

INVESTMENT DOCUMENTATION

January 17, 2018



OVERVIEW

- Background
- Investment transaction cycle
- Non-disclosure Agreement (NDA)
- Term-sheet
- Due diligence
- Share Subscription Agreement (SSA)
- Shareholder's Agreement (SHA)



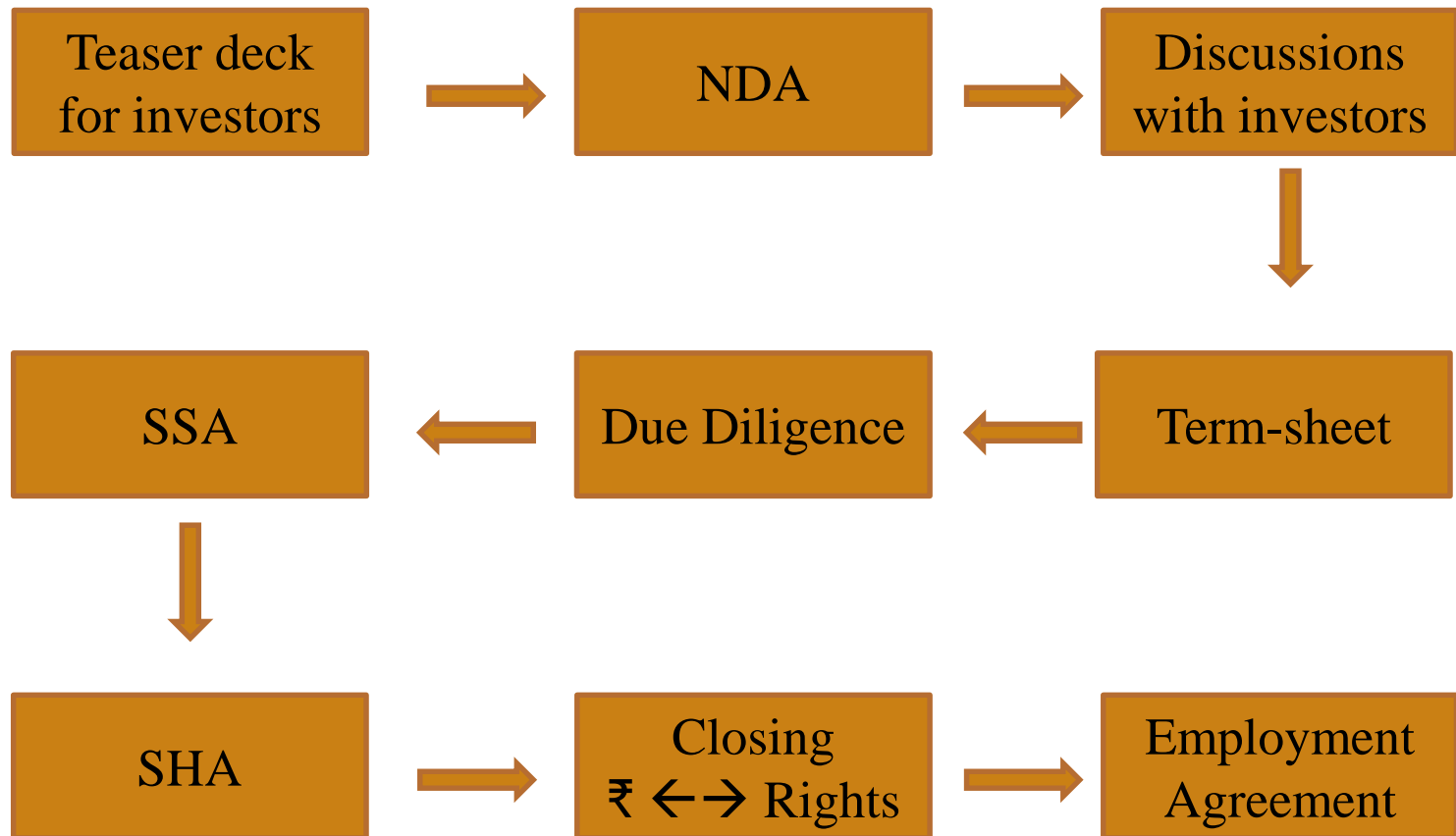
BACKGROUND

Type of documentation and rights granted thereunder is dependent upon:

- Structure of the investee entity - private limited company / limited liability partnership
- Type of investor / stage of investment - angel / institutional investors
- Nature of securities issued - equity shares or convertible shares or debt



INVESTMENT TRANSACTION CYCLE



NON-DISCLOSURE AGREEMENT

Why is an NDA required?

- To protect the information shared with prospective investors
- Privileged information will be disclosed (business plans, financial status, technical algorithms and names of customers of the company)
- Discussions with investors may not always materialise into actual investments



TERM-SHEET

Why is a Term – Sheet required?

- To lay the foundation for future discussions on the terms of investment
- If parties are unable to even agree on the broad commercial terms, may not be worthwhile to pursue negotiations
- To grant exclusivity to an investor for a finite period

Nature of Term-sheet : Non- binding | exclusivity is usually binding

Note for founders : Please involve a lawyer at the stage of term-sheet itself!



TERM-SHEET | Contd

Basic contents of a Term – Sheet

- Parties (investor, founder and company)
- Current capital structure of the company
- Pre-money and post-money valuation
- Size of the investment
- Stages of the investments – single bullet or in tranches
- Securities issued – equity or convertible securities
- Basic agreed terms of issue of securities (also the terms of conversion)
- Key Provisions in SSA
- Key Provisions in SHA



DUE-DILIGENCE

What is meant by a due-diligence?

- An investigation into the business of the company
- To check the compliances by the company
- Along with legal, financial and technical due diligences may occur in parallel

Why is a due-diligence conducted?

- Principle of caveat emptor | buyer beware
- To assure the investor that the company actually runs the business as indicated by founders and is in compliance with applicable laws

What does it entail for founders?

- Multiple requests for documents, lots of back and forth with investor counsel



DUE-DILIGENCE | Contd

Types of legal due-diligence

- Issues-based : only to highlight red flags and deal-breakers
- Comprehensive : detailed investigation into the records which usually summarizes each document reviewed

Impact of due-diligence

- If any fraud is found - no investment
- If any material gap is found between information conveyed earlier and actual documents – adjustment to valuation
- Clean-up actions are identified as conditions precedent / subsequent to investment
- To identify specific warranties / indemnity



SSA

Why is an SSA required?

- To record the terms and conditions governing the issuance of the company's securities to investors

What does an SSA cover?

- Nature and terms of securities to be issued
- Number of securities to be issued
- Consideration payable
- Tranches of investment – one time or in different tranches
- Shareholding pattern of the company – pre and post investment
- Conditions precedent / subsequent to closing



SSA | Contd

- Manner of utilisation of the investment amounts
- Closing Actions
 - Remittance of Investment Amount
 - Issuance of Securities
 - Amendment of Articles
 - Appointment of Investor Director
 - Reporting requirements (including with respect to foreign investment, if applicable)
- Representations and warranties; Indemnities
- Dispute Resolution



INDEMNIFICATION

- **Founders may be required to provide the indemnity for:**
 - Breach of representation or warranty
 - Breach of obligation
 - Fraud or gross negligence
- **Limitation to indemnification**
 - Incidental, indirect, special or consequential damages (including lost profits or lost revenues) should be excluded
 - Cap on indemnification amount linked to percentage of investment
 - De minimis and basket threshold
 - Cap on indemnification period | usually 2-3 years



SHA

Why is an SHA required?

- Securities are issued under SSA – Rights in the company are given under SHA
- To provide contractual rights which exceed the rights provided under the Companies Act

Basic contents of SHA

- Minority protection for the investor – board seat, information rights, affirmative vote rights, pre-emptive and anti-dilution rights
- Transferability of shares - lock-in on founders, ROFR, ROFO, Tag, Drag
- Exit rights



MINORITY PROTECTION RIGHTS

- **Board Seat**
 - Quorum
- **Information Rights**
 - Investors usually require regular updates on company's financials
 - Monthly MIS + quarterly management report + annual report + minutes of board and shareholder meetings etc



MINORITY PROTECTION RIGHTS | Contd

- **Affirmative Vote Rights**

- Investor has a veto
- Examples: change in articles or share capital, fund raising, business plan, merger/restructuring, change of business line, related party transactions, change in key personnel, IPO, subsidiary/JV, down-round

What it means for founders

- Investors can roadblock founders' decisions on key matters



Reserved Matters



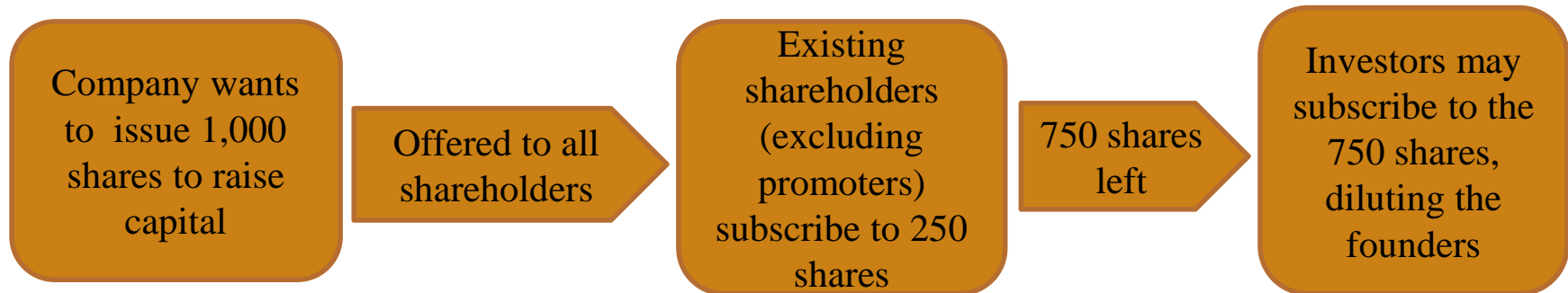
Investor has the key



MINORITY PROTECTION RIGHTS | Contd

- **Pre-emptive Rights**

- If company issues further securities - existing shareholders (including investor) will have the right to subscribe to such securities
- If one shareholder fails to subscribe then the other shareholder can subscribe to that portion of shares as well and increase its stake



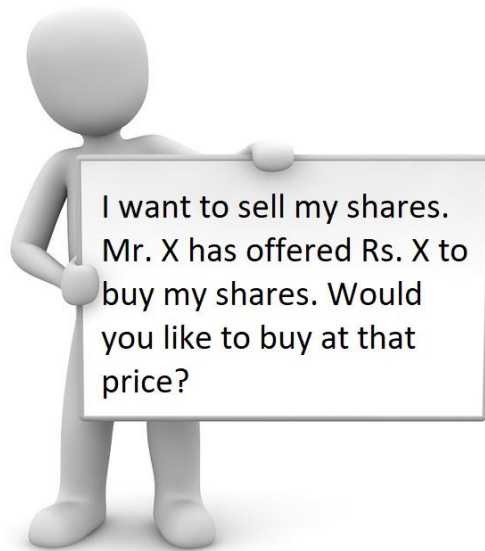
- **Anti-Dilution Rights** – a price protection mechanism

- Usually linked to conversion terms of CCPS if there is a down-round

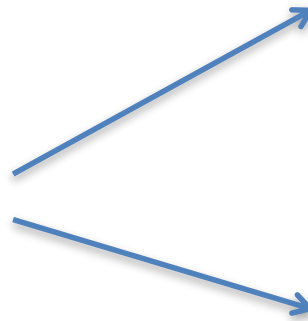


TRANSFERABILITY | ROFR

- Selling shareholder *needs to go to market* and get a buyer
- Ideally founder should have an ROFR over investor's shares
- Practically investors ask for an ROFR over founder's shares (after lock-in)



Selling shareholder
(usually investor)



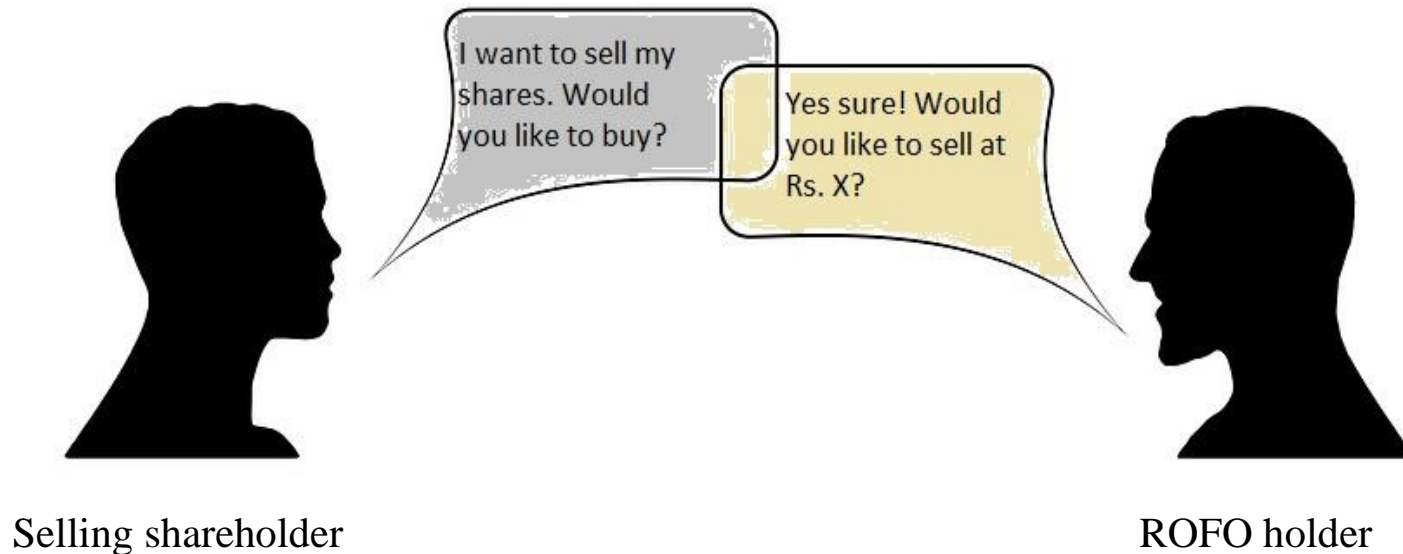
ROFR holder accepts: Selling shareholder has to sell the shares at Rs. X to ROFR holder

ROFR holder declines: Selling shareholder is free to sell the shares to Mr. X, but at a price which is not less than Rs. X. Selling shareholder cannot sell to competitor



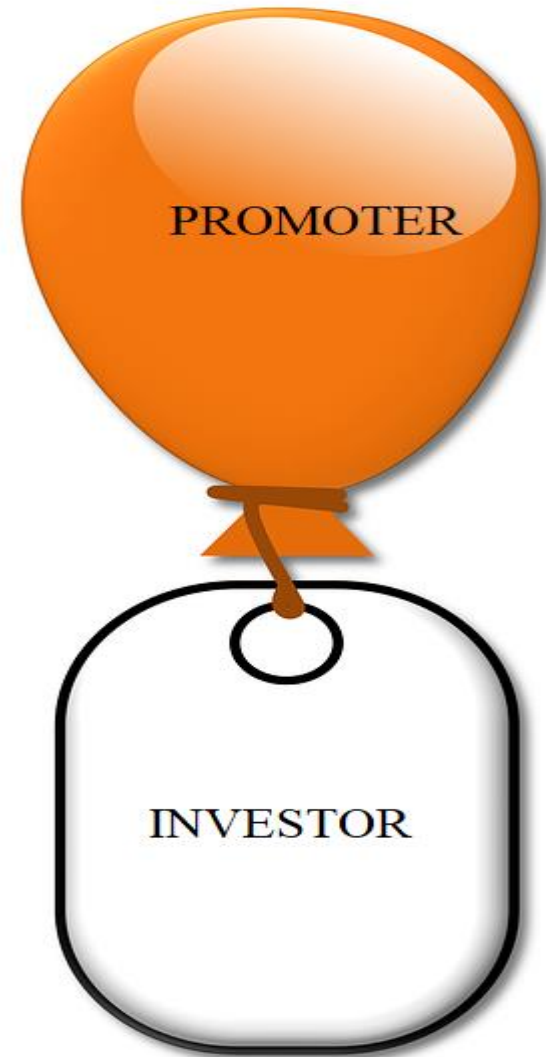
TRANSFERABILITY | ROFO

- Selling shareholder *does not have to go to market*
- Selling shareholder can accept the price offered by ROFO holder or sell it to market at a higher price | cannot sell to a competitor



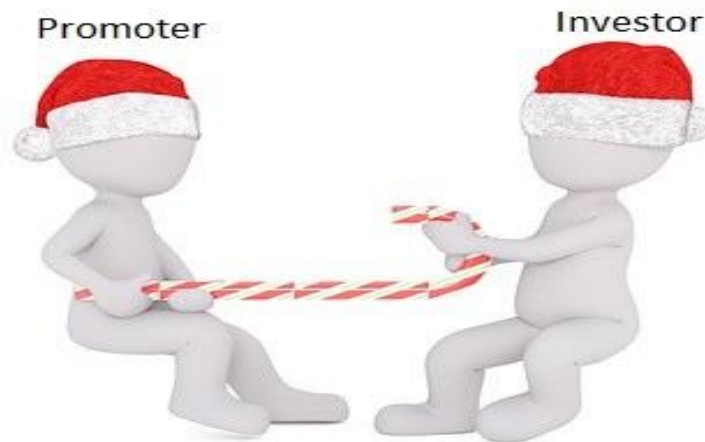
TAG ALONG

- If founder wishes to sell then investor will tag along and sell its securities at the same price
- Third party buyer can either choose to buy investor's securities as well or not purchase any securities of founder
- Pro-rata or entire stake of investor, depending on whether founder retains 50.1% stake or not
- Fair clause - provides an exit to investor when founder exits partially / fully



DRAG ALONG

- Investors will generally ask for it if they do not get an exit at the end of 5-7 years
- Can even sell the shares to a competitor



EXIT RIGHTS



- Right to exit whether with or without a guaranteed return
- Beware of fixed price exit
- Not advisable to grant any exit rights at early stage
- Later stage investors usually ask for assured exit
- Examples of exit: IPO / company buy-back / founder buy-out (put option) / third party sale arranged by founders, strategic sale of entire company



LIQUIDATION PREFERENCE

- If there is a liquidation or event of default such as fraud or breach of obligation, investor asks for an assured exit
- Ranges between 1x and 3x
- Founders beware of return $> 1x$
- If company's worth is less than the assured price, founders may have to fund investor's exit



OTHER DOCUMENTATION

- Employment agreement for founders
- Co-founders agreement to be in place
- Assignment of intellectual property
- Additional documentation under law required (for instance valuation certificate; passing of resolutions; filing of forms with authorities)



QUESTIONS?

**For further queries please contact:
kaushik.rajana@tatvalegal.com
+91 9167686981**



Tatva House, Plot No. 107A, Road No. 72, Jubilee Hills, Hyderabad – 500110, India
Tel: + 91 40 2358 1000–04 | Fax: + 91 40 2358 1005