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[On letterhead]

**Strictly Private and Confidential**

Dated [ ]

To: [ ]

Dear Sirs

## Proposed Investment in [Insert Company Details] (Company)

We write further to our recent discussions to confirm the terms and conditions agreed in principle between [ ] and [ ] in relation to a proposed investment by [insert investor(s) details] in the Company (Investment).

### Basis of Agreement

- A This letter sets out the principal terms agreed and does not seek to set out all of the details of the proposed Investment. As such, this letter is not intended to be legally binding except in relation to Part B, which the parties agree to be bound by.
- B There shall be no obligation to proceed with the proposed Investment, which shall be subject to one or more formal written agreements (Legal Documents) being prepared and signed by the parties, including an investment agreement (Investment Agreement). All oral and written communications, exchanges of correspondence and information and discussions will not bind the parties until the parties have signed the Legal Documents.

## Part A

### Terms of the Proposed Investment

#### 1 Background

- 1.1 The Company's registered number is [insert number] and its registered office is at [insert detail].
- 1.2 The Company has the following issued share capital held by the following shareholders:

Name and Address	Number of [ordinary] Shares of [ ] each (Ordinary Shares)

- 1.4 [The following options have been granted to the following persons on the following basis:  
[insert detail]]
- 1.5 [The Company has the following subsidiaries:

Name	Percentage of Shares Held
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The Company, and the subsidiaries described above, comprise the group.]

## 2 Proposed Investment

2.1 It is proposed that:

[ ] Ordinary Shares and *[insert other shares details e.g. Preference Shares (A Preferred Ordinary Shares)]* (together – New Shares) will be issued at a price of £[ ] per [ordinary share] and £[ ] per [share] respectively, giving an aggregate investment of £[ ] (Investment). This represents [ ]% of the enlarged issued share capital of the Company *[including after exercise of the options described in paragraph 1.3 [and conversion of the Loan Notes]. [Include reference to other A Preferred Ordinary Shares, etc].* [Please see the Appendix for a cap table providing further details].

The New Shares will be subscribed as follows:

Details of Investor(s)	Name	Address	Number of Ordinary Shares of [ ] Each	<i>[Number of [A Preferred Ordinary] Shares of [ ] each]</i>

2.2 £[ ] [unsecured][secured] [convertible] loan notes (Loan Notes) will be issued by the Company on the following terms:

*[Include coupon, redemption date and whether they are cumulative and/or convertible, and basis of conversion.]*

2.2.1 Giving an aggregate investment of £[ ] (Investment).

## 3 Conditions to Investment

Completion of the proposed Investment shall be subject to the following matters being satisfied:

3.1 *[insert detail]* – to include e.g. matters such as the following:

- 3.1.1 Business plan duly completed and acceptable to the investor(s)
- 3.1.2 Due diligence questionnaires duly completed and acceptable to the investor(s)
- 3.1.3 Directors' declarations duly completed and acceptable to the investor(s)
- 3.1.4 Directors' and officer liability insurance for £[5,000,000] of liability being in place
- 3.1.5 Evidence that all intellectual property rights have been transferred to the Company
- 3.1.6 Advance assurance from HM Revenue & Customs that the Company and the proposed Investment comply for the purposes of the Enterprise Investment Scheme such that the Company is a qualifying company, and the new shares will be eligible shares
- 3.1.7 *[Insert Others]*

## 4 Share Rights and Quorum for Shareholder Meetings

4.1 The Ordinary Shares to be issued shall rank *pari passu* with the existing Ordinary Shares in the capital of the Company.

4.2 [The [A Preferred Ordinary Shares to be issued] shall be [participating] shares [and shall carry [a fixed [cumulative] dividend of [6%] [which shall not be cumulative]].

4.3 On a sale or initial public offering (IPO) of the Company, a sale of the business of the Company or a liquidation of the Company (each an Exit), the proceeds available to shareholders will be distributed in the following order of priority:

- 4.3.1 Firstly, the holders of the A Preferred Ordinary Shares will receive back the subscription price paid by them
- 4.3.2 Secondly, the holders of the Ordinary Shares will receive back the subscription price paid by them
- 4.3.3 Thirdly, the balance of the proceeds will be divided equally between the holders of [the A Preferred Ordinary Shares and] the Ordinary Shares
- 4.3.4 [In all other respects, the A Preferred Ordinary Shares and Ordinary Shares will rank equally in relation to a return of capital/proceeds on Exit.]
- 4.4 Each A Preferred Ordinary Share and each Ordinary Share shall carry one vote. *[Note – Some investors may ask for enhanced voting rights in certain situations. Care is needed when drafting enhanced rights in circumstances where EIS/SEIS relief is being sought and where there is an intention to adopt an EMI scheme. Appropriate tax advice should be sought.]*
- 4.5 The quorum for shareholder meetings shall be two shareholders, of which one must be [an][the] investor, [save where the meeting is adjourned for failing to be so quorate, where a quorum shall be any two shareholders and need not include [an][the] investor].

## 5 [Anti-dilution]

[If equity shares in the Company are issued following completion at a price less than the price paid by the investor(s) for A Preferred Ordinary Shares, the investor(s) will be issued out of reserves or, alternatively have the right to subscribe at par for additional A Preferred Ordinary Shares so as to result in the investor(s) having paid in subscribing for its entire holding of shares, on average, a price per share equal to the subsequent price. Appropriate exemptions including in respect of the grant of employee options will apply.]

## 6 [Investor protections]

- 6.1 The investor(s) will have the right at [its][their] option to reconstitute the board of directors and appoint a majority in number of the directors to the board of the Company, in the event that there is (i) a material breach of warranty that remains unremedied, (ii) a continuing breach of the shareholders' agreement (other than by the investor(s)) [or (iii) a payment default under the [Loan Notes]].
- 6.2 The investor(s) will have the right to remove a director who has become bankrupt, committed a criminal offence, become prohibited by law from being a director or who is in [material] breach of the shareholders' agreement, the articles of association of the Company, their service agreement or consultancy agreement and/or their duties to the Company.
- 6.3 Appropriate indemnities will be provided by the founder/managers in relation to any tax burden placed on the Company or its subsidiaries as a result of the issue of any shares to such founders/managers.]

## 7 Warranties and Indemnities

Warranties of the nature and type that would be usual, in investments of a similar nature to the proposed Investment, will be incorporated, including, without limitation, that the business plan has been prepared on a fair basis and incorporates all relevant facts and that the directors' declarations are correct and will be given by [insert relevant managers and founders] and the Company.

The Warranties will be subject to customary limitations.

The [manager/founders] liability will be capped, in each case, to [ ] times their annual salary as an employee of the [Company][Group]. The liability of the Company will be capped at [level of investment].

Appropriate *de minimis* limits will be incorporated, along with time limits for bringing claims (seven years in respect of tax matters and [18] months for other claims).

## 8 Use of Proceeds

The Proceeds from the proposed Investment will be used for [working capital purposes only] .

## 9 Reserved Matters

[The Company shall not, without the prior written consent of [the investor/investor majority] [shareholders holding [75% ] of the issued shares] carry out certain matters to be agreed including, without limitation, changes to share capital, the creation of new share classes, changes to the articles, and certain key management decisions.

## 10 Transfers of Shares

### 10.1 Founder/Manager Restrictions on Transfer

[Except in the circumstances referred to in paragraph 10.6,] the [founder/managers] shall not be entitled to transfer their shares [for a period of [three ] years following completion] without the prior written consent of the investor(s).

### 10.2 Investor(s) Freedom To Transfer

The investor(s) shall be free to transfer their shares to [any third party][certain permitted transferees including [other investment funds financial institutions and partners etc. free of any restriction]].

### 10.3 Preemption rights on transfer

[Except for permitted transfers referred to above and below] each shareholder will be required to offer their shares to the other shareholders *pro rata* to their existing shareholdings before being able to sell to any third party. [The board, with the written consent of investors [holding a majority of the A Preferred Ordinary Shares] (Investor Consent)][the investor(s)] , can nominate the Company to acquire the shares in place of the other shareholders, subject to certain legal requirements being met, or may nominate a third party to acquire the shares instead].

### 10.4 Tag Rights

If shareholders holding more than [50%] of the issued shares wish to sell their shares, they must first procure that an offer is made for all other shares on the same terms.

## 10.5 Drag Rights

Shareholders holding more than [75%] of the issued shares who wish to sell their shares to a purchaser shall, with Investor Consent, have the right to require each of the other shareholders to sell their shares on similar terms.

For this provision to apply, the purchaser must be a *bona fide* third party (not connected with any of the proposing sellers) and the purchase must be on arm's length terms.

## 10.6 Permitted Transfers

A [founder/manager] will be entitled to transfer their shares without preemption rights applying to family members and family trusts. All corporate shareholders shall be entitled to transfer their shares to other group companies while they remain in their group.

## 10.7 Leaver Provisions<sup>1</sup>

A [founder/manager] who is employed by the Company [(or a member of its group)] or who acts as a consultant to the Company [(or a member of its group)], will be obliged to offer [the number, as determined below][all] of the shares held by that [founder/manager] to the [other shareholders], on a *pro rata* basis, to their existing shareholdings [(or to the Company or another person if the board, with Investor Consent, in its discretion directs)][or to convert [the number, as determined below][all] of the shares held into deferred shares (having negligible value)] and on the terms described below.

### Good Leaver Outcome

If the founder/manager is a good leaver [all shares will be offered, and market value will be paid for all of the shares (Good Leaver Price)] [all of the shares shall be retained by the [founder/manager]].

### Bad Leaver Outcome

If the leaver is a bad leaver, all shares will be offered for sale at the lower of (1) market value and (2) [nominal value] [price paid for the shares (Bad Leaver Price)][all shares will be converted to deferred shares].

### Voluntary Leaver Outcome

If the founder/manager leaves employment/consultancy and is a voluntary leaver, then the shares held by the founder/manager will be subject to vesting criteria such that [the shares to be retained shall be based on the percentage in Column (2) below and all other shares held by that leaver shall be [offered for sale at the Bad Leaver Price][converted into deferred shares]][all shares shall be offered for sale but the price to be paid for the number of shares applying the percentage in Column (2) below shall be the Good Leaver Price and the remainder of shares held by the leaver shall be transferred at the Bad Leaver Price.

Time When Cessation of Employment/Consultancy Occurs (1)	Shares To Be Retained (%) (2)
During first year following later of (i) date of adoption of new articles; and (ii) commencement of employment/consultancy	0%
During second year following later of (i) later of ( date of adoption of new articles; and (ii) commencement of employment/consultancy	25%
During third year following later of (i) date of adoption of new articles; and (ii) commencement of employment/consultancy	50%
During fourth year following later of (i) date of adoption of new articles; and (ii) commencement of employment/consultancy	75%
After fourth year following later of (i) date of adoption of new articles; and (ii) commencement of employment/consultancy	100%

### Definition of Bad Leaver

A bad leaver is a [founder/manager] who leaves for any reason not being a good leaver or a voluntary leaver.

### Definition of Good Leaver

A good leaver includes the following reasons for cessation of employment/consultancy – death, [redundancy,] unfair dismissal (save for procedural unfair dismissal only), illness, mental incapacity (not being inflicted from abuse of drugs or alcohol) or retirement and/or leaving employment/consultancy voluntarily after [four] years following completion, without having committed or subsequently discovered to have committed acts or offences entitling the group to dismiss for cause.

<sup>1</sup> The leaver provisions can take many forms. We would, therefore, encourage you to take professional advice on these provisions. The "penalty" for leaving employment/consultancy/directorship, will usually result in some, or all, shares having to be transferred or converted into worthless deferred shares on such cessation. The price payable for the shares that are to be transferred, or the number of shares to be converted into deferred shares, will usually depend on the circumstances giving rise to the cessation. The suggested drafting incorporates a number of common options.

## Definition of Voluntary Leaver

A voluntary leaver is a founder/manager who leaves employment/consultancy voluntarily, without having been dismissed for cause and/or without having committed, or subsequently discovered to have committed, acts or offences entitling the group to dismiss for cause, during the first [four] years following Completion.

## Dismissal for Cause – Meaning

A founder/manager may be dismissed for cause in the following circumstances:

- (i) Being convicted of a criminal offence capable of carrying a custodial sentence
- (ii) Having committed fraud or there being sufficient evidence to convict them of fraud
- (iii) They have breached the restrictive covenants in the Investment Agreement and/or their service/consultancy agreement
- (iv) They have committed a [material] breach of any other provision of the Investment Agreement
- (v) They are summarily dismissed as a result of gross misconduct or material breach of the terms of their employment or engagement with the group

## 10.8 Other Forced Transfers

If required by the board, with Investor Consent, shares must also be transferred to the other shareholders (*pro rata*) in certain circumstances, e.g. death, mental illness, insolvency [change of control of a corporate shareholder].

## 11 Preemption on New Share Issues

[Except with the prior written consent of the holders of [75%] of the issued shares, and] Investor Consent, all new issues of shares, options or other rights to subscribe for shares or convert loans into shares, will only be permitted after completion of the proposed Investment, if they are first offered to existing shareholders *pro rata* to their existing shareholdings before they can be offered to a third party and then, at no less than the price per share offered to the existing shareholders.]

## 12 Directors and Observers

12.1 [While the investor(s) continue[s] to hold [at least [ ]% of the issued shares][shares], [it][they] shall be entitled to appoint [ ] directors to the board (Investor Director). [ ] shall act as the first Investor Director. The investor will be entitled to receive a director fee of £[ ] per annum].

12.2 [In addition to appointing an Investor Director,] [while an Investor Director is not appointed,] the Investors (while [it] [they] continue[s] to hold [at least [ ]% of issued shares from time to time][shares]) shall be entitled to appoint an observer to attend board meetings of the Company (but not vote).

[ ] shall act as the first observer.

[Consider whether any board or other consent to be incorporated or prior consultation required].

## 13 Board Meetings and Chair

13.1 [A new independent chair of the board will be appointed as soon as reasonably practicable following completion of the Investment with the approval of the investor(s).]

13.2 The chair shall [not] have a casting vote.

13.3 Board meetings will be held at least [10 times] per year unless otherwise agreed by the investor(s).

13.4 The quorum for board meetings shall be two directors, of which one must be an Investor Director, [save where the meeting is adjourned for failing to be so quorate, where a quorum shall be any two directors and need not include the Investor Director].

## 14 Right to Receive Information

Each of the investor(s) shall be entitled to receive management accounts each month and other financial information reasonably required, together with annual accounts within [four] months following the financial year end. [Note: investors are likely to have specific information requirements that will need to be included]

## 15 Service/Employment Matters

The following individuals shall enter into new service agreements with the Company on completion with the following basic terms:

Name	Remuneration	Initial Term	Role	Notice Period

The remaining terms are to be on the basis customary for a person of similar role.

## 16 Restrictive Covenants

The [founder/managers] shall be required to enter into noncompete and nonsolicit (of employees and customers) restrictions (i) while they continue to be an employee/consultant of the [Company][group]; and/or (ii) for a period of [two] years after ceasing to be a shareholder.

## 17 [Employee Share Options]

*Up to [5][10]% of the issued share capital fully diluted after the proposed Investment will be available for the grant of options to such employees as determined by the board, with Investor Consent, from time to time.*

## 18 Exit

The [founder/managers] shall use their reasonable endeavours to procure a sale, or IPO of the Company [or sale of the group's business and assets] (Exit) within [3] years from completion. On an Exit, the investor(s) will not be required to give any warranties except as to title to their shares and, in relation to an IPO, will not be required to agree to any dealing restrictions on its shares (other than as required by the rules of the relevant exchange). Founders/managers will be expected to provide customary warranties and indemnities.

## 19 Confidential Information

Appropriate restrictions will be incorporated in the Legal Documents to protect the [Company's][group's][investor(s)'] information (Information).

## 20 General

### 20.1 Costs and Fees

Each party shall pay their own costs in relation to the negotiations and preparation of Legal Documents in relation to the proposed Investment [except the Company will pay *[include any fee]* together with reasonable legal fees in connection with the Investment on behalf of the investor(s) up to a maximum of £[ ] plus VAT.]

### 20.2 Existing Shareholder Arrangements

All agreements binding the existing shareholders shall terminate on completion.

### 20.3 Keyman Insurance

This will be put in place in respect of [ ] and [ ] by completion in such amounts reasonably acceptable to [the investor(s)].

### 20.4 Transaction Bible

Within 30 days of completion, a transaction bible containing copies of the signed versions of the Legal Documents will be prepared by the Company, or its advisers on its behalf, and the Company will deliver the bible to the investor(s).

## Part B

### Legal Matters

#### 1 Confidentiality

- 1.1 The parties undertake to each other, except as provided below, that they will [and will procure that their respective group companies and officers, employees and agents, representatives and professional advisers (Beneficiary/-ies) will]:
  - 1.1.1 Keep all Information received by it [and/or any Beneficiary] confidential and use the Information solely for the purpose of negotiating the proposed Investment
  - 1.1.2 Not disclose to any third party and treat as confidential all discussions and negotiations relating to the proposed Investment together with the fact they are taking or have taken place, including the terms in this letter (Negotiations)
  - 1.1.3 Not make any public announcement of any Information and/or detail concerning or gained during the Negotiations:
    - 1.1.3.1 Except to the extent required by law or any government or other regulation to which a party is subject (Permitted Reasons), in which event the party required to make the announcement will consult with the others on the form and content of the announcement, if practicable, before making the announcement
    - 1.1.3.2 [To those Beneficiaries who need to receive and consider the details of such Negotiations and Information, for the purpose of negotiating and considering the terms of the proposed Investment]
    - 1.1.3.3 Which is reasonably necessary to disclose to a third party in order to obtain any consent or approval from that third party to enable the proposed Investment to proceed
    - 1.1.3.4 Immediately on request by the other party of them, at any time, return [and instruct Beneficiaries to return] to the relevant party or the Company, all Information in their possession or in [the possession of Beneficiaries or under] their respective control, together with all copies of such Information, or otherwise confirm in writing that such Information has been destroyed, save where a particular party [or Beneficiary] is required by any law or regulation to maintain records that include Information
- 1.2 It is agreed and acknowledged between the parties that the undertakings in paragraph 1.1 of this Part B shall not apply:
  - 1.2.1 To any Information that, at the time of disclosure, is in the public domain, or that, after such disclosure, comes into the public domain otherwise than through any failure on the part of the party receiving the disclosure [or a Beneficiary] to comply with the terms of this letter
  - 1.2.2 To any Information that is trivial, obvious or otherwise clearly of a nonconfidential nature
  - 1.2.3 Where such Information was lawfully in the possession of the party concerned prior to disclosure and was not otherwise acquired in circumstances giving rise to a breach of any duty of confidence in relation to it
- 1.3 Each of the parties agrees and acknowledges that neither they nor their directors, officers, employees or other agents or advisers accept any responsibility or liability in any way whatsoever for, or make any representation or warranty, express or implied, in respect of the accuracy and completeness of any Information or any other information made available to the other(s) of them or that any such information remains unchanged from the date of receipt of it, other than as may be specifically set out in the definitive Legal Documents.
- 1.4 It is acknowledged that damages may not be an adequate remedy for any breach of the undertakings in this paragraph 1 and that a party shall be entitled to seek remedies of an injunction and other equitable reliefs for any threatened or actual breach of such undertakings.

#### 2 Costs

If the proposed Investment does not proceed, each of the parties involved in the proposed Investment will bear their own costs in relation to the proposed Investment.

#### 3 [Good Faith

- 3.1 It is agreed that, if a party decides not to proceed with the proposed Investment, that party will immediately notify the other[s] of the decision not to proceed.
- 3.2 Each of the parties shall notify the other[s] at any time if it becomes aware of circumstances that may lead to it not being possible to adhere to the timetable outlined in this letter for the proposed Investment.]

## 4 General

- 4.1 This letter and all Negotiations shall in all respects be governed by English law and the parties submit to the nonexclusive jurisdiction of the English courts.
- 4.2 This agreement may be executed in counterparts, [both][all] of which, when taken together, shall constitute a single instrument.
- 4.3 No provision of [this letter] is enforceable pursuant to the Contracts (Rights of Third Parties) Act 1999 or otherwise by any person who is not a party to them.

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[ ]  
on behalf of the Company

[ ]  
Founder

Agreed

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Dated [ ]

[ ]  
for and on behalf of [investor]

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[ ]  
for and on behalf of [investor]