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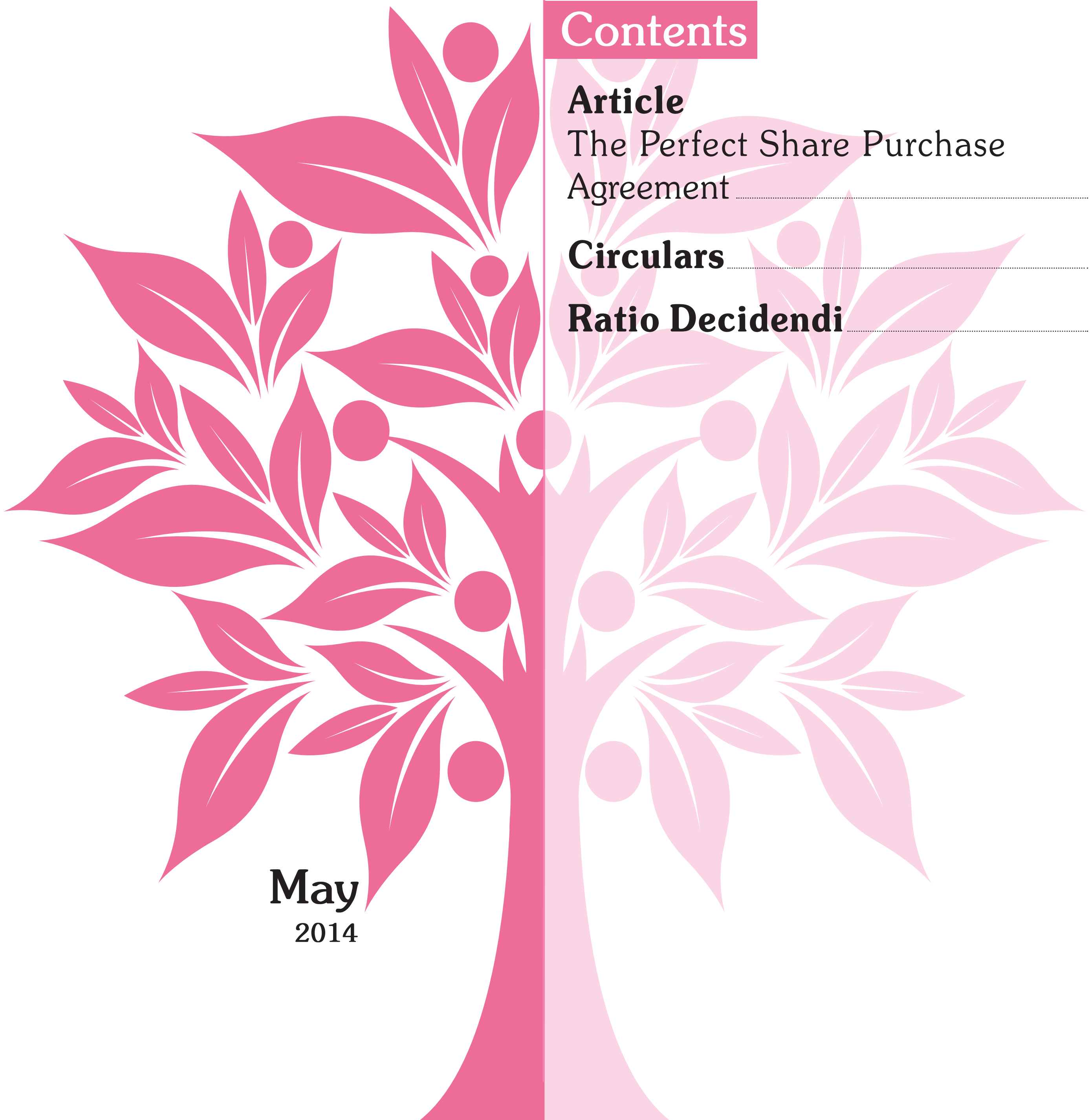

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Article

The Perfect Share Purchase Agreement

By **Barnik Ghosh**

Share Purchase Agreements (SPA) come in different colors and shapes - long, short, detailed, complicated, conditional, two or multi-party. One common thread is the need to make SPAs balanced and most importantly, enforceable. While keeping in mind the fundamentals of the transaction, a lawyer needs to prioritise the business aspects while ensuring that the legal points are not relegated to footnotes. Over the years, thousands of SPAs that have been "executed", but the perfect completely error free agreement eludes us all, despite the hundreds of years of collective experience in this field. Some of the essential features of a classic textbook document are discussed below for a better understanding of the topics that need to be covered while drafting an SPA.

The parties to the agreement

Parties to the agreement generally comprise the seller and the acquirer, though at times, these parties are mere shell holding companies or incorporated just for the SPA with no financial history or stability. In such cases, it is important for substantive entities of the principals to be added as covenanters/guarantors to ensure that claims post the closing are paid and promises made in the agreement are kept.

Recitals

The factual background of the transaction should be clearly spelt out in the recitals with no lacunae in identifying and laying down the relationship between the parties, the objective of the transaction and the role of each of the parties.

Definitions and Interpretation

Definitions are important to provide a context and meaning to certain words and phrases as used in the agreement. If a word is defined in the text of the agreement, the clause referencing needs to be done diligently in the definitions section for ease of reference. Ideally, a definition should be limited to the meaning of the term and should not contain any covenants that are meant for inclusion only in the main text.

Consideration and sale of shares

An exhaustive structure of payment needs to be spelt out including the deposit to be given at the time of execution; the sum that is payable on closing (pricing formula to be determined on a case to case basis) and if applicable, the sum held in escrow to be set off against indemnities or breaches of representations and warranties and the amount payable in case any security is registered against the company.

In current times, consideration is transferred directly through bank accounts and cheques/ demand drafts are the exception not the rule. In case of an escrow fund, the dynamics of the operations need to be clearly set out. If the payments are to be done in tranches, the details of the trigger for the payments should be spelt out in the document to pre-empt differences on interpretation at a later date.

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Conditions Precedent

The conditions precedent clause should be exhaustive providing for all authorizations, permissions and permits which are necessary, both internal and external and the person responsible for obtaining each of these should also be stated. Normally a clause on the right of the acquirer to waive any condition is also included to provide flexibility in case certain routine approvals that do not impact a transaction from closing are not forthcoming or are delayed. The conditions precedent clause should also provide for fulfilling all the representations, warranties, obligations, execution of agreements and covenants under the agreement.

Closing

The Closing Mechanism should establish the time frame, place as well as the actions (including but not limited to exchange of documents) in which the closing shall take place. It is prudent to include a closing memorandum listing the actions that are to take place on closing day including the board resolutions to be passed. A particular line clearly stating that the closing should take place on satisfaction of condition precedents is also wise.

Conditions Subsequent

Ideally, there should not be any conditions subsequent in a share purchase agreement, but this becomes necessary though rare. There are some permits and obligations which are always residuary in the conditions subsequent. However, protection should be afforded to the purchaser in case any of the conditions subsequent are breached.

Covenants by the parties

Covenants may be negative or positive and provide a level of comfort to each of the parties on their past and proposed actions regarding the SPA. Covenants are also required by the purchaser from the seller regarding management of the company between signing and closing. Acts that are permissible during this period will normally require the consent of the acquirer though the company is still technically managed by the seller in the interim.

Vendor's Representations and Warranties

The corporate status of the company and the good standing in the market needs to be clearly spelt out. The capital structure of the company including the list of directors and the number of shares owned by the vendor should be provided. In addition, this clause contains an affirmation regarding the title and rights of the seller on the shares/property of the company, status of compliance with law, any pending or threatened litigation or dispute, information on loans and related agreements and fairness of accounts and financial and other information provided by the seller. It is a good practice to state that the vendor has the unhindered right to sell and transfer title to the shares to the purchaser there are no restrictions imposed by any other agreement or contrary court orders.

Purchaser's Representations and Warranties

The purchaser's right to contract, purchase and ability to pay the compensation and enter into subsequent agreements are clauses for inclusion in this chapter. In case, the purchaser is

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a company, the corporate status of the purchaser also needs to be highlighted.

Obligations pre and post closing

This is primarily a repeat of the representations and warranties clause but is incorporated in the share purchase agreement to protect the interests of the parties. Some of the warranties fall away at closing, while others like right and ownership of shares will continue well past the closing.

Confidentiality

This is particularly important when parties have exchanged confidential information and/or when listed entities are involved in a transaction. It is also standard to state that the terms of the agreement are confidential and cannot be revealed without the consent of both parties. Confidentiality clauses are limited in time ranging between 18 months and two years.

Indemnification

Indemnification clauses are hotly negotiated, particularly the lower and upper threshold limit on claims, time period, subject matter and the procedure inter se the parties for dealing with disputes including tax disputes that have an impact on claims. They also provide the process for reimbursement of claims and often the most scrutinized clause in case of disputes, hence particular attention has to be paid to ensure that the purchaser is adequately covered in case of issues relating to the company prior to the transaction but which emerge post closing. This is also the reason why a purchaser will demand a substantive party from the seller's side as the guarantor for indemnification.

Notice

The notice clause is generally overlooked but this is extremely important. Not only should the locations be specified, but the manner in which the notice is to be dispatched and whether the parties are ready for electronic formats of notices to be dispatched needs to be keyed in.

Force Majeure

Though *force majeure* is a standard clause, the interests of the parties can be strengthened by putting in a phrase regarding fluctuating market conditions including that of a sudden financial crisis. Though this type of clause is extremely rare in India, we can adopt the western practices which follow the inclusion of such a clause post the financial crisis of 2008.

Dispute Resolution and Arbitration

Arbitration in India has gained notoriety for delays and abuse of process by resorting to courts to set aside arbitral awards. The Supreme Court has ruled that if both parties are based in India, it will be a domestic arbitration under the Arbitration and Conciliation Act, if at least one of the parties is an overseas entity, the parties may choose any international forum like ICC or Singapore International Arbitration Center for quick resolution, keeping in mind the notified countries for enforcement of arbitration awards in India. The clause must contain in addition to the procedural law, the seat of arbitration, the number of arbitrators, language (English), the disputes that will be referred to arbitration after an initial attempt to resolve amongst themselves. Poorly and hastily drafted clauses will cause a lot of pain to affected parties when this clause is sought to be enforced.

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Jurisdiction & General Clauses

Indian laws will be applicable and the courts in the city of the registered office of the vendor will have the jurisdiction. The usual and standard clauses should be provided but special emphasis should be provided to the assignment clauses and the relationship clause which will set out clearly that the agreement does not create or envisage creating any particular form of relationship between the vendor and the purchaser except as otherwise categorically provided in the agreement. No employer employee or principal agent relationship is deemed to be created.

Conclusion

The drafting of a share purchase agreement depends on the party a lawyer is representing. Similarly, the number of representations and warranties also change. But the beauty of the agreement lies in the transaction which governs the agreement. A share purchase agreement is the crown agreement which every corporate lawyer wishes to draft. This article sets the tone for drafting an SPA.

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Circulars

Designated Depository Participants registering Foreign Portfolio Investors to have appropriate systems in place: To ensure proper functioning of Foreign Portfolio Investors (FPI) regime, adequate infrastructure facilities and appropriate systems and controls should be in place. The SEBI Circular CIR/IMD/FIIC/09/2014, dated 28-4-2014, accordingly provides for segregation of activities, infrastructure, manual and monitoring of systems and controls with the Designated Depository Participants (DDPs). It also provides for submission of periodic reports and other reports as required by SEBI. These provisions would be applicable upon commencement of FPI regime. It may be noted that SEBI (Foreign Portfolio Investors) Regulations 2014 have been notified on 7th January, 2014 wherein SEBI approved DDPs would grant registration to FPIs on behalf of SEBI and carry out other allied activities as mentioned in regulations and guidelines.

Repayment of Rupee loans through ECBs from overseas branches of Indian banks: Indian companies will not be allowed to raise ECBs from overseas branches/subsidiaries of Indian banks for repayment of Rupee loans in respect of Scheme of take-out financing [Reference A.P. (DIR) Series Circular No. 4, dated 22-7-2010]; Repayment of existing rupee loans for companies in infrastructure sector [Reference A.P. (DIR Series) Circulars Nos. 25 and 111, dated 23-9-2011 and 20-4-2012 respectively]; Spectrum Allocation [Reference A.P. (DIR Series) Circulars Nos. 28 and 54, dated 25-1-2010 and 26-11-2012 respectively]; and Repayment of Rupee loans [Reference A.P. (DIR Series) Circulars Nos. 134, 26, 78 and 12, dated 25-6-2012, 11-9-2012, 21-1-2013 and 15-7-2013 respectively]. According to RBI A.P. (DIR Series) Circular No. 129, dated 9-5-2014, these changes will come into effect immediately.

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ECBs – AD Category-I Banks allowed to reschedule ECB: Designated AD Category-1 Banks have been allowed to re-schedule ECB due to changes in draw-down or repayment schedule subject to certain conditions. RBI A.P. (DIR Series) Circular No. 128, dated 9-5-2014 issued in this regard states that for the purpose, changes in all-in-cost should only be on account of change in average maturity period due to re-schedulement of ECB and post re-schedulement, the AIC and AMP should be in conformity with applicable guidelines. Such re-schedulement is allowed only once, before the maturity of the ECB and the prudential norms applicable on account of re-schedulement should be complied with if the lender is an overseas branch of a domestic bank. It is also stated that there should not be increase in the rate of interest and no additional cost should be involved and the changes on account of re-schedulement should be reported to DSIM through revised Form 83. ECB should be in compliance with all applicable guidelines related to eligible borrower, recognized lender, AIC,AMP, end-uses, etc and the borrower should not be in default/caution list of RBI and should not be under the investigation of Directorate of Enforcement. Provisions of this circular are, however, not applicable to FCCBs.

Ratio Decidendi

Public offer as per Takeover Regulations includes voluntary open offer - Economic viability not ground for withdrawal: The fundamental issue which arose in this appeal before Supreme Court was whether an open offer voluntarily made through a public announcement for purchase of shares of the target company can be permitted to be withdrawn under Regulation 23(1)(d) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('New Takeover Regulations') on the ground that the voluntary open offer has become financially unviable. It was contended that a delay of 13 months in clearance of offer documents by SEBI made the offer unviable. SEBI had withheld its approval of the offer documents due to detection of a previous breach by the respondent. The respondent had made certain acquisitions of shares in the target company between 2006 and 2011 that caused the Respondent to breach the creeping acquisition limits under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('Old Takeover Regulations'). The Apex Court upheld the sanctity of a voluntary open offer made under Regulation 11 of the new Takeover Regulations. The Court held that Regulation 27 of New Takeover Regulations and the restrictive interpretation of the corresponding provision of the Old Takeover Regulations in the Apex Court's judgment of *Nirma Industries Ltd.* v. *SEBI*, [(2013) 8 SCC 20] is equally applicable to both mandatory offers and voluntary offers under the New Takeover Regulations. Although the delay by SEBI in clearing the offer documents was criticized, it was held that such a delay in itself would not nullify its action. Also economic viability could not be said to be 'impossibility' of performance as envisaged in Regulation 27

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of the Takeover regulations [*SEBI* v. *Akshya Infrastructure Pvt. Ltd.*, Judgment dated 25-4-2014 in C. A. No. 6041/ 2013, Supreme Court]

Non-competitor cannot be held liable for denial of market access: The Competition Appellate Tribunal (COMPAT) has overruled the ruling given by Competition Commission of India in 2012 [*Please refer Corporate Amicus-July 2012 issue for CCI Order*] imposing penalty on cable operators for denial of market access to the broadcasters and other stakeholders, by certain cable operators who worked as a group, and hence acting in contravention to Section 4(2)(c) of the Competition Act, 2002. Noting that the informant-broadcaster and the appellant-Multi System Operator (MSO) were at different levels of supply chain in the market, and there was no question of competing with each other, it was held that question of denial of market access to the broadcaster by an MSO cannot arise. The Tribunal in this regard, further went on to hold that even if they were competitors, the Commission had not found that there was denial of market access as a result of a practice adopted by MSO, as a group, by termination of contract. It was hence held that it cannot be said that by termination of a contract of interconnection of services between two service providers, there has been a denial of market access to the actual transmission of the channels and that there was denial of services to the viewers causing consumer harm. [*Fast Way Transmission Pvt. Ltd.* v. *Kansan News Pvt. Ltd.* – Order dated 2-5-2014 in Appeal No. 116 of 2012, COMPAT]

Absence of tendering procedure not always anti-competitive: Competition Commission of India has held that there is no abuse of dominant position by the Central Government entities providing e-procurement solutions to the Central Government/ State Governments/ Government Departments/ PSUs/ Government Agencies *etc.*, on nomination basis, without any open tender or otherwise going through competitive bidding process due to the alleged insistence of the Central Govt. The Commission noted that e-procurement platform developed by these entities need not be used by unwilling Central Ministries/ State Governments/ PSUs etc. and that the Central Govt. had given assurance before the Delhi High Court that it will not impose its e-procurement solution. Concerns of the government, like hidden costs and national security considerations were also considered by the Commission while it held that a criterion other than tendering/ bidding cannot be *per se* construed as anti-competitive as long as same is not unfair/discriminatory or otherwise results in denial of market access to other market participants. It was also noted that the act of the Central Govt. in prescribing or making such requirements would not make government an enterprise in the absence of any economic activity undertaken by it. [*NexTenders (India) Private Limited* v. *Ministry of Communication and Information Technology* – Order dated 29-4-2014 in Case No. 7 of 2014, CCI]

Arbitration – Order returning application made under Section 34 for want of jurisdiction, not appealable: Allahabad High Court has held that appeal under Section

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37(1)(b) of the Arbitration and Conciliation Act, 1996 against the Order of the District Judge returning the application of the appellant made under Section 34, for want of jurisdiction with liberty to present it before a competent court, is not maintainable. Deliberating on the question as to whether such an order would amount to refusal to set aside an arbitral award, and noting the contents of the order of the District Court, it was held that impugned order was not a decision on merits of the application under Section 34 and hence no appeal was maintainable. The court in this regard distinguished its earlier judgement in the case of *U.P. Cooperative Sugar Factories Federation Ltd.* observing that the application was 'rejected' for territorial jurisdiction in the earlier dispute while here the application was 'returned' as it was not a court as defined in Section 2(1)(e) since proceedings for enforcement of the award were pending in the Delhi High Court. It was noted that Arbitration and Conciliation Act, 1996 is a specific code and that the proceedings under said Act are different from that under Code of Civil Procedure. [*International Trade Expo Centre Ltd.* v. *Mukesh Sharma* – Judgment dated 2-4-2014 in First appeal from order defective No. 1304 of 2011, Allahabad High Court]

'Control' or 'joint control' – Provisions of competition law not relevant for Takeover Regulations: 'Control' or 'joint control' of the target company in terms of Competition Act whether can be considered as 'control' in terms of Takeover Regulations? SEBI in this case which was taken up based on an observation made by Competition Commission of India that although the deal between Etihad Airways PJSC and Jet Airways is not anti-competitive, with no appreciable adverse effects on the relevant market in India, by acquisition of 24% of the equity shares in Jet Airways, Etihad shall be acquiring 'joint control' in the company along with the promoter group, answered the question in negative. It was hence held that Etihad was not required to make an open offer in the case in accordance with Regulation 4 read with Regulation 13(1) of the Takeover Regulations, 2011. Noting that the definition of 'control' under Section 5 of the Competition Act, 2002 is different from the definition under the Takeover Regulations in meaning, scope and purpose, it was held that definition under FDI Policy which is *pari materia* with the definition under Takeover Regulations should be relied upon to decide the issue. SEBI in this regard, unlike CCI, considering number of independent directors to calculate the strength of the board of the company, held that since the acquiring company could appoint only 2 directors out of 12, it would not confer 'control' of the company under Takeover Regulations. It was also observed that clauses of Commercial Cooperation Agreement did not confer control over Jet to Etihad along with the existing promoters of Jet under the Takeover Regulations, 2011 and that the transaction documents were also modified to ensure that the 'effective control' over Jet Airways shall remain with the Indian promoter group. [*In the matter of acquisition of shares of Jet Airways (India) Limited by Etihad*, SEBI Order No. WTM/RKA/CFD-DCR/17/2014, dated 8-5-2014]

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Three year limit for sale of attached property not applicable to recovery under RDDB Act: Examining the applicability of Rule 68B of the Income Tax Act, 1961, to proceedings under the Recovery of Debts due to Banks and Financial Institutions Act, 1993, (RDDB) the Bombay high court held that the bar on sale of immovable property attached under the proceedings, after expiry of three years would not apply to recovery under the RDDB act. In the instant case, the bank had obtained a fresh attachment order on expiry of three years from date of original decree. The appellant argued that since the Rule 68B applied with necessary modification to recovery under the RDDB, the bank could not sell the attached property and the fresh attachment order was also invalid. Delineating clearly between the objects and provisions of tax and recovery proceedings the court opined that if Rule 68B applied as such, the very object of recovery would be impeded. It was held that the purpose of adopting Rule 68 B is only to provide for a fair procedure and prevent arbitrariness by Recovery officer and not to import *in toto* the provisions applicable to tax dues. [*Mitexcos* v. *Canara Bank*, Judgment dated 16-4-2014 in WP 1300/2013, Bombay High Court]

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