

WIRC SEMINAR ON

**UNDERSTANDING START-UP COMPANY
ECO SYSTEM**

IMPORTANT ASPECTS IN SHAREHOLDERS'
AGREEMENTS AND OTHER LEGAL DOCUMENTS

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Typical transaction flow (post-term sheet)

Due Diligence

- Preparing a start-up for diligence (tax, financial / business, legal)
- Validation of business model
- Validation of valuation
- Legal & compliance issues
- Risk identification & mitigation

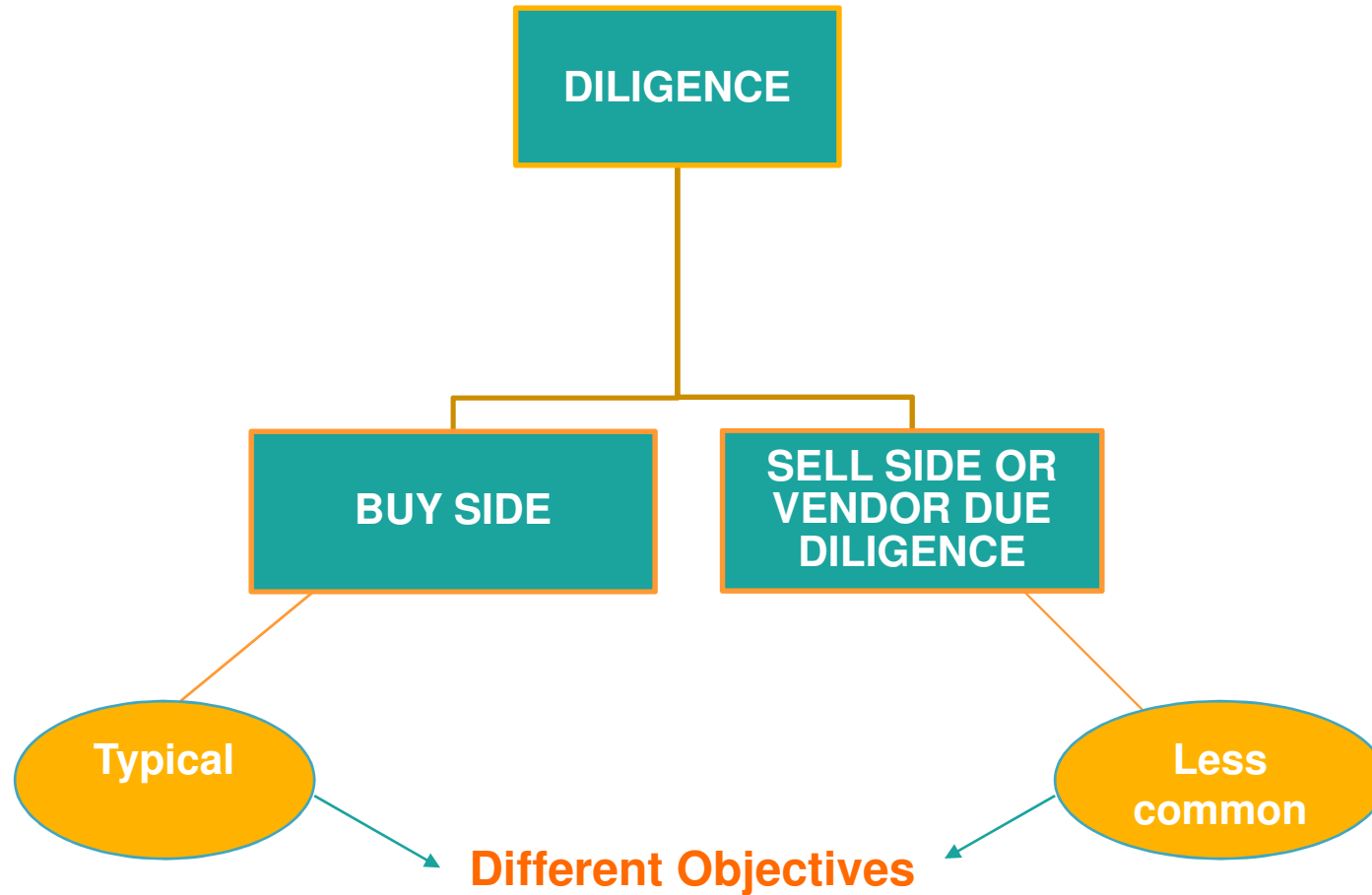
Agreement

- **Negotiation** – value, structure, conditions, indemnity
- **Signing** of definitive agreements
- **Closing** (Actual investment and amendment of articles)

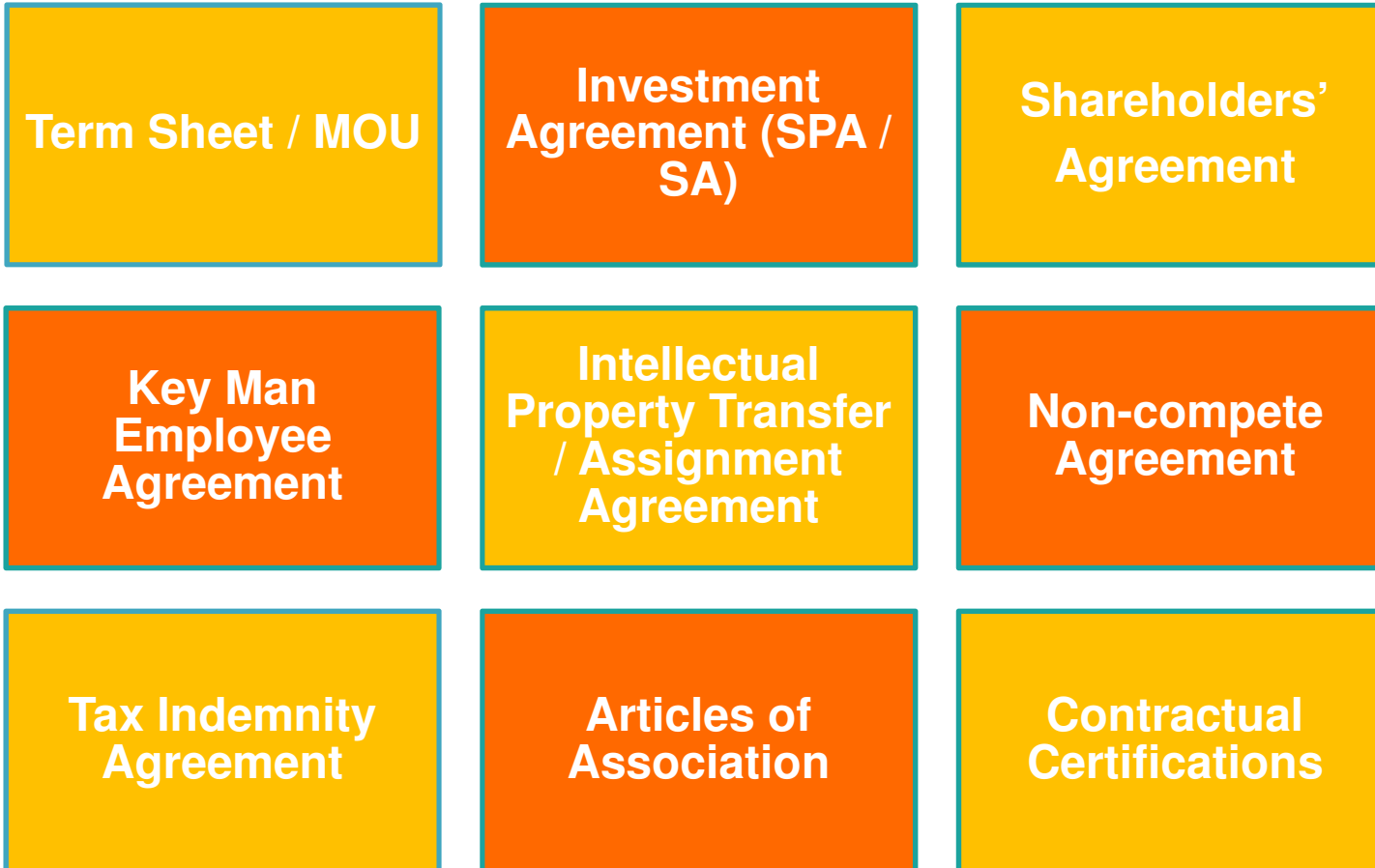
Monitoring

- Conditions subsequent
- Information rights, board & general meetings, consent rights
- Value adjustment (negative / positive)

Legal Due Diligence



Documentation – An overview



Term Sheet

➤ Binding or Non-binding?



➤ Purpose ?

➤ Key Provisions:

- ✓ Pre-money valuation
- ✓ Investment size
- ✓ Target timelines
- ✓ Exclusivity or No-shop
- ✓ Confidentiality
- ✓ Costs
- ✓ Dispute Resolution

Investment Agreements

- Subscription Agreement
 - ✓ Investment in tranches

- Share Purchase Agreement

- Key Provisions:
 - ✓ Stand-still clauses
 - ✓ Conditions precedent
 - ✓ Closing process
 - ✓ Conditions subsequent
 - ✓ Representations & warranties
 - ✓ Indemnification
 - ✓ Termination

Investment Agreements – Some concepts

- Conditions Precedent
 - ✓ Long stop date

- Failure to fulfill conditions
 - ✓ Break fee
 - ✓ Termination

- Limitations on indemnity
 - ✓ De-minimus
 - ✓ Cap
 - ✓ Basket
 - ✓ Personal liability

- Holdback of purchase consideration

Shareholders' Agreement

➤ Corporate Governance

- ✓ Board of Directors
 - Director
 - Observer
- ✓ General meetings
- ✓ Notice and agenda
- ✓ Promoter – compliance officer
- ✓ D&O liability insurance

➤ Reserved Matters / Affirmative Vote Matters

- ✓ Matters on which Target cannot take action without investor consent
- ✓ Operational matters
- ✓ Policy matters

**Companies Act, 2013
perspective – duties of
directors, classification as
'promoter'**

Shareholders' Agreement

➤ Further funding

- Investor's rights with respect to further issue of capital by the company:
 - ✓ Pre-emption
 - ✓ Consent rights
 - ✓ Exceptions

➤ Anti-dilution

- Protection from down round:
 - ✓ Value protection
 - ✓ Methodology – full ratchet / weightage average
 - ✓ Transfer / issue of further shares
 - ✓ Convertible instrument - adjustment of ratio

**Companies Act, 2013 perspective –
New capital issue process, feasibility
of adjustment of conversion ratio**

Shareholders' Agreement

➤ Sweat equity

- Common in start-ups
- Validation of business model
- Caps imposed under Companies Act, 2013:
 - ✓ 15% of paid up equity share capital in a year; or
 - ✓ Rs. 5 Crores

➤ Employee Stock Option Plan

- Common investment condition
- Dilutive or non-dilutive issuance
- Restrictions under Companies Act, 2013:
 - ✓ Beneficiaries
 - ✓ Time period of vesting

Shareholders' Agreement

➤ Restrictions on transfer of shares

- ✓ Lock-in period
- ✓ Right of first offer
- ✓ Right of first refusal
- ✓ Tag along rights
- ✓ Extent of restricted shares
 - Pro-rata
 - Complete restriction
- ✓ Exceptions
- ✓ Transfers to competitors
- ✓ Time period for which restrictions apply

Shareholders' Agreement

➤ Exit Clause

- ✓ IPO
- ✓ QIPO
- ✓ Strategic Sale
- ✓ Sale to other financial investor
- ✓ Other exit modes

➤ Liquidation Preference

- ✓ Meaning of 'liquidation event'
- ✓ Last-in, first out
- ✓ Put option
- ✓ Call option
- ✓ Drag along right
- ✓ Adjustment of conversion ratio
- ✓ Falling of transfer restrictions

Shareholders' Agreement

➤ Default & Consequences

- ✓ Typical default events
 - Failure to provide exit
 - Failure to indemnify for loss
- ✓ Put option
- ✓ Call option
- ✓ Drag along right
- ✓ Adjustment of conversion ratio
- ✓ Falling of transfer restrictions

FEMA Perspective
– Optionality
clauses and
assured returns

Shareholders' Agreement

➤ Other Clauses

- ✓ Information rights
- ✓ Inspection rights
- ✓ Audit rights
- ✓ Most favorable rights
- ✓ Fall away threshold
- ✓ Confidentiality

➤ Non Compete

- ✓ Applicability
 - Promoters
 - Company
 - Affiliates
- ✓ Time period
- ✓ Enforceability
- ✓ Separate consideration?

Articles & Ancillary Agreements

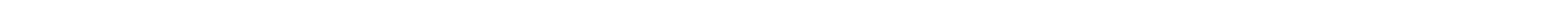
➤ Amendment of Articles

- ✓ Purpose
- ✓ Conflict between documents

➤ Ancillary Agreements

- ✓ Key man employee agreements
- ✓ Intellectual property assignment agreement
 - Objective - Vesting of rights
 - Transfer from promoter to business vehicle
- ✓ Tax indemnity agreements

Cross-default provisions



QUESTIONS ?

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