

ALMT Legal


ADVOCATES AND SOLICITORS



Mumbai Bangalore

DOCUMENTATION, LEGAL ISSUES AND NEGOTIATIONS FOR PE, VC AND M&A DEALS

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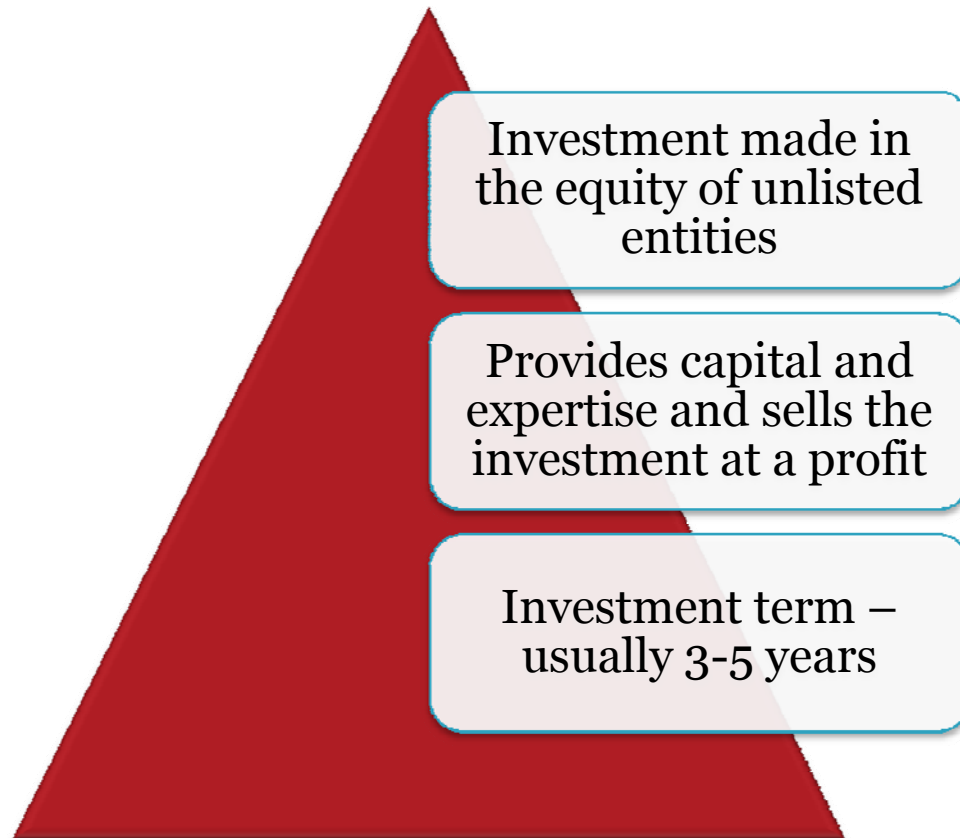


“Money is like gasoline
during a road trip. You
don’t want to run out of gas
on your trip, but you’re not
doing a tour of gas stations.”

—Tim O’Reilly, O’Reilly Media founder and CEO

PE / VC/ M&A - GENERAL

What is a PE/VC transaction?



PE / VC/ M&A – GENERAL (cont'd..)

What is M&A?

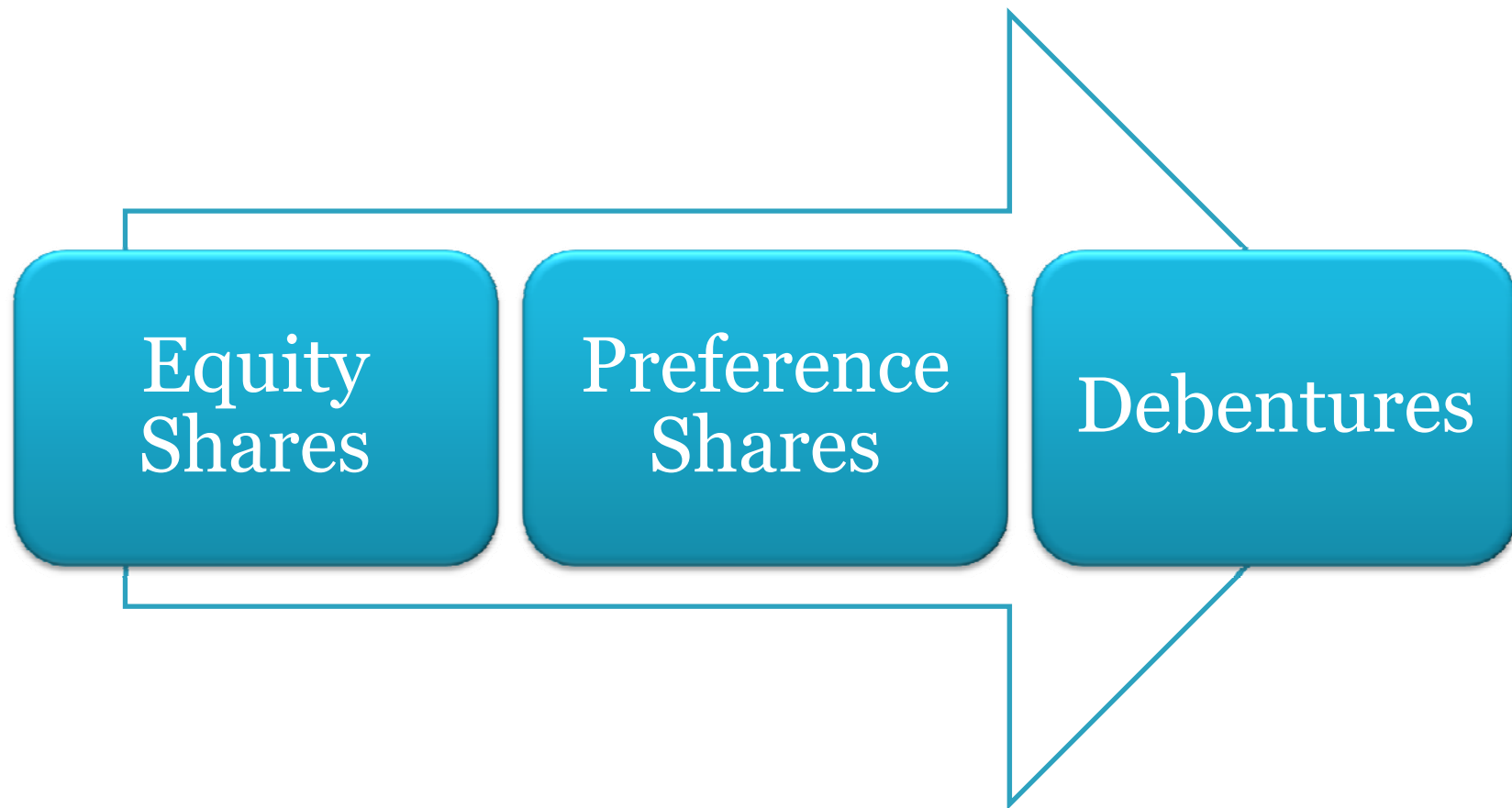
Mergers

- combination of two or more entities to form one company; or
- one company merges with another company

Acquisition

- Purchase of controlling interest in the share capital, or assets and liabilities of the target company

INSTRUMENTS ISSUED BY COMPANY



INSTRUMENTS - BRIEF ANALYSIS

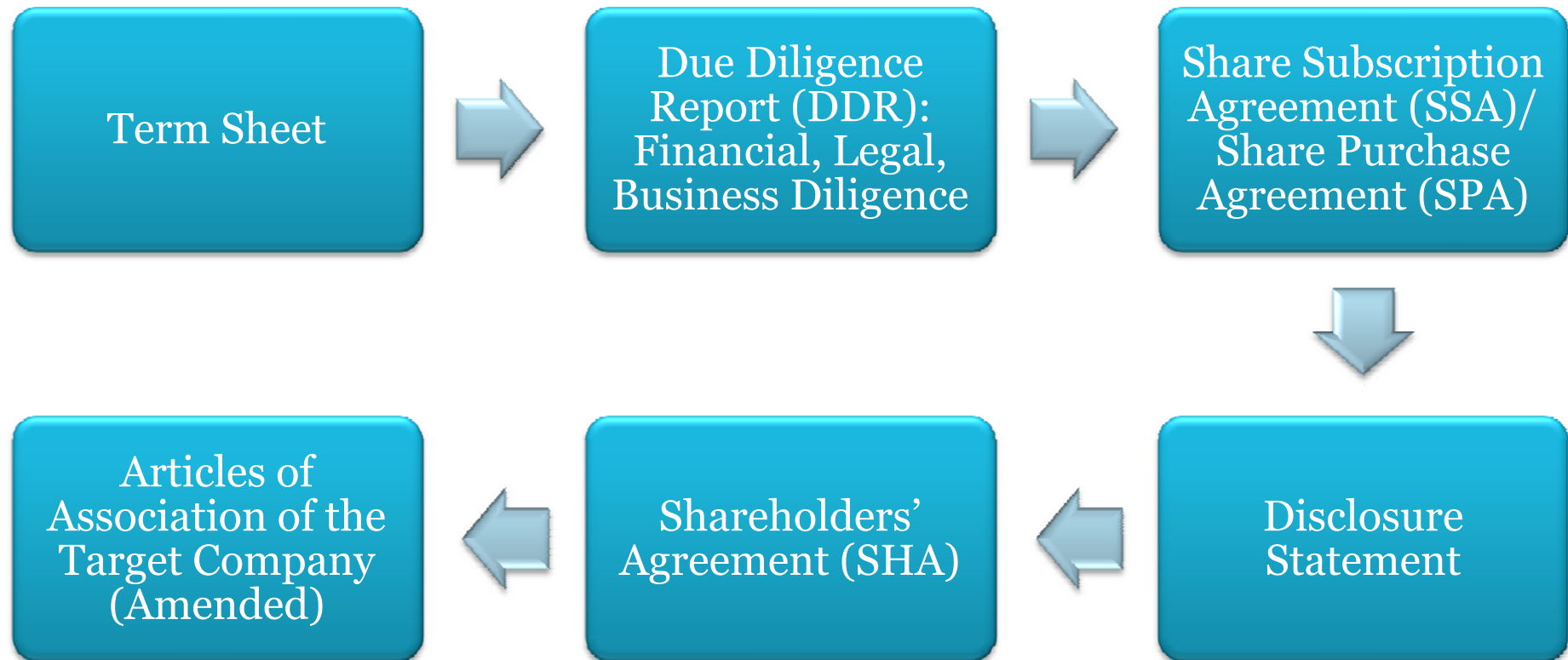
Sr. No.	Particulars	Equity	Preference	Debentures
1	Nature	Capital	Capital	Debt
2	Status of Holders	Owner	Owner	Creditors
3	Form of return	Dividend	Dividend - Priority in payment over equity shareholders	Interest
4	Security	No	No	Yes
5	Conversion	No	Can be converted to equity shares	Can be converted in equity shares
6	Repayment in case of winding up	After payment of all liabilities	Repaid before equity shareholders	Priority over Equity / Preference shareholders
7	Redemption	No	Redeemable	Redeemable
8	Arrears of Dividend	No	Usually Yes	NA

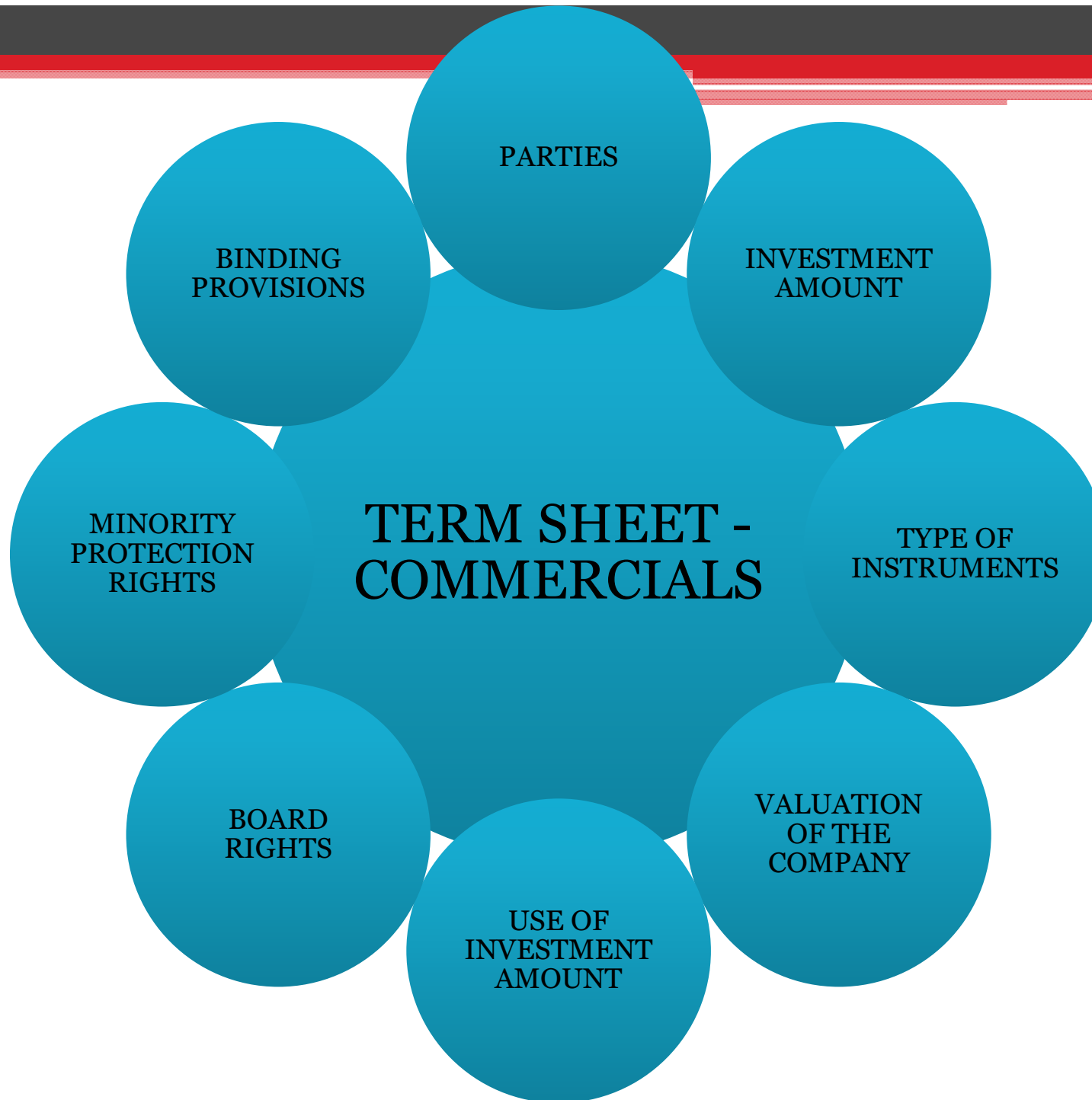


FINDING THE RIGHT INVESTOR

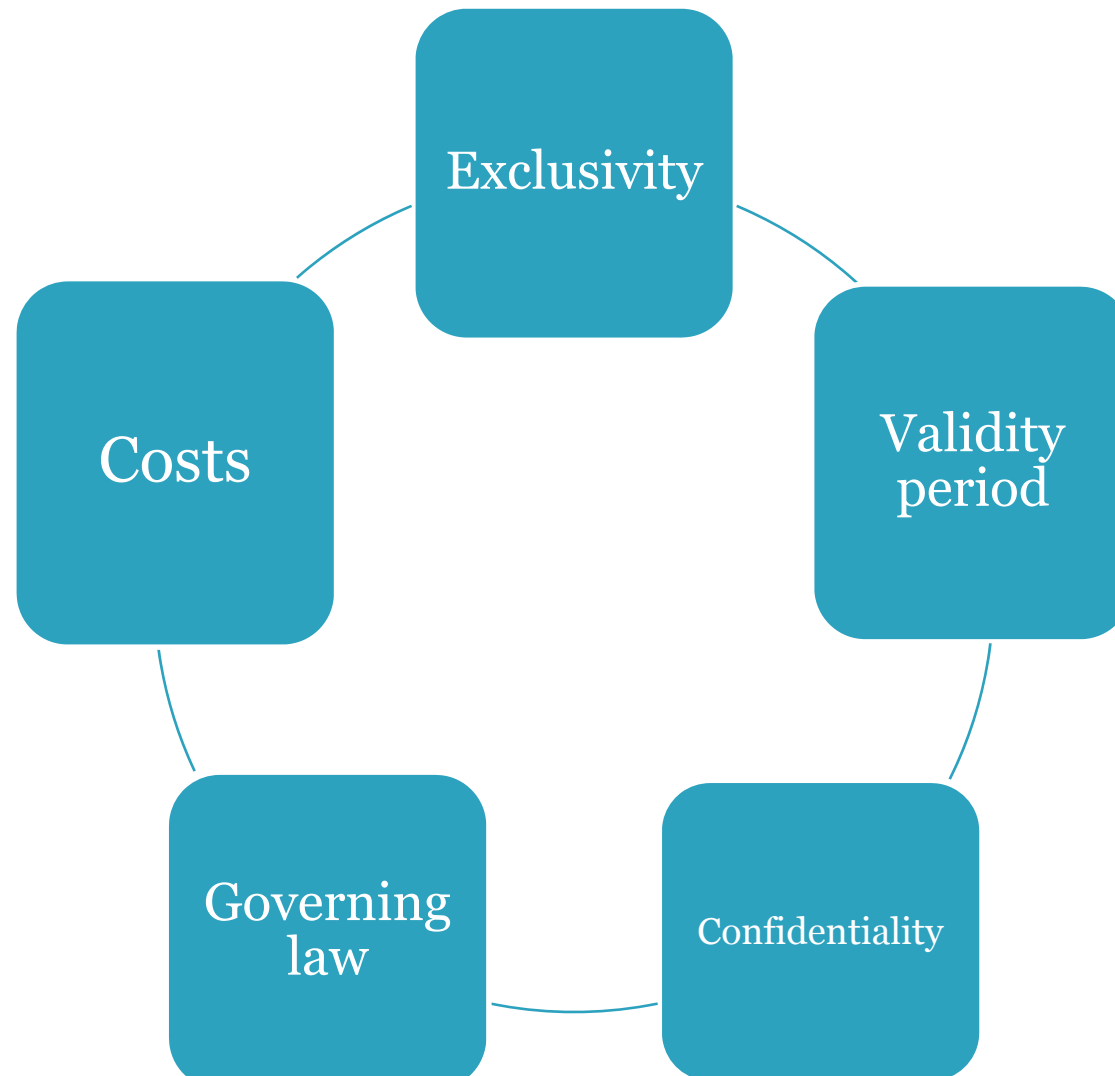
- Talk to as many investors as possible.
- A clean term sheet is better than a higher valuation.
- Talk to past and present portfolio companies of every investor.
- Look for expertise in investor team that complements your strengths
- Do not overcomplicate terms
- Be ready to walk away from deals, if it is not financially viable.
- Do not compromise on good legal counsel. Get introduced to a good lawyer and consult.

DOCUMENTATION





TERM SHEET - BINDING PROVISIONS





DUE DILIGENCE REPORT (DDR)

Highlights the following:

- ❖ Infirmary in ownership of assets – tangible or intangible;
- ❖ Non-compliances (regulatory, tax, property, labour, etc);
- ❖ Irregularities in the business process of the Company;
- ❖ Liabilities (tax, employment, regulatory, property, contractual, etc).

SSA / SPA – IMPORTANT TERMS

- ❖ Detailed process of investment
- ❖ Conditions Precedent
- ❖ Closing
- ❖ Post closing actions/ Conditions subsequent
- ❖ Undertaking by Promoters to run the business in its ordinary course until closing
- ❖ Representations and warranties – Company & Promoters
- ❖ Indemnities
 - Capped liability
 - De-minimus liability
 - Limitation period



DISCLOSURE STATEMENT

- ❖ To provide exceptions or qualifications to the representations and warranties of the target company
- ❖ Examples:
 - ❖ Notice from a tax authority to be disclosed against the warranty on tax compliance.
 - ❖ Claim of an employee to be disclosed against the warranty on no employee claims
- ❖ To negotiate for all data shared in the diligence and the due diligence reports to be treated as a disclosure.
- ❖ To disclose complete and accurate information



SHA - IMPORTANT TERMS

- ❖ Board representation of investor
- ❖ Quorum and manner of conducting board and shareholders meetings
- ❖ Anti Dilution & Pre-emptive rights: Right to purchase any issue of shares to retain its shareholding percentage
- ❖ Liquidation preference
- ❖ Information Rights
- ❖ Dispute resolution

SHA -TERMS - CONTD...

Affirmative Vote items: Examples

- Any amendment of the Company's MOA & AOA
- Any issue of shares, buy backs, issuance of convertible debt/instruments
- Transfer any assets the Company exceeding Rs. 5 lakhs
- Change in the constitution of the Board except as agreed in the Agreement
- Borrowings by the Company exceeding the limits approved by the Business Plan.

SHA -TERMS - CONTD...

Transfer restrictions

- ❖ Lock in
- ❖ ROFR/ ROFO
- ❖ **Tag along**: means “if you sell, I will have the right to sell along with you”
- ❖ Exceptions may be carved out for inter-se transfers/ transfer to affiliates of Promoters
- ❖ Investor to be restricted from selling to competitors

SHA -TERMS - CONTD...

- **ROFO**

- Selling shareholder must first offer its shares to the other shareholder before approaching third parties.
 - Example: A & B are shareholders in a Pvt. Co. B has a ROFO against A. A decides to sell his shares, then A must first offer his shares to B. Only if B refuses to purchase A's shares, or if A can obtain a higher price for his shares from a third party than that offered by B, can A sell his share to a third party.

- **ROFR**

- Selling shareholder must offer its shares to third parties to obtain the price before approaching the other shareholder.
 - Example: ROFR granted in favour of B, then A is first required to offer his share to third parties and obtain a price. A is then required to approach B with the price offered by third parties. If B can match or better the price offered by third parties, A must sell his share to B.
- ROFO may be the preferred option if a shareholder wishes to exit to avoid the process of due diligence by a third party.

SHA -TERMS - CONTD...

- ❖ Exit Rights - IPO/Offer for Sale, Strategic Sale
- ❖ **Events of Default or Dead lock** - Drag Along/ Put option/ Call option/ Company Buy Back
 - **Drag Along right:** “if I sell, you will be required to sell with me”
 - **Put Option:** “I put my shares which you must buy”
 - **Call Option:** “I call upon you to sell your shares to me”
 - Promoters to agree on Put Option only if they have the financial means to provide exit
 - **Safeguards for promoters in drag along:**
 - sale to occur at FMV determined by independent valuer;
 - bid sourced by promoter to be considered;
 - Promoter and investor shares to be sold at the same price

SHA -TERMS - CONTD...

❖ Non Compete and Non Solicitation

❖ Promoters to negotiate limits such as:

- Time cap – not beyond period of employment;
- Limit the number of relatives subject to non-compete restrictions - ideally spouse and children;
- Exclusion of financial investments (investments below agreed value or % of shareholding, investments in mutual funds)
- Carve out existing businesses of the promoters and family members

PE / VC TRANSACTION - MAJOR PROS AND CONS

Sr. No.	Advantages	Disadvantages
1.	Faster growth	Investor board involvement and veto rights
2.	Unsecured finance	Accountability to Investor
3.	Strengthens financial position	Transfer restrictions on the promoters
4.	Assists with obtaining other forms of finance	Restrictive covenants for promoters
5.	Funding committed until exit (unlike bank loan)	Warranties to be given by promoters
6.	Management and relationship advice	Investor is exit driven

MERGERS AND ACQUISITIONS - DOCUMENTATION

- ❖ Merger: Court approved Scheme of Amalgamation/
Demerger
- ❖ Acquisition:
 - ❖ Term Sheet
 - ❖ Due Diligence Report
 - ❖ Investment Document:
 - ❖ Share Purchase Agreement (Acquisition of share capital)
 - ❖ Business Transfer Agreement (Acquisition of all assets and liabilities on a slump sale as a going concern)
 - ❖ Asset Purchase Agreement (Acquisition of all or part of the assets)

BTA (Slump Sale) vs. Asset Purchase Agreement

BTA (SLUMP SALE)

Capital gains tax benefit under section 50B of the Income Tax Act

- Capital gains tax is payable on the “net worth” of the undertaking being transferred on a slump sale basis as a going concern.
- No values are to be assigned to the individual assets and liabilities of the undertaking
- Succession risk under Income Tax Act (Section 170), Maharashtra VAT Act (Section 44)

ASSET PURCHASE AGREEMENT

No such benefit available

- Short term or long term capital gains payable on each capital asset transferred.
- No such succession risk.



BTA (Slump Sale) vs. Asset Purchase Agreement

BTA

- No VAT Applicable

APA

- VAT is applicable on the value of goods transferred



*"No, it doesn't stand for
vodka and tonic!"*

BTA (Slump Sale) vs. Asset Purchase Agreement

Important Clauses

BTA

- Water-tight tax warranties and indemnities to protect the buyer from succession risks
- Escrow arrangement can be considered to cover any potential tax liability
- *The transfer of the Business is a “slump sale” within the meaning of section 2(42C) read with section 2(19AA) (Explanation 1) and section 50B of the Income-tax Act, 1961.”*

APA

- Warranties and indemnities to be provided in the APA as well.



"The paper and ink content is within acceptable norms, but the contract itself appears to have too many clauses."

STAMP DUTY - MAHARASHTRA STAMP ACT, 1958

INSTRUMENTS	STAMP DUTY	
Term Sheet	Nil	
SSA	Private Company	Public Company
	0.1% (upto Rs. 10 lakhs) or 0.2% (above Rs. 10 lakhs)	0.01% of the value of shares
SHA	Rs. 100 + Rs. 500	
SPA	Private Company	Public Company
	0.1% (upto Rs. 10 lakhs) or 0.2% (above Rs. 10 lakhs)	0.01% of the value of the shares
Share transfer Form (Form SH-4)	0.25% on consideration or market value whichever is higher	
Business Transfer Agreement	0.1% (upto Rs. 10 lakhs) or 0.2% (above Rs. 10 lakhs) Trademark Assignment at 3% Immovable property at 5%	
Asset Purchase Agreement	0.1% (upto Rs. 10 lakhs) or 0.2% (above Rs. 10 lakhs) Moveable delivery receipt – Re 1 Trademarks Assignment – 3% Copyright Assignment (Agreement) – 0.25% (upto Rs. 10 lakhs) or 0.5% (above Rs. 10 lakhs) Immovable property at 5%	

THANK YOU

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In this world nothing can
be said to be certain,
except death and taxes.

-Benjamin Franklin