The Legal 500 Country Comparative Guides

India: Private Equity

This country-specific Q&A provides an overview of private equity laws and regulations applicable in India.

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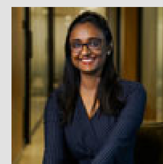

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1. **What proportion of transactions have involved a financial sponsor as a buyer or seller in the jurisdiction over the last 24 months?**

   For the purposes of this Q&A, we have provided our responses on the premise that a 'financial sponsor' is an entity, usually in the form of a private equity fund, which acquires a significant stake and some nature of control in Indian companies. These funds are different from buyout funds or purely strategic sponsors, both of which, in our experience, are not common in the Indian private equity ecosystem. One reason for this is that the external commercial borrowing-related regulations in India do not allow leveraged buyouts, i.e., investments and/or purchases in Indian companies against borrowings and/or loans, especially those where the aim is to strap such leverage onto the Indian target company (unless the target company is a foreign company). This also extends to domestic financing, as Indian banks are prohibited to lend funds for the purpose of making investments or purchases in companies. Further, 'hostile' acquisition of listed securities is capped at 10% for 'foreign portfolio investors' and other modes of acquisition are restricted to off-market purchases under India's FDI regime. Therefore, in the private equity ecosystem in India, financial investors are more common than pure play financial sponsors, and for the purpose of a holistic view of this space in India, we have worked on the aforementioned premise.

   The last decade has seen many initiatives being taken by the Government of India to incentivize foreign investors/sponsors to invest in India, including liberalizing India's foreign investment policies, furthering the ease of doing business in India etc. As per the deal tracker reports released by Grant Thornton , the total number of M&A transactions involving financial sponsors in India, in the year 2018, was 189, involving an aggregate value of over USD 38.5 billion. In 2019, till the end of the second quarter, the total number of M&A transactions involving financial sponsors was 132, involving an aggregate value of over USD 7.8 billion. Further, the aggregate domestic and foreign private equity transactions in India, in 2018, were 786 for a value of USD 20.5 billion, and till the second quarter of 2019, these have been 595 for a value of USD 24.3 billion.

   As reported by the India Private Equity Trend Report 2018 by Venture Intelligence, India Private Equity Report 2019 by Bain & Company,2 Deals in India: Mid-year review and outlook for 2019 by PWC, private equity firms invested USD 26.3 billion in 2018 in India. Foreign direct investment (FDI) equity inflows rose by 28% in the first quarter of 2019-20, to USD 16.3 billion.

2. **What are the main differences in M&A transaction terms between acquiring a business from a trade seller and financial sponsor backed company in your jurisdiction?**

   The main difference in acquiring a business from a trade seller versus acquiring it from a financial sponsor would be the nature of representations, warranties and indemnities that are provided for the relevant acquisition. While trade sellers are more comfortable providing representations and indemnities with respect to business and operations, a financial sponsor

is not comfortable providing these. Financial sponsors prefer to provide only title, authority, capacity and insolvency-related fundamental representations. A financial sponsor may back up the representations provided by the company, founder(s) and/or the management through indemnity, without providing any business representations itself. However, this may be in rare cases, with such representations and indemnities being heavily qualified with concepts such as actual vendor knowledge. It may also be that the indemnity is backed or completely excluded by providing a warranty and indemnity insurance for which the premium and costs could be partially or fully borne by the financial sponsor seller. Though such insurances are not very common in pure India-based M&A transactions, queries regarding the same are definitely gathering momentum.

A significant difference between acquiring from a trade seller versus a financial sponsor is with respect to earnouts. The principle of deferred payments is applied here, where acquisitions from trade sellers are linked to a maximum holdback of 25% of the total consideration amount. This is because, as per the foreign exchange rules in India, in the case of any transfer between a person resident in India and a person resident outside India, within a period of up to 18 months from the date of the transfer agreement, a maximum of 25% of the total consideration can be paid by the buyer on a deferred basis or can be settled through an escrow mechanism. This is also true if the entire consideration is paid at the outset, with up to 25% being indemnified by the seller for a period of up to 18 months from the date of payment of the full consideration. The earnout of 25% in these forms can be done through indemnity payouts or may be linked to the achievement of milestones or key performance indicators to be met by the seller, which may also be given in the form of a put option with a minimum internal rate of return. It is also crucial to note that such earnouts are required to, at all times, until their full and final payment, meet the pricing guidelines set out under the foreign exchange rules which, currently, state that the consideration shall not be less than the fair market value of the instrument being sold, where the trade seller is resident in India. These provisions are important to understand how domestic and foreign parties view such deferred payment arrangements and earnouts. Given that a maximum of 25% can be held back, the buyer could acquire a minimum of 75% from the trade seller, which would, in turn, entitle the buyer to complete control under company law. Therefore, once such control is fully established in any case, the decision of the earnouts with respect to the remaining 25% (or less) depends on whether the buyer is a domestic entity or a foreign one. A domestic buyer will not have to comply with pricing guidelines prescribed under the foreign exchange rules of India, whereas a foreign buyer will have to ensure that the consideration is not less than the fair market value, at every point in time when the earnouts are made. Therefore, usually, it is ideal for foreign buyers to purchase approximately 75% from the trade sellers, to avoid foreign exchange non-compliances, and for domestic buyers to simply purchase (on a deferred consideration basis) a larger percentage, up to 100%, given that there is no risk of foreign exchange non-compliance in that respect. However, the ultimate decision depends on the factors at play, on the time periods and shareholding percentage involved, and on the potential impact of a partial transfer vis-à-vis a full transfer.

Additionally, advisory contracts and/or employment lock-ins are common in deals with trade sellers in India. In our experience, we have seen buyers insist on founders and/or key

managerial personnel of the company continuing their employment even post the acquisition, for the purpose of a smooth transition. This could be done through contracts of an advisory nature or contracts specifying lock-ins for such key employees. Any earnouts to be received by the trade sellers may become subject to such continued employment and/or the completion of the advisory arrangements.

Another key difference is with respect to non-compete obligations. In acquisitions from trade sellers, we have seen non-compete covenants being imposed on founders and/or key managerial personnel, in various cases. However, in rare cases, even financial sponsors are subject to non-compete restrictions, depending on their shareholding, seat on the board of directors and extent of control in the company.

3. **On an acquisition of shares, what is the process for effecting the transfer of the shares and are transfer taxes payable?**

Shares can be transferred either through a physical process or through a dematerialized process. To transfer shares in physical form, a share transfer deed needs to be executed in the prescribed format, i.e., Form SH-4, and accordingly, the deed is required to be stamped as per the applicable stamp duty (currently, at the rate of 0.015% of the sale consideration). For the transfer of dematerialized shares, only a notification through a delivery instruction slip to the depository is enough, along with a stamp duty at the rate of 0.015% of the sale consideration. Further, to give effect to any transfer of shares between a person residing in India and a person not residing in India, a form referred to as the single master form and, within it, Form FC-TRS, is to be filed with the Reserve Bank of India through an online portal known as the Foreign Investment Reporting and Management System (FIRMS).

In India, transfers are effected in public listed companies through the stock exchange, and are recorded in real-time, once the dematerialized shares are credited to the transferee's dematerialization account, through a transfer agent. In private unlisted companies, transfers occur by way of share transfer deeds, in Form SH-4, and are said to be effected once they are taken on record by the company's board of directors and recorded in the register of members (if it is a physical transfer of shares) of such company, although the date of the transfer is usually recorded as the date on which the share transfer deed is signed.

Taxes in the nature of capital gains are imposed on the transfer of shares since shares are considered as capital assets. Applicable treaty benefits may reduce the tax implications for a non-resident seller who is from a jurisdiction with whom India has such favorable tax treatment under their double taxation avoidance treaties.

4. **How do financial sponsors provide comfort to sellers where the purchasing entity is a special purpose vehicle?**

While, in our experience, it is not common for sellers to seek comfort from financial sponsors as financial sponsors can provide this comfort by extending representations on the

availability of liquid funds to close the transaction. In certain cases, they may also provide proof of availability of such liquid funds in their bank accounts or provide copies of their agreements with debt financiers, in order to provide comfort to sellers. Providing such comfort could also involve a guarantee from the purchaser's parent entity to cover the solvency risk of the special purpose vehicle, or a comfort letter from a bank, for this purpose.

5. **How prevalent is the use of locked box pricing mechanisms in your jurisdiction and in what circumstances are these ordinarily seen?**

While this could be heavily negotiated, post-closing holdbacks/cash adjustments with respect to foreign buyers and investors are not very popular in India and could also involve regulatory hurdles in case the deal is subject to the requirements of the foreign exchange laws in India, which restricts the commercial freedom of such parties. However, such a mechanism, due to the vastly reduced set of conditions and compliances, is fairly common amongst Indian domestic parties. This has already been dealt with in Question 2 of this section and applies to any primary investment or secondary transfer in a company. This also applies in the event that a non-resident buyer (i) agrees to purchase 100% and defers payment of, say, 25% from it for a later date; and (ii) makes payment for a lesser amount, say, for 80% at the first instance, and thereafter, makes payment of the remaining 15% via a separate transaction altogether, with no deferred or tranched payments. Therefore, non-resident financial sponsors and investors prefer the locked box pricing mechanism because it offers them a pre-agreed, definite and fixed price for a clean exit, without having to comply with foreign exchange pricing guidelines every time that a payment is made. A fixed price ensures return of capital to the limited partners of such financial sponsors during their fund life and provides comfort to them, given that they no longer have to bear the risk of any requirements to adjust such amounts at a later date.

Despite the general preference of financial sponsors to use the locked box pricing mechanism, there may be situations in which certain issues are negotiated towards specific indemnity holdbacks, escrow arrangements and/or for adjustments, subject to the deferred payment mechanism and conditions set out under the foreign exchange rules in India, and dealt with in Question 2 above. Such adjustments/holdbacks are mostly agreed in relation to known or contingent accounting liabilities, tax risks, litigation or liability with respect to regulatory non-compliances, among other things. However, in such cases, it is agreed between the parties that the risk of foreign exchange fluctuations and potential non-compliance with pricing guidelines will be borne by the non-resident buyer.

6. **What are the typical methods and constructs of how risk is allocated between a buyer and seller?**

Purchasers usually mitigate risk in sale transactions by seeking adequate protection from the sellers as well as the target company, in the form of warranties and indemnities, which cover areas of litigation, environmental law, intellectual property rights, assets, financial statements, labour, employment and taxation, among others. However, it is possible for late-stage companies to negotiate agreements such that they are not bound to provide any

warranties or indemnities to the purchaser. For the purpose of this query, we will limit the analysis of risk mitigation to the purchaser and the seller.

One way of allocating risk is by way of earnouts and holdbacks, in the manner and subject to the conditions set out in Question 2 and Question 5 above, where payments are either deferred or tranched, or allocated under escrow or indemnity arrangements, or subject to the achievement of certain milestones.

Further, for mitigating uncertainty in sale transactions, purchasers generally adopt clauses relating to the occurrence of any material adverse effect (MAE) during the period between the execution of the agreement and closing/completion of the transaction. In addition to this, and most commonly, purchasers use general and specific indemnities and warranties, against which, sellers generally make a disclosure of specific facts as specific carve-outs to such warranties. MAE clauses state that transaction documents can be terminated if there is a material negative impact on the target company or the seller's title to the shares being sold, during the period between the execution of the agreement and closing/completion of the transaction.

Indemnity provisions are often fairly detailed and also cover third party claims. It is also common for sellers to negotiate a limitation of their liability under indemnity provisions, in the form of monetary thresholds and time periods for the survival of the purchaser's indemnity claims against the sellers. In India, monetary thresholds, i.e., aggregate cap on the indemnity liability amount, get negotiated in a very wide range and are generally represented as a percentage of the total sale consideration involved in the transaction. Monetary limitations also include basket provisions and a de-minimis threshold. Based on the risk identified by the purchaser through its due diligence exercise, the time limitation for (i) taxation-related warranties is usually 7 years from the end of the financial year in which closing of the transaction occurs; (ii) fundamental warranties is usually unlimited, i.e., claims for the breach of fundamental warranties (like those relating to title and authority) could survive in perpetuity; and (iii) other warranties is usually anywhere between 1 year and 3 years.

Generally, specific indemnity provisions contain separate monetary and time limitations, given that they relate to specific and identified non-compliance risks, usually stemming from the purchaser's due diligence findings, which could potentially affect the core business of the company, or the inherent title to the seller's shares or some material litigation.

Another way of mitigating risk, or ensuring that adequate measures are taken to provide protection in the event of a claim, is that the purchasers and sellers negotiate the dispute settlement clause, keeping in mind factors such as the seat and venue of arbitration and the procedural law governing the arbitration. The choice of forum can be critical to the efficient resolution of disputes. In recent times, it has been seen that parties prefer institutional arbitration to ad hoc arbitration, given that it is the more cost-effective option.

7. **How prevalent is the use of W&I insurance in your transactions?**

While the concept of a W&I insurance is evaluated in almost all deals, in our experience, deals where it is procured are few and far between. Such insurance involves a high transaction cost and premium, which sellers are not very comfortable bearing in the context of India-focused deals. Further, due to various factors such as evasive regulatory regimes and grey areas in respect of disclosures made by sellers, many insurers are not comfortable covering a vast variety of matters for India-specific M&A transactions, which also makes such insurance an undesirable and often unpopular for the parties involved. However, we have recently seen trends where W&I insurance is being actively sought in Indian M&A deals, especially where a foreign parent company or group of companies is involved.

8. **How active have financial sponsors been in acquiring publicly listed companies and/or buying infrastructure assets?**

We note that the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (popularly known as the Takeover Code in India) has been triggered approximately a dozen times by financial sponsors in India since April 1, 2018. As reported in the data provided by the Indian Department of Industrial Policy and Promotion (DIPP)6, in the financial year 2018-19, specifically with respect to publicly listed companies, (i) 418 acquisitions and investments took place in India; and (ii) these acquisitions/investments were for an aggregate sum of USD 1.31 billion.

As reported by the IBEF, the infrastructure sector in India has witnessed private equity and venture capital investments worth USD 1.97 billion in 2018 and M&A deals worth USD 5.4 billion in 2017.

As per the deal tracker reports released by Grant Thornton , in 2018, 29 M&A and private equity transactions took place in the real estate sector in India, for an aggregate amount of USD 3.3 billion. Till the end of the second quarter of 2019, in India, 5 private equity transactions have taken place in the real estate sector in India, for an aggregate amount of USD 562 million.

9. **Outside of anti-trust and heavily regulated sectors, are there any foreign investment controls or other governmental consents which are typically required to be made by financial sponsors?**

As per the foreign exchange rules in India, sectors requiring the prior consent of the government for foreign investment fall within the government route, and those not requiring such consent fall within the category of the automatic route. Presently, in line with the Indian government’s attempt to invite and incentivize foreign investment in India, most sectors in India are permitted to receive foreign investment under the automatic route. These sectors include agriculture, mining, manufacturing, civil aviation (100%, except in cases of air transport services and domestic passenger airlines, for which the permissible limit is 49% for

resident Indians and 100% for non-resident Indians), infrastructure, wholesale trading, e-commerce, duty free shops, pharmaceuticals (up to 74%), asset reconstruction companies, non-banking financial companies (NBFCs), insurance and other financial services. However, some sectors, including (i) defence, banking and telecommunication services (beyond 49%), (ii) print media, and (iii) multi-brand retail trading, are required to take the government route to receive foreign investment. Additionally, there are some sectors, such as lotteries, gambling, real estate businesses, tobacco and the railways, where foreign investment is prohibited entirely.

In addition to this, the Indian Department of Industrial Policy and Promotion (DIPP) has set out conditions for various sectors in India. The DIPP has been actively trying to liberalize various sectors, to encourage and strengthen the ease of doing business in India. However, there are a few sectors in which the DIPP has been very particular about restricting foreign investments. One such sector which is usually unregulated in other jurisdictions but heavily regulated in India is that of retail trading. This is essentially to protect smaller retailers and micro, small and medium enterprises in India. Through foreign exchange regulations in India, the DIPP has, since the inception of these regulations, prohibited foreign investment in retail trading in India. A fairly straightforward and simple way of defining ‘retail trading’ is that it includes buying from another person and selling to end consumers. Foreign investment in Indian ecommerce entities is restricted to entities with marketplace, manufacturing or business-to-business (B2B) models; retail trading in any of these sub-sectors is also prohibited. The only avenues where 100% foreign investment under the automatic route is allowed for entities engaged in retail trading are (i) single brand retail trading (SBRT); and (ii) manufacturing entities. The DIPP has not prescribed too many conditions for a manufacturer to sell its products (including through e-commerce and including by way of contract manufacturing), except that a manufacturer can be eligible for 100% FDI under the automatic route only if it sells products manufactured in India. However, with respect to SBRT, the government has prescribed various conditions. For instance, products sold can only be of a ‘single brand’. It is unclear whether sub-brands not carrying the name of the main brand can be utilized to engage in such an SBRT business. Further, in respect of proposals involving foreign investment beyond 51%, at least 30% of the value of goods procured, need to be sourced from India, preferably from smaller vendors and retailers.

Further, based on the residential status of the purchaser and the seller, there are minimum pricing requirements, known as pricing guidelines, to be adhered to under Indian foreign exchange rules.

Another way of determining foreign investment controls in India, is by governing foreign portfolio investment. Foreign portfolio investment (FPI) in India means any foreign investment by one single portfolio investor of less than 10% of the total capital of a listed Indian company. Currently, and till April 1, 2020, the aggregate FPI limit for a company is 24%, which can only be increased with the consent of its shareholders. However, the foreign exchange rules now state that, starting from April 1, 2020, the deemed aggregate limit for FPI will be the relevant sectoral cap (as mentioned above). If a company wishes to decrease

this limit, its board of directors and shareholders will have to pass resolutions to that effect, before March 31, 2020. However, if FDI is prohibited in a company, the cap for FPI for such company remains at 24%, in aggregate. In case FPI thresholds are exceeded, such FPI entity will have 5 trading days to divest such excess holding, failing which, the investment will be deemed to be FDI. Therefore, in the past, how foreign portfolio investors were prevented from taking a controlling stake in Indian listed companies, but now it appears that the Indian government is open to easing its position in this regard. Interestingly, this deemed increase in the limit for FPI (unless specifically decreased by March 31, 2020) may make Indian listed companies susceptible to a creeping acquisition or a hostile takeover under the Takeover Code by an FPI, even without the board of directors and the shareholders agreeing to increase the limit to allow for such acquisitions.

In addition to the above, as mentioned in Question 1 above, the external commercial borrowing-related regulations in India dictate that financial sponsors cannot engage in or effect any leveraged buyouts, i.e., investments and/or purchases in Indian companies against borrowings and/or loans, especially those where the aim is to strap such leverage onto the Indian target company (unless the target company is a foreign company). This also extends to domestic players, to whom banks are prohibited to lend funds for the purpose of making investments or purchases in companies.

10. **How is the risk of merger clearance normally dealt with where a financial sponsor is the acquirer?**

In India, an acquisition which breaches certain prescribed asset or turnover thresholds (Combination) is required to be notified to the Competition Commission of India (Commission) for its approval, prior to taking any steps towards completion of the proposed transaction. The Commission may either approve the combination unconditionally or in the event the Commission concludes that the Combination could potentially have an appreciable adverse effect on competition (AAEC), it may either refuse to provide merger clearance or impose obligations on the parties which could be behavioral in nature or may require disinvestment from particular business lines in order to eliminate the AAEC.

An exemption from the notification requirement has been provided for acquisitions made pursuant to investment agreements by public financial institutions, banks, SEBI registered foreign institutional investors, or SEBI registered venture capital funds.

The Indian law on merger control also identifies certain categories of Combinations which are ordinarily not likely to cause an appreciable adverse effect on competition. Accordingly, a notice to the Commission is normally not required to be filed for such Combinations. However, this is a self-assessment test and if upon a preliminary analysis, it is perceived that such a Combination may cause an appreciable adverse effect on competition, the Commission may be notified to seek an approval. Of particular importance to financial sponsors/investors (who are not registered financial institutions as above) are the following categories:

(i) an acquisition of shares or voting rights solely as a non-controlling investment (i.e. without strategic intent or special rights that confer policy influence such as board seats, veto etc), where the total shares or voting rights acquired do not exceed 25%(twenty five percent) or more of total shares or voting rights of the company; and

(ii) acquisition of additional shares or voting rights, where the acquirer already holds more than 25% (twenty five percent) but less than 50% (fifty percent) of the shares or voting rights of the enterprise, except in the cases where the transaction results in transfer from joint control to sole control.

In August 2019, the Commission has notified a ‘green channel’ whereby deemed prior approval is granted to those Combinations in which there is no vertical, horizontal or complementary overlap in the target and acquirer groups, which can include downstream portfolios companies in India as well. This is of particular importance to financial investors who acquire minority positions and have no operational activity in their ‘group’.

From a document risk and security perspective, it is customary for acquirers in India to make unconditional approval by the Commission, a condition precedent to closing and require the target to provide full cooperation and complete information (especially in unlisted companies) in order to enable the competition law analysis and successful statutory filings. An acquirer may ask for, but does not typically get indemnity protection for an unsuccessful merger clearance, depending on complexity of analysis. Further, it is unusual for the seller to have ‘break-fee’ rights in such an eventuality either.

11. **Have you seen an increase in the number of minority investments undertaken by financial sponsors and are they typically structured as equity investments with certain minority protections or as debt-like investments with rights to participate in the equity upside?**

In our experience, financial sponsors making minority investments in Indian target companies has been the preferred route for most. To put it simply, minority investments appear to be the majority in India when it comes to financial sponsors. Financial sponsors generally prefer their direct investments to be structured in terms of equity shares and compulsorily convertible preference shares (i.e., shares which is compulsorily convertible into equity shares after a certain time period and hence, on a fully diluted basis, are classified as equity instruments and are voting securities). Therefore, equity investment structures are preferred over debt-like investment structures. However, it may be argued that the way liquidation preference rights are structured in India, makes such convertible preference share structures more debt-like than equity. Given that Indian foreign exchange rules are liberal only towards equitylinked securities such as equity shares, compulsorily convertible preference shares and compulsorily convertible debentures to be issued to foreign financial sponsors, and not towards any other fully debt structure, the route taken by financial sponsors is to enforce various rights which ensure that the economic benefits they derive from their investment in terms of liquidation preference and exit value, are somewhat similar to those that a financial

lender would have had, without the upside. Essentially, the terms are structured such that if there is a positive liquidity event in the company, the investors have the right to get an upside. However, in the event of a negative liquidity event, such as winding up or a court-ordered liquidation, the investor should be entitled to at least the minimum possible protection.

Along with taking the equity investment route, financial sponsors usually negotiate certain basic rights under the shareholders' agreement of the target company, which include (i) rights of management (board rights), (ii) affirmative voting matter rights, (iii) special rights with respect to exit provisions, (iv) rights to procure information from the target company, (v) rights to carry out inspection of the target company, (vi) quorum rights, (vii) pre-emption rights (right to maintain capital), (viii) rights of first refusal and/or rights of first offer against the founders' and/or other shareholders' shares, (ix) drag along rights, (x) tag along rights, (xi) founder claw back rights, and (xii) lock-in on the founders' shares.

12. **How are management incentive schemes typically structured?**

It is easiest to structure management incentive schemes by issuing employee stock options (ESOPs). Companies which are not start-ups are prohibited from issuing ESOPs to their promoters/founders. Therefore, in such cases, other schemes are usually opted for, in the form of management options, warrants, stock appreciation rights and phantom stocks. However, in our experience, it is common to have management incentive schemes in private unlisted companies in India, but it is rare to come across such a concept in listed companies due to the statutory restrictions mentioned above. In any event, the most ideal option is usually chosen based on the tax analysis for the relevant promoter/founder.

13. **Are there any specific tax rules which commonly feature in the structuring of management's incentive schemes?**

The most common management incentive scheme adopted by companies in India is that of stock options, the taxation of which is governed by the Indian Income Tax Act, 1961, and the specific rules and regulations made thereunder. Under these tax rules, the tax is payable under the head of 'salary' by the management member (similar to an employee) at the time of exercising the stock option, and is calculated based on the difference between the value of the stock option and the amount paid by the management member. Instead of the payment being made by the management member, the target company is required to withhold the applicable tax amount when such member exercises his or her stock options. Further, in the event of any sale of the shares allotted to such member upon exercise of the stock options, tax rules require the member to pay capital gains tax on the difference between sale price of the shares and the amount paid by such member/deemed cost of acquisition on which the tax was paid upon the exercise of the option (as 'salary').

14. **Are senior managers subject to non-competes and if so what is the general**

duration?

It is quite common to have senior managers in a company be subject to non-compete restrictions in India, during the course of their employment with the company, and even post termination of their employment and/or when they cease to hold shares in the company. Non-compete restrictions get commonly built into the transaction documents, with the shareholders' agreement and the employment agreement generally including such provisions. The duration of non-compete restrictions could vary, depending on the sector of the company, the seniority level of the manager and the stage of the company. It ranges between 6 months and 24 months, with a 12 to 18-month duration being the most common. Non-compete provisions are easily enforceable in India during the term of a person's employment. However, post termination of his or her employment, non-compete restrictions are considered 'restraint of trade' under Indian contract law (as also interpreted in legal precedents), and may be difficult to enforce. To ensure adequate protection to the extent possible, parties usually insert such non-compete provisions against the senior managers in their employment agreements, along with clauses regarding confidentiality, protection of intellectual property, work-for-hire provisions, territorial restrictions etc., which are capable of ensuring that the true intent behind any non-compete clause is achieved.

15. **How does a financial sponsor typically ensure it has control over material business decisions made by the portfolio company and what are the typical documents used to regulate the governance of the portfolio company?**

Financial sponsors exercise control over material business decisions made by the portfolio company, through rights, most commonly included in the parent document, which is the shareholders' agreement, and publicly filed by way of articles of association (similar to a constitution in other jurisdictions) such as (i) a seat on, and the right to appoint observers to, the board of directors of the portfolio company, (ii) the right to be present in meetings to form a valid quorum, (iii) affirmative voting rights or reserved matter rights, (iv) veto rights (usually available only for a few shareholders with substantial shareholding), most commonly in relation to the company's key employees and founders, any new line of business, entering into any debt arrangements etc., (v) information and inspection rights against the company, and (vi) the right to receive documents such as a director appointment letter and a management rights letter in a form that has been reviewed and confirmed by such financial sponsors (requested by specific investment funds).

16. **Is it common to use management pooling vehicles where there are a large number of employee shareholders?**

In our experience, it is not very common to use management pooling vehicles in smaller Indian unlisted companies, because of the lower number of employee shareholders. In such cases, there are usually notional pools of options to be issued at a later date to a select few person from the management, in accordance with the employee stock option policy. However, in many listed companies and larger unlisted companies, the large number of employee shareholders (which usually crosses 1,500 in number, in such cases) are managed through

management pooling vehicles by creating an employee stock option trust, which holds vested shares on behalf of such large number of employees, and then transfers such shares to the employees at the relevant point in time. It is important to note that employee shareholders, to whom shares are issued by way of employee stock option schemes, are not considered part of the shareholders of the company, for the purpose of calculating the maximum permissible limit of 200 members for a private company in India.

17. **What are the most commonly used debt finance capital structures across small, medium and large financings?**

The most commonly used debt financing capital structure for small financing is working capital loan. Medium and large financings include working capital loans, term loans, asset financing, acquisition financing, bank guarantees, letter of credit restructuring and re-financing of existing loans. The most commonly used debt financing options are given as below:

1. Loans from banks: This option is a suitable option across small, medium and large funding requirements. Most of the long-term loans by banks are required to be secured as per the Reserve Bank of India (banking sector regulator). Most common form of securities are pledge charge over shares, hypothecation (for movable assets), mortgage charge (mostly for immovable assets), assignment (cash flows, contractual rights etc.) and guarantees. Further, the end use of loan under this option is highly regulated and banks in India are not allowed to lend for land acquisition, capital market transactions, acquisition of own shares by the borrower, subscription to or purchase of shares/debentures, including that of subsidiaries /Special Purpose Vehicles or for any other speculative purposes.
2. Loans from non-banking financial companies: This option is again a suitable option across small, medium and large funding requirements. It is however a costlier option in terms of interest rate(s) as compared to loan from banks. Further, most of the end use restrictions that are applicable to loan from a bank are not applicable to loan from non-banking financial companies.
3. External Commercial Borrowings (ECBs) from offshore lenders– ECBs can be availed in Indian rupee and in eligible foreign currency in the form of bank loans, loans from foreign equity holders, floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments), trade credits beyond three (3) years, foreign currency convertible bonds, foreign currency exchangeable bonds, etc. The end-use restrictions also apply to the ECB loans as per the local laws. Interestingly, the banks are now permitted to sell, through assignment, their stressed assets to eligible ECB lenders (except foreign branches/ overseas subsidiaries of Indian banks), subject to certain restrictions and compliances as per local laws.
4. Issuance of non-convertible bonds (listed or unlisted) which are subscribed by financial institutions and foreign portfolio investors, subject to compliance with relevant guidelines of the Reserve Bank of India and the Securities and Exchange Board of India, as applicable. This option is also subject to compliance of deposit regulations under the Companies Act, 2013. This option is more suitable to medium and large funding

requirements.

18. **Is financial assistance legislation applicable to debt financing arrangements? If so, how is that normally dealt with?**

    Under the Companies Act, 2013 a public company is not permitted to finance, either directly or indirectly (or support the financing by giving securities, guarantees etc.) the acquisition of its own shares or shares of its holding company. There are penal provisions against such financing by companies in India. Private companies are exempted from such restrictions, subject to compliance of certain compliances under the Companies Act, 2013.

19. **For a typical financing, is there a standard form of credit agreement used which is then negotiated and typically how material is the level of negotiation?**

    All banks and financial institutions have formulated own set of financing documents, which are largely based on LMA/APLMA standard agreements and applicable local laws. For medium and large financings, standard forms are customised to fit in the commercial terms agreed between the lender and the borrower. Thereafter, the document is mostly negotiated for certain key clauses such as restrictive covenants, representations and warranties, events of default and indemnities. Usually, the level of negotiations depends up on factors like financial health, past compliances and key facts disclosed in due diligence of the borrowing entity. However, small financings are generally not negotiated by the parties.

20. **What have been the key areas of negotiation between borrowers and lenders in the last two years?**

    The key negotiating terms in a typical debt financing transaction involves clauses relating to negative covenants (such as, debt to equity ratio, restriction on merger/amalgamations, restriction on change in control), commercial terms, event of defaults and consequences, indemnities and manner of securing the finances. Specifically, in the past two years, we have seen that the Reserve Bank of India is focusing on compliance of end-use of facilities by the borrowers.

21. **Have you seen an increase or use of private equity credit funds as sources of debt capital?**

    In the recent years, Indian market has witnessed an increase in private equity funds having separate credit arms which are registered as non-banking financial companies, alternative investment funds and other similar investment vehicles. The rise in such alternate debt financing model has mainly occurred due to the higher risk appetite of shadow bankers and consequently, they charge a higher interest-rate. Usually, such credit funds tend to be sector focused, for example, real estate, alternate energy, health care and others. Accordingly, the Reserve Bank of India releases sector-specific guidelines from time to time. Very soon, the government of India is expected to release guidelines for setting-up of specific funds for the real estate investments, with primary objective of reviving the real estate sector.