiction, do the various corporate bodies (e.g., board of directors, directors, management) have

- ***an obligation to "act in the best interest of the company"? If so, how is the "interest of the company" defined? Is it the interest of all stakeholders (including the interests of all equity holders (e.g., holder of non-voting shares), debt holders, management, employees and public) or just the shareholders? Are only long term interests taken into account or also short term interests?***
- ***"fiduciary duties" or a duty to treat equity holders equally? How are these defined?***

In England, company directors are subject to statutory duties. The obligation to act in the best interests of the company is expressed as an obligation to promote the success of the company for the benefit of its members. In so doing, the director must have regard to the following non-exhaustive list of matters set out in the Companies Act 2006:

- The likely consequences of any decision in the long term.
- The interests of the company's employees.
- The need to foster the company's business relationships with suppliers, customers and others.
- The impact of the company's operations on the community and the environment.
- The desirability of the company maintaining a reputation for high standards of business conduct.
- The need to act fairly as between the members of the company.

The other statutory duties are for directors: to act within their powers; to exercise independent judgement; to exercise reasonable care, skill and diligence; to avoid conflicts of interest, to declare conflicting interests and not to accept benefits from third parties. These duties apply to both executive and non-executive directors equally.

3.2 In your jurisdiction, how are conflicts of interest addressed by the law? Are the rules on conflicts of interests for listed companies applied to non-listed companies? Have the rules on conflicts of interests become more rigid in recent years?

The basic statutory duties of directors that relate to conflicts of interests apply to all company directors, both listed and unlisted. Listed companies (and their directors) will be subject to more onerous requirements on certain aspects which are related to conflicts and transparency. For example, common themes are restrictions on directors (or their connected partners) from dealing in shares and require related disclosures.

3.3 In your jurisdiction, is it common to put in place incentive plans for key management and employees or are they only entitled to receive a cash bonus (usually based on individual and overall performance)? Do incentive plans provide tax advantage for the company?

It is usual, in more mature companies, for incentive schemes to be put in place for key management and employees, particularly as many schemes offer tax advantages for employees. These schemes tend to operate alongside a basic salary and a discretionary entitlement to a bonus. As a general rule – but this will depend on the particular option scheme – a company will be able to claim a corporation tax deduction on the exercise of an option by an employee.

4. IPO/ Listed phase

Reaching an IPO is often the pinnacle of private companies which have reached certain growth and have an attractive equity interest. Obviously, the management and employees play a significant role in the IPO / listing process. In this context:

4.1 It is our understanding that when a company goes from a private to a public setting it implies considerable changes for management and employees. In your experience and within this framework, what is the most significant change for management and employees? Does going public usually increase the total amount of the compensation and/or does it usually change the structure of the compensation (cash, shares, warrants, etc.)?

The principal areas of change are: (a) a more complex regulatory environment and the need to appoint advisers and put in place systems to address this; (b) a need to ensure that good governance is followed (remuneration, audit and appointments committees are required); and (c) greater transparency and public scrutiny.

There is also a greater need to ensure that the senior executive management have the necessary credibility (in the market) and experience. As such, a listing might require a change to the executive management – it is important to appoint a credible Chairman, CEO and FD. The remuneration of the senior management will need to take account of the market standard, in terms of salary and the grant of options.

4.2 Following the IPO the management is constantly assessed by the performance of the share price. Also the management's pay may to large extent depend on the share price performance. One could expect that management may abstain from taking any steps that are likely to weaken the share price – even if such steps are beneficial to the company in long term. In your jurisdiction, are there any measures that are commonly taken to address this conflict (i.e., incentives for long term strategies)? Is, for example, by law or by agreement a part of the pay paid in mid- to long term options?

In our experience, basic salary for senior employees is not affected by changes to the share price but it will be an important metric in deciding personal bonuses and grant of options. Option schemes are commonplace for public companies and there are usually obligations on the company to notify the market of the grant of options. There has been much discussion (mainly in the context of banks) on how to ensure that employees are focused on long-term value and, broadly, annual cash bonuses are seen as bad and option schemes good.

4.3 Is the management and/or employees bound by a mandatory lock up period upon the IPO? In the event the lock up period is not mandatory, please explain the common standards in your jurisdiction towards implementing a lock up period.

Directors and substantial shareholders will usually be subject to a lock in period of one year in the event of an IPO and this will be re-inforced by contractual orderly market clauses in agreements put in place at the time of an IPO.

5. Acquisition

In the scenario of the acquisition, it is frequent that the management is essential towards the subsequent development of the company. In this context:

5.1 The focus of the board of directors of a listed company may be set to a large extent on the share price performance. Usually, this should be in

line with the corporate interest. However, in case a listed company is being approached by a potential bidder, the board of directors and the management of the potential target may face a conflict of interest: an acquisition that may be beneficial to the shareholders of the potential target, may at the same time require replacement or adjustment of the target's board of directors and management. In your jurisdiction, how is this conflict of interest addressed? For example, are there limits to the defense measures that the board of directors of the target may take?

The first point to make is that directors are subject to statutory duties (see paragraph 3.1 Part C) and these require the directors to promote the success of the company, and not to act in a way which protects their personal interests (e.g. employment). However, given that it is fact based, there is no certain rule as to what action promotes the success of the company and there may well be action taken to resist a takeover bid which nonetheless fulfils this duty. It is, however, clear that anything with the primary motive of protecting the management's position is unlawful.

In addition, the Takeover Code contains limitations on a target company from taking frustrating actions during a takeover bid without shareholder approval, for example by issuing shares, granting options or entering into contracts outside the normal course of business. These requirements are more onerous than the statutory directors' duties.

The role of the independent directors on the board becomes important in this circumstance, as they do not have the same actual or potential conflict as executive directors. It is usually sensible for both the independent directors and the executive directors to receive separate advice on their position, and how to manage the conflicts.

5.2 *Which are the common alternatives in order to keep management / key employees focused and keen to continue in the company?*

It is not unusual to incentivise key employees with some form of additional remuneration in the event of a successful transaction. This recognises that employees will need to carry out a significant amount of additional work as part of the transaction and helps to ensure that they push for a successful deal. The usual – and simplest – form of remuneration is a cash bonus of a fixed amount on completion of a transaction. The costs will need to be factored into the transaction and will generally be a cost of the seller(s). It is possible to put in place other forms of incentive but this will usually need the consent of the buyer, as if they are longer term incentives the buyer will need to deliver them.

5.3 In parallel, is it common to reinforce non-competition and confidentiality undertakings of the management / key employees upon

acquisition? Is it common to regulate a non-solicitation by the Seller and that it is enforceable (for which period)?

It is commonplace for restrictive covenants to apply to senior employees in their employment contract and these will not be changed or waived on an acquisition. Any restructuring of employees tends to take place after completion of the sale and it is unlikely that a buyer will release any person from their restrictive covenants. 12 months is the maximum period for covenants in relation to employees.

It is usual for a seller to agree to restrictive covenants as part of a sale. A longer restricted period can apply to a seller (as compared to an employee) and, in practice, three years is generally considered a maximum commercial period for a seller to agree to, but it does depend on the circumstances.

D. Interest of advisors / lawyers

1. Startup

During the startup phase, it is one of the most difficult stages to advice companies and/or projects since the company does not have the resources (funds) to implement an appropriate legal scheme and the management/equity holders tend to think in the short term rather than the long term.

1.1 Which are the common difficulties you liaise with during this stage? How do you tend to structure your fees (for example, do you go below your standard rates and agree to have this difference compensated at a later stage when the company has become more successful)?

This is the most difficult stage for legal advisers; startups often do not see the need for legal advice and do not want – or cannot afford - to pay for proper advice. We do not tend to reduce our standard rates but we do agree fixed or capped fees (subject to an agreed scope of work) and our focus is to put in place short form, fit-for-purpose agreements (i.e. a startup probably does not need a 60 page shareholders' agreement). Certain firms will offer free precedents (although not free advice) and others publish fixed rates for certain work. It is unattractive for a law firm to rely on future work as often a client cannot control this; e.g. it may be in the control of the next investor.

1.2 In case you accept warrants / rights to shares as compensation for professional services rendered: how do you set the amount or the value of such warrants and rights? Do you rely on valuations of the company? If so, whose valuations? Is it common for an advisor in this situation to request that the company has previously successfully completed a

minimum viable product ("MVP") stage which reduces the risk of failure (i.e., as part of the lean startup methodology it is advisable to diminish uncertainty for the project by means of developing an MVP to validate the project)?

We do not take equity in return for the provision of legal services and our feeling is that this is relatively rare in the legal market. If this was the case, we expect that it would be in relation to work at the startup phase and – other than for very material costs – that a legal advisor will use the same valuation for the shares / options issued to the other investors at that stage, i.e. they would follow, and sit alongside, the money.

1. Growth

Commonly, it is important to provide appropriate legal advice when the company intends to achieve going from the start-up phase to a growth phase. The role of lawyers and advisors would likely enhance the possibilities to effectively reach a solid growth phase. In this context:

1.1 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to the start-up phase)?

The principal change in the growth phase is that the volume of work undertaken will increase and it is therefore easier to offer a discount on fees to a client. There may also be more certainty that the business has a future (often not the case with a startup) and that there will be ongoing / regular legal work outside a transaction.

1.2 Is it common for advisors (in particular, lawyers) to take board positions during this phase? If so, how is such board member compensated? In cash? Or with exclusivity for providing legal services to the company?

Although there is no regulatory objection to this, it is not common for legal advisers to take a board position at this stage. It is also not usual for a board seat to go hand-in-hand with exclusivity for the provision of legal services. Any board role taken by a legal adviser would probably not be in return for compensation.

1.3 As the lawyer you may be asked by the entrepreneur to render advice on the division of equity (in particular to FFF)? What is the basis for your advice regarding the division of equity?

It is not the key job for the lawyer to advise on valuation (which is a vital piece of information in this context) or the division of equity. However, we can comment based on previous experience and by reference to the (objective) thresholds which apply to voting shares (for example 75% is required to pass a special resolution which can amend the Articles). We can also raise practical points about the effect of future transactions (assuming a growing company), and discuss, for example, dilution so that the founder can retain sufficient shares in order to be in a position to agree to dilution in future funding rounds.

1.4 In certain jurisdictions corporate law is rigid and does not allow to regulate certain rights of the shareholders in the by-laws of the company (such as, preferential preemptive rights, drag along or tag along rights). Please explain (succinctly) which is corporate legal scheme that applies in your jurisdiction. Is the shareholders agreement enforceable against third parties in your jurisdiction or is only binding between the relevant shareholders?

The Articles of Association (the by-laws) bind all members of the company and are a public document. The shareholders' agreement only binds the parties to that agreement (it is therefore possible for there to be a shareholders' agreement between some, but not all, of the shareholders) and is a confidential document.

There is no objection for the by-laws to grant additional rights to shareholders. However, it is usual for there to be a shareholders' agreement and articles, and for the latter to deal with matters relating to the share capital (for example pre-emption rights and drag and tag rights), to ensure that these fundamental aspects bind all shareholders.

Neither document binds third parties although it is possible to grant rights (but not impose obligations) to third parties in the shareholders' agreement (but not the Articles) under the Contracts (Rights of Third Parties) Act 1999 and these rights can be enforced by those third parties.

2. Maturity

After having reached maturity, the business activity is much more complex and the interests of the company become more intricate. In this context:

2.1 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to the start-up or growth phase)?

Fees tend to be structured in a number of ways. The hourly rate is the benchmark – and this might apply in relation to small, regular matters - but it is common to agree fixed / capped fees for transactions or larger matters, give hourly rate discounts for certain volumes of work and/or agree blended rates. In all cases, we are required to give fee estimates and to keep the client up to date with costs.

2.2 Are you able to become member of the board of directors of the companies? Do you tend to render more unique advice to companies (while the corporate counsel provides the typical ongoing corporate advice)?

As above.

2.3 From a lawyers' perspective, how is the conflict of interest of the management liaised with (are there any mandatory provisions that apply in your jurisdiction)?

As above.

2.4 Does the anti-money laundering provisions in your jurisdiction have changed the form your render advice?

Not substantially. We need to comply with AML requirements before we can provide advice to clients and this therefore needs to be completed at the start of a matter. In our experience, clients are accustomed to providing this information to us.

3. IPO/ Listed phase

Reaching an IPO is often the pinnacle of private companies which have reached certain growth and have an attractive equity interest. It is unlikely that the process of becoming a listed company will be successful without the proper advice. In this context:

3.1 How do you structure your fees for an IPO?

It is a matter for agreement but we usually start by breaking the work into phases / tasks and estimating the cost of each task against a defined scope of work. If the scope of work changes, then we approach the client and agree revised fee arrangements. There are a wide variety of ways to charge overall fees but the usual method is a fixed / capped fee against a defined scope of work. If the client asks for an abort fee if the deal does not proceed, we might seek to negotiate a success fee if it does complete. We do not charge on a percentage basis – unlike corporate finance – and this is not usual.

3.2 From a lawyers' perspective, which are the main regulatory aspects of offering equity to the public? Is it common that companies reach this stage (in certain jurisdictions becoming a listed company is less rigid)?

The main regulatory requirement is the need to publish a prospectus or an admission document on an IPO (and to carry out a related verification exercise to ensure the accuracy of the information in the document). This is the most time consuming, and costly, aspect.

There is also a need to put in place governance arrangements (for example an audit committee) and to ensure that the contracts of employment of senior executives are comprehensive and at a market standard. As such, there is usually a fair amount of 'tidying-up' that needs to be carried out at the same time as an IPO.

3.3 Is there any specific secondary market in your jurisdiction that allows early startup companies to become listed with the aim of obtaining more equity (given the complexity of becoming a public company in certain jurisdictions a startup company can become listed in a specific market which is less rigid and allow it to obtain other sources of financing, among others)?

AIM is a well-established secondary market for the listing of shares as is ICAP Securities & Derivatives Exchange (ISDX). Each market has its own rules of admission and continuing obligations. It is generally cheaper and less complicated to IPO on AIM and ISDX compared to the Main Market and the ongoing obligations are less rigid.

3.4 Does the fact of becoming a listed company imply that the lawyers and/or advisors adjust rates their rates accordingly?

No but this probably happens as a result of the need for larger, more expensive advisers. For example, a law firm that primarily advises start-ups is unlikely also to advise on a Main Market IPO.

4. Acquisition

In the scenario of the acquisition, it is frequent that lawyers and advisors are highly involved. In this context:

4.1 Which is most frequent scheme of implementing an acquisition (asset deal vs share purchase deal)?

A share transaction is the more usual structure, particularly where the seller is an entrepreneur, as he will only pay capital gains tax at 10% on the first £10 million of gain (a lifetime allowance). Asset sales do happen but usually where there is a corporate seller or where there is a particular commercial reason, for example to reduce the risk for the buyer on the purchase as it does not take on the historic liability of a company.

4.2 From a lawyers' perspective, which are the main differences within the process of acquiring a stake in listed companies versus private companies?

The regulatory process for a listed company acquisition is much more complex, particular as the Takeover Code will apply and this contains detailed requirements. See, for example, paragraph 5.2 of Part A and paragraph 5.2 of Part C.

4.3 From a lawyers' perspective, which are the main steps in your jurisdiction in order that a public entity becomes a private entity as a consequence of an acquisition?

Shareholder consent by a special resolution (75% of shareholders voting on the resolution) is required. The consent of the Takeover Panel is also required and a circular may need to be sent to the shareholders to inform them that the Takeover Code will no longer apply to private companies, and the effect of this. Members have a right to object to the process. The Articles will need to be updated and thought given to whether additional provisions – such as pre-emption rights – are included to recognise that the company will be private. Certain public filings will need to be made.

4.4 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to other phases)?

As above.