

# RAISING EQUITY FINANCE – A GUIDE TO THE UK REGULATORY FRAMEWORK

A key source of financing for start-up companies is by way of equity financing. This often takes the form of personal investment or investment by third parties (including friends and family, professional investors and/or alternative sources such as crowdfunding).

When an investor acquires shares in a start-up company, there is a risk that the investor may lose his entire investment if the company is not successful. Shares in private limited companies are also illiquid assets and difficult to value. It is for this reason that the UK legislative regime has developed to protect investors and to restrict a company's ability to induce investors to invest in a company.

This note provides an overview of the relevant UK legislation to be considered by start-ups (though it should not be viewed as legal advice). It is not possible to provide comprehensive advice on the matters that may apply in the particular circumstances of your business in this note. This checklist is also by no means exhaustive. If you have any queries or concerns in relation to the UK regulatory framework, we recommend that you seek legal advice before taking any further action.

This information is intended as a general overview and discussion of the subjects dealt with. The information provided here was accurate as of the day it was posted; however, the law may have changed since that date. This information is not intended to be, and should not be used as, a substitute for taking legal advice in any specific situation. DLA Piper is not responsible for any actions taken or not taken on the basis of this information.

## OFFERS TO THE PUBLIC

### **General Prohibition on limited companies making offers to the public**

Pursuant to section 755 of the Companies Act 2006 ("CA 2006"), a private limited company must not offer shares of the company to the public. Under the CA 2006, an offer is **not** regarded as an offer to the public if it can properly be regarded in all the circumstances as:

- not being calculated to result, directly or indirectly, in the shares of the company becoming available to persons other than those receiving the offer; or
- otherwise being a private matter between the company and the recipient of the offer (this is often the case when an offer is made to a person who has a connection with the company or one of its founders (which includes existing members and employees of the company and their family)).

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| <b>Requirement to prepare a prospectus</b> | <p>Pursuant to section 85 of the Financial Services and Markets Act 2000 ("<b>FSMA</b>"), it is unlawful for a company to offer transferable securities (i.e. shares) to the public unless a prospectus, approved by the Financial Conduct Authority has been prepared. Breach of section 85 is a criminal offence.</p> <p>Under FSMA, there is an offer of transferable securities to the public if there is a communication to any person which presents sufficient information on the transferable securities to be offered and the terms on which they are to be offered to enable an investor to decide to buy or subscribe for the securities in question. The communication can be in any form and by any means.</p> <p>There are a number of exemptions commonly used by start-up companies seeking equity financing:</p> <ul style="list-style-type: none"> <li>■ the total amount being raised from investors in EEA states is less than €5,000,000 (calculated over a period of 12 months);</li> <li>■ the offer is made to or directed at qualified investors only (e.g. venture capitalists and business angels and other persons regulated by the FCA);</li> <li>■ the offer is made to or directed at fewer than 150 natural or legal persons, other than qualified investors, in each EEA state; or</li> <li>■ the minimum consideration payable by any person is €100,000.</li> </ul> |
| <b>General Guidance</b>                    | Before any offer is made by a start-up company, the scope and extent of the offering should be assessed to ensure that these restrictions are not triggered. Ideally any offer should be targeted at specific individuals (whether it be professional investors or friends and family) only rather than the general public.  |

## FINANCIAL PROMOTION

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| <p><b>Financial Promotion Prohibition</b></p> | <p>Even if the shares can be offered without the need to issue a prospectus (see above), this does not mean that the offer will fall outside the scope of all regulatory requirements. Specifically, the financial promotion regime contained in FSMA needs to be considered.</p> <p>Under Section 21 of FSMA, any communication which invites or induces a person to engage in investment activity is a financial promotion and, unless the communication is <b>exempt</b> or <b>approved by a FCA or PRA registered firm</b>, it is a criminal offence to make such a communication and any agreement entered into in breach of this provision is unenforceable as against the other person entering into it.</p> <p>The provision of a business plan, an executive summary of the company and its business and/or any other materials provided by a company or a founder to elicit investment is likely to be classified as a financial promotion. The prohibition under s. 21 FSMA will apply regardless of the amount of investment sought from investors.</p> <p>Obtaining approval by a FCA or PRA registered firm (such as an investment bank or an IFA) is not likely to be feasible for a start-up as it may be expensive and impractical.</p> <p>A common approach taken by start-ups seeking investment is to rely on the statutory exemptions set out in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO"), as more particularly described below. Given that non-compliance is a criminal offence, any person making a financial promotion should ensure that such communication does fall within a particular exemption before it is relied upon and the communication made. If you are in any doubt, legal advice should be sought before making any communication.</p> |
| <p><b>Terminology</b></p>                     | <p>FSMA and the FPO contains a number of key terms that are relevant when determining whether an exemption applies. A communication is:</p> <ul style="list-style-type: none"> <li>■ "made to" a person if it is addressed to a particular person (e.g. where it is contained in a telephone call or letter);</li> <li>■ "directed at" another person if it is addressed to persons generally (for example, where it is contained in a television broadcast or website);</li> <li>■ "real time" if it is made in the course of a personal visit, telephone conversation or other interactive dialogue. All other types of communication are "non-real time" communications (e.g. letters and other forms of correspondence); and</li> <li>■ "solicited" if it was initiated by the recipient or takes place in response to an express request from the recipient. All other communications are regarded as unsolicited.</li> </ul>  |
| <p><b>Disclaimers</b></p>                     | <p>It is advisable for any communications to include a disclaimer on the front page to the effect that it is only communicated to a specific class of recipient falling within one of the exemptions (and a disclaimer is mandatory in order to fall within certain FPO exemptions). Whilst the communication still needs to fall within the scope of an exemption, the disclaimer <b>may</b> assist in establishing that the terms of the financial promotion regime have been complied with.</p> <p>It should also be stated that any recipients who do not fall within that specific class should return the document to the sender.</p> <p>Example disclaimers are provided in the annexures to this summary.</p>   |

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| <b>Exemption: Investment Professionals</b>   | <p>Any communication <i>made to</i> investment professionals or which may reasonably be regarded as directed to investment professionals will not require approval. In order to rely on this exemption, the relevant communication must:</p> <ul style="list-style-type: none"> <li>■ be <i>made only</i> to recipients whom the person making the communication believes on reasonable grounds to be investment professionals; or</li> <li>■ be reasonably regarded as <i>directed only</i> at such recipients.</li> </ul> <p>An investment professional includes (but is not limited to) a person who is authorised for the purpose of FSMA, a person whose ordinary activities involve him carrying on certain investment-related activities, a government, local authority or an international organisation and certain directors, officers or employees of any of the same.</p> <p>To benefit from this exemption, any communications need to make it clear to whom such communication is directed and that other persons should not act on it. Part 1 of Annex 1 sets out an example form of disclaimer to be included in any communications seeking to rely on the investment professional exemption.</p> <p>Part 2 of Annex 1 sets out a form of confirmation to be signed by the relevant investment professional. Although this confirmation is not required by article 19 of the FPO, it may be prudent to require it.</p> |
| <b>Exemption: High Net Worth Individuals</b> | <p>Any communication <i>made to</i> high net worth individuals will not require approval. In order to rely on this exemption, the relevant communication must:</p> <ul style="list-style-type: none"> <li>■ be a <i>non-real time</i> or a <i>solicited real time</i> communication;</li> <li>■ be <i>made to</i> an individual whom the person making the communication believes on reasonable grounds to be a certified high net worth individual;</li> <li>■ be accompanied by a warning in the form set out in part 1A of Annex 2 and which complies with the requirements set out in part 1B of Annex 2 of this summary; and</li> <li>■ contains certain “indications” (see Part 2 of Annex 2 for an appropriate form of wording).</li> </ul> <p>A certified high net worth individual means a person who has signed, within the period of 12 months ending with the day on which the communication is made, a statement in the terms set out in Part 3 of Annex 2 of this summary (i.e. that they have an annual income of at least £100,000 or had net assets, excluding their main home, life insurance and any pension funds in excess of £250,000 (Note: These thresholds are likely to rise in 2015)).</p> <p>A person would have reasonable grounds to believe that a person falls into this exemption if they had sight of the relevant certificate(s) before making the communication.</p>                              |

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| <b>Exemption: Self Certified Sophisticated Investors</b> | <p>Any communication <i>made</i> to a person whom the person making the communication believes on reasonable grounds to be a self-certified sophisticated investor will not require approval. In order to rely on this exemption, the relevant communication must:</p> <ul style="list-style-type: none"> <li>■ be <i>made</i> to an individual whom the person making the communication believes on reasonable grounds to be a self-certified sophisticated investor; and</li> <li>■ be accompanied by a warning in the form set out in part 1A of Annex 3 and which complies with the requirements of part 1B of Annex 3.</li> </ul> <p>A self- certified sophisticated investor would include an individual who has a current certificate in the form set out in part 2 of Annex 3. A certificate is current if it is signed and dated not more than 12 months before the date on which the communication is made. A person would have reasonable grounds to believe that a person falls into this exemption if they had sight of the relevant certificate(s) before making the communication.</p>   |
| <b>Exemption: Business Angels</b>                        | <p>Another potentially useful exemption relates to communications made to business angels. This permits <i>non-real time</i> or <i>solicited real time</i> communications being made to associations or members of associations made up of persons who are certified high net worth individuals, high net worth companies, unincorporated associations or partnerships, trustees of high value trusts or certified or self-certified investors.</p>   |
| <b>Exemption: One off communications</b>                 | <p>There is an exemption for one-off <i>non-real time</i> or <i>solicited real time</i> communications which are <i>made</i> rather than directed at persons which applies if the communication meets one or more of the following three conditions:</p> <ul style="list-style-type: none"> <li>■ the communication is <i>made</i> only to one recipient or only to a group of recipients in the expectation that they would engage in any investment activity jointly (such as family members);</li> <li>■ the product or service which is the subject of the communication has been determined with regard to the particular circumstances of the recipient; and</li> <li>■ the communication is not part of an organised marketing campaign.</li> </ul> <p>Even if a communication does not satisfy all of the conditions above, it may still be regarded as a one-off communication. Guidance suggests that there are two essential elements for a one-off communication being that it must be tailored to the circumstances of the recipient(s) and it is individual in nature and not simply a personalised letter sent out as part of a general mail shot.</p> <p>There is an <b>additional</b> exemption for one-off <i>unsolicited real time</i> communications where, in addition to the three conditions noted above, the communicator believes on reasonable grounds that the recipient understands the risks involved in engaging in the activity being promoted and expects to receive the communication in relation to the relevant investment activity. It will be difficult to be sure that these further conditions are satisfied so it may be desirable to obtain formal consent to real time communications wherever possible.</p> <p>The exemptions for one-off communications are subjective in nature and a company/founder should therefore only seek to rely on these exemptions when absolute necessary and on the basis that the company/founder has complete confidence that the conditions are met. If there is any doubt, reliance on these exemptions should be avoided and/or formal legal advice should be sought.</p> |

## LIABILITY FOR MISLEADING STATEMENTS

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| <b>Liability for Misleading Statements</b> | <p>It should be noted that, in addition to the requirements set out above, liability for misleading statements can arise under English law in several ways.</p>   |
| <b>Financial Services Act 2012</b>         | <p>A criminal offence may be committed under section 89 of the Financial Services Act 2012 ("FSA") if false or misleading information is published which may induce another person to buy or refrain from buying the shares. This applies regardless of whether the prospectus requirements (referred to above) apply.</p> <p>Under FSA, the offence may be committed even where a person did not intend to publish false or misleading information or to influence a person's investment decision. The offence can also be committed if material facts are dishonestly concealed.</p> <p>If Section 89 is contravened a person may be liable to a maximum of seven years' imprisonment or to a fine or both.</p> |
| <b>Breach of Contact</b>                   | <p>If an investor can demonstrate that he bought shares in reliance on a false or misleading pre-contractual representation for which the company is responsible he may be able to bring a claim against the company under the law of misrepresentation unless liability is clearly and properly included. The proforma subscription and shareholders' agreement provided in this start-up pack excludes liability for any pre-contracted representations made.</p>   |
| <b>Misstatement</b>                        | <p>Where a person relies on a misstatement of fact made by the company or any of its directors to buy shares and suffers a loss as a result of the misstatement, and such misstatement was negligently made, a civil action for negligence may arise to recover damages for such loss. Civil liabilities may also arise in respect of a fraudulent statement of fact or under the law of deceit. The proforma subscription and shareholders' agreement provided in this start-up pack expressly excludes liability for such claims.</p>   |

# ANNEX I: INVESTMENT PROFESSIONALS

## **Part 1: Example Disclaimer**

This [insert name of document] is being sent only to investment professionals (as that term is defined in article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO")) or to persons to whom it would otherwise be lawful to distribute it. Accordingly, persons who do not have professional experience in matters relating to investments should not rely on this [insert name of document].

The shares in [insert company name] will only be available to an investment professional (as defined above) or a person who has provided written confirmation to the effect that he is an investment professional within the meaning of article 19 of the FPO.

## **Part 2: Suggested form of confirmation to be obtained from investment professionals**

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To [insert name of communicator]:

### **[INSERT DESCRIPTION OF TRANSACTION/COMPANY NAME]**

[I][We] confirm that [I am][we are][ ] is an investment professional within the meaning of article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005[, on the basis that [I am][we are][ ] is [a person authorised for the purposes of the Financial Services and Markets Act 2000] [an exempt person for the purposes of the Financial Services and Markets Act 2000] [a government, local authority or international organisation person for the purposes of the Financial Services and Markets Act 2000] [a director; officer or employee of a [person authorised][exempt person] [government, local authority or international organisation]]]\*.

.....  
[For and on behalf of] [name of company/firm/person]

\* Note: Please delete as appropriate. These are only the most common examples of an investment professional. If you are in any doubt, please seek legal advice.

## **ANNEX 2: CERTIFIED HIGH NET WORTH INDIVIDUALS**

### **Part IA: Prescribed form of warning**

#### **IMPORTANT NOTE**

Ensure that the paragraph below is included in **bold** type, has a **black border** and complies with the remainder of the requirements set out in part 1B of Annex 2.

The content of [this promotion\*] has not been approved by an authorised person within the meaning of the Financial Services and Markets Act 2000. Reliance on [this promotion\*] for the purpose of engaging in any investment activity may expose an individual to a significant risk of losing all of the property or other assets invested.

\* Note: if the warning is sent to the recipient after the communication has been made the words "this promotion" must be substituted by wording which clearly identifies the promotion which is the subject of the warning.

### **Part IB: Prescribed requirements of the warning set out in part IA above**

The warning must:

1. be given at the beginning of the communication;
2. precede any other written or pictorial matter;
3. be in a font size consistent with the text forming the remainder of the communication;
4. be indelible;
5. be legible;
6. be printed in black, bold type;
7. be surrounded by a black border which does not interfere with the text of the warning; and
8. not be hidden, obscured or interrupted by any other written or pictorial matter.

## **Part 2: Suggested form of wording of “indications” for inclusion in the communication**

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[Name of recipient of the document]

[Address]

[INSERT DESCRIPTION OF TRANSACTION/COMPANY NAME]

This [insert name of document] is being sent to you on the basis that you are a certified high net worth individual (as that term is defined in article 48(2) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (“FPO”)). Accordingly, this [insert name of document] is exempt from the general restriction on the communication of invitations or inducements to engage in investment activity set out in section 21 of the Financial Services and Markets Act 2000 (“FSMA”).

To qualify as a certified high net worth individual, you must have signed a statement (within the last 12 months) in the terms set out in part I of schedule 5 of the FPO.

To be certified as a high net worth individual, you must have had annual income of at least £100,000 for, or held net assets to the value of not less than £250,000 throughout, the financial year immediately preceding the date on which the certificate is signed.

If you are in any doubt about [insert description of investment to which the document relates, eg “the shares in X Limited”], you should consult a person authorised under the FSMA who specialises in advising on [insert description of type of investment to which the document relates, eg “shares in private companies”].

### **Part 3: Statement for a Certified High Net Worth Individuals**

#### **IMPORTANT NOTE:**

Ensure that the words shown in bold type in this prescribed form of statement are in bold type in the statement, as failure to comply with this requirement will invalidate the statement.

#### **STATEMENT FOR CERTIFIED HIGH NET WORTH INDIVIDUAL**

I declare that I am a certified high net worth individual for the purposes of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

I understand that this means:

- (a) I can receive financial promotions that may not have been approved by a person authorised by the Financial Conduct Authority;
- (b) the content of such financial promotions may not conform to rules issued by the Financial Conduct Authority;
- (c) **by signing this statement I may lose significant rights:**
- (d) I may have no right to complain to either of the following:
  - (i) the Financial Conduct Authority; or
  - (ii) the Financial Ombudsman Scheme;
- (e) I may have no right to seek compensation from the Financial Services Compensation Scheme.

I am a certified high net worth individual because **at least one of the following applies:**

- (a) I had, during the financial year immediately preceding the date below, an annual income to the value of £100,000 or more;
- (b) I held, throughout the financial year immediately preceding the date below, net assets to the value of £250,000 or more.  
Net assets for these purposes do not include:
  - (i) the property which is my primary residence or any loan secured on that residence;
  - (ii) any rights of mine under a qualifying contract of insurance within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001; or
  - (iii) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled.

**I accept that I can lose my property and other assets from making investment decisions based on financial promotions.**

I am aware that it is open to me to seek advice from someone who specialises in advising on investments.

Signature .....

Date .....

# ANNEX 3: SELF-CERTIFIED SOPHISTICATED INVESTORS

## Part IA: Prescribed form of warning

### IMPORTANT NOTE

Ensure that the paragraph below is included in **bold** type, has a **black border** and complies with the remainder of the requirements set out in part IB of Annex 2.

**The content of [this promotion\*] has not been approved by an authorised person within the meaning of the Financial Services and Markets Act 2000. Reliance on [this promotion\*] for the purpose of engaging in any investment activity may expose an individual to a significant risk of losing all of the property or other assets invested.**

\* Note: if the warning is sent to the recipient after the communication has been made the words "this promotion" must be substituted by wording which clearly identifies the promotion which is the subject of the warning.

## Part IB: Prescribed requirements of the warning set out in part IA above

The warning must:

1. be given at the beginning of the communication;
2. precede any other written or pictorial matter;
3. be in a font size consistent with the text forming the remainder of the communication;
4. be indelible;
5. be legible;
6. be printed in black, bold type;
7. be surrounded by a black border which does not interfere with the text of the warning; and
8. not be hidden, obscured or interrupted by any other written or pictorial matter.

## **Part 2: Statement for a Self-Certified Sophisticated Investor**

### **IMPORTANT NOTE:**

**Ensure that the words shown in bold type in this prescribed form of statement are in bold type in the statement, as failure to comply with this requirement will invalidate the statement.**

I declare that I am a self-certified sophisticated investor for the purposes of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

I understand that this means:

- (a) I can receive financial promotions that may not have been approved by a person authorised by the Financial Conduct Authority;
- (b) the content of such financial promotions may not conform to rules issued by the Financial Conduct Authority;
- (c) **by signing this statement I may lose significant rights;**
- (d) I may have no right to complain to either of the following:
  - (i) the Financial Conduct Authority; or
  - (ii) the Financial Ombudsman Scheme;
- (e) I may have no right to seek compensation from the Financial Services Compensation Scheme.

I am a self-certified sophisticated investor because **at least one of the following applies:**

- (a) I am a member of a network or syndicate of business angels and has been for six months before the date of the statement;
- (b) I have made more than one investment in an unlisted company in the two years before the date of the statement;
- (c) I am working or have worked in the two years prior to the date below, in a professional capacity in the private equity sector or in the provision or finance for small and medium enterprises;
- (d) I am currently or have been in the two years prior to the date of below, a director of a company with an annual turnover of at least £1 million.

**I accept that I can lose my property and other assets from making investment decisions based on financial promotions.**

I am aware that it is open to me to seek advice from someone who specialises in advising on investments.

Signature .....

Date .....