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The International Comparative Legal Guide to:

Private Equity 2019

5th Edition

A practical cross-border insight into private equity

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PREFACE

We are privileged to have been invited to preface the 2019 edition of *The International Comparative Legal Guide to: Private Equity*, one of the most comprehensive comparative guides to the practice of private equity available today. The Guide is in its fifth edition, which is itself a testament to its value to practitioners and clients alike. Dechert LLP is delighted to serve as the Guide's Editor.

With developments in private equity law, it is critical to maintain an accurate and up-to-date guide regarding relevant practices and legislation in a variety of jurisdictions. The 2019 edition of this Guide accomplishes that objective by providing global businesses leaders, in-house counsel, and international legal practitioners with ready access to important information regarding the legislative frameworks for private equity in 31 different jurisdictions. This edition also includes five general chapters, which discuss pertinent issues affecting private equity transactions and legislation.

The fifth edition of the Guide serves as a valuable, authoritative source of reference material for lawyers in industry and private practice seeking information regarding the procedural laws and practice of private equity, provided by experienced practitioners from around the world.

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Chapter 18

India

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1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions? Have you seen any changes in the types of private equity transactions being implemented in the last two to three years?

Private equity ("**PE**") transactions in 2018 amounted to approximately USD 35.1 billion across 761 deals. The majority of the transactions involve investment in unlisted companies. Despite non-banking financing companies ("**NBFCs**") facing liquidity concerns especially in the second half of the year, the financial services sector was the most attractive sector for PE investments in 2018. It was followed by the real estate and e-commerce sectors, both attracting substantial PE investments in 2018. 2018 was also a great year for exits, as the year saw significant PE exits of approximately USD 26 billion, being an almost 100% increase from 2017 and almost equal to the total number of exits in the previous three years cumulatively. In particular, Walmart's acquisition of Flipkart led to exits for multiple PE funds at a significant valuation. This year also saw a number of investments in start-ups, beating the earlier record in 2015.

India will continue to attract significant PE investments in the coming years.

1.2 What are the most significant factors encouraging or inhibiting private equity transactions in your jurisdiction?

Some of the changes in the taxation and foreign exchange law regime addressed the various operational difficulties faced by entrepreneurs as well as investors, and these measures in turn had a positive impact on the ecosystem. Please see our response in section 10 on the nature of reforms introduced in the recent past.

With these regulatory reforms and policy announcements, the general outlay for PE transactions in India continues to be positive. With the increased political stability, India continues to be an attractive destination for PE investments.

1.3 What trends do you anticipate seeing in (i) the next 12 months and (ii) the longer term for private equity transactions in your jurisdiction?

Political stability and socio-legal reforms will continue to play a key role in ensuring a further raise in PE investments in India. From a sectoral standpoint, IT-ITeS, e-commerce, consumer, insurance and financial services sectors (both traditional and fintech) seem to be promising in the next 12 months. Large global PE giants such as SoftBank, Macquarie, KKR, Carlyle, CPPIB, CDPQ continue to be bullish about investment in India.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

Co-investment structures have gained popularity in recent times. As co-investment structures offer access to funds, better assets, increased degree of control over investment portfolios and increased returns from capital, PE houses have increasingly adopted this medium of investment. It is also becoming increasingly common to see control stake transactions, or transactions involving PE investors holding significant stake in the portfolio company. Transactions are typically structured either as a primary investment or a secondary acquisition, or a combination of the two.

PE investors typically invest in a combination of equity shares and convertible instruments (such as convertible preference shares, warrants and convertible debentures) wherein, the investors also typically acquire a nominal number of equity shares to exercise voting rights. The convertible instruments are mandatorily convertible when issued to offshore investors.

Convertible notes are essentially instruments evidencing receipt of money initially as debt, which is either repayable at the option of the holder or which converts to equity shares of the company. Indian foreign exchange laws previously did not permit convertible notes to be treated as "investment" and were therefore not a popular instrument for investment. The foreign exchange laws have recently allowed convertible notes to be issued by registered start-ups to foreign investors for raising funds, subject to a maximum convertibility period of five years from the date of issue.

2.2 What are the main drivers for these acquisition structures?

Regulatory considerations such as the tax regime, foreign exchange laws and anti-trust laws act as a catalyst in structuring acquisition transactions. Several restrictions are imposed on Indian companies for investments/acquisitions especially in case of share acquisitions/ investments by a foreign investor. Restrictions such as who can be an eligible investor, the nature of instruments that can be issued, limits on investment and sectoral caps, government approval for investments, anti-trust approvals, timelines for payment of consideration and issuance of securities and feasibility of escrow arrangements are some of the restrictions imposed by the foreign exchange laws.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

PE investors generally hold between 10%–25% of the share capital of a company and the controlling stake is typically held by the promoters/promoter groups. In the recent past, there has been an increase in promoters/promoter groups having a minority stake in the group, with the capital structure of the company being dispersed across multiple investors. Where the PE investor is desirous of acquiring a controlling stake, promoters retain anywhere between 10%–25%. There are also upside sharing structures based on the performance of the company.

2.4 If a private equity investor is taking a minority position, are there different structuring considerations?

It is common for PE investors to hold a significant minority stake in the company. Accordingly, customary protections such as board seat, veto rights, quorum rights, information/inspection rights, tag-along rights and exit rights play a key role in ensuring that an investor's rights are protected. The scope and extent of veto rights granted to minority investors are generally limited, especially to matters affecting the rights attached to such investors' shares . It is possible to see special investor consents being structured around economic rights. In the case of an event of default, it is common to see certain specific exit rights kicking in, such as accelerated drag for undertaking the strategic sale of the company

2.5 In relation to management equity, what is the typical range of equity allocated to the management, and what are the typical vesting and compulsory acquisition provisions?

In a promoter-led company, management typically holds 12%–15% of the equity shares in the company along with other benefits like employee stock option plans ("**ESOPs**") and compensation packages. Adopting appropriate incentive structures to adequately incentivise the management team is an emerging trend.

A typical vesting of ESOP period ranges from four to five years, with compulsory acquisition proposed in case of termination on account of egregious situations such as fraud, embezzlement, wilful breach and other similar instances.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

A management equity holder is considered as a bad leaver where his exit is for "cause" or in case of voluntary resignation. Termination for "cause" covers termination on account of fraud, embezzlement, wilful breach, significant non-performance, being held guilty of any crime involving moral turpitude or such other instances that cause grave reputational loss to the company or its investors.

A management equity holder is typically considered as a good leaver where his exit is for reasons other than "cause".

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

The portfolio companies are typically board-managed with the senior management team reporting to the board.

PE investors seek to have a right to nominate directors on the board of the portfolio companies. Presence of such director is made mandatory for quorum, and meetings are adjourned in the absence of such quorum. Very often, the investors also require appointment of independent directors to ensure the highest level of corporate governance. Investors also seek to appoint observers to the board to attend meetings. Such observers are appointed in the capacity of non-voting and speaking observer.

The governance arrangement includes the ability of the PE investors to exercise the veto rights on certain identified matters, which could even include operational matters. Acquiring such rights in the listed companies does trigger an open offer. One would also notice transfer restrictions being imposed on the promoters and the existing managements and this also ensures that they have enough skin in the game for creating shareholder value. The PE investors have also ensured that the management team is adequately incentivised by way of implementation of employee stock option schemes.

The articles of association ("AoA") of the company are the bye-laws of the company and the governance structure is reflected in the AOA. The AOA is a publicly available document.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

PE investors are given significant veto rights with respect to all material aspects of the business of a portfolio company and its subsidiaries including in relation to corporate restructuring, fund raising, related party transactions, incurring indebtedness, disposal of assets, appointment and removal of key management team, litigation, change in business, diversification of the business etc. These rights are even provided to PE investors holding minority stake. In listed companies, SEBI is trying to make a distinction between "protectionist rights" and "operational rights".

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

Yes. There are certain restrictions in effectively exercising the veto rights at the board level of the portfolio companies, given that every director has a fiduciary duty towards the company, which may or may not always be aligned with the interest of the investor.

However, there are no such limitations on the effectiveness of veto arrangements at the shareholder level. As a result of this, very often the veto rights are structured at the shareholder level rather than at the board level. In certain cases, such veto rights are exercised by way of investor consent even prior to the matter being taken up at the board/shareholder level.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

PE investors holding majority stake in a company should ensure that they do not act in an unfair, fraudulent or oppressive manner against the interest of minority shareholders. A shareholder is considered a minority shareholder if he/it holds at least 10% shares in the company. The Companies Act, 2013 provides the following protections to minority shareholders:

- Right to file an application before the tribunal in the event affairs of the company are being conducted in a manner that is prejudicial to public interest or prejudicial or oppressive to the shareholder(s) or prejudicial to the interest of the company.
- Right to file an application with the tribunal (class action suit) against the company, directors, auditors in the event the affairs of the company are being conducted in a manner prejudicial to the interest of the company, its members or depositors.
- Consent rights with respect to merger and acquisitions.
- Minority shareholders of listed companies have the right to appoint a director to represent the interest of such small shareholders in the company.

It is important to note that a promoter holding a minority stake can also allege oppression and mismanagement in the event of arbitrary exercise of control rights by a PE investor.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

The shareholders' agreements often contain restrictive covenants regarding competition, solicitation and confidentiality to ensure promoters maintain executive roles in the company. Enforceability of non-competition restrictions is limited to sale of goodwill under the Indian laws, but the enforceability of breach of confidentiality and non-solicitation restrictions are possible. Furthermore, non-compete restrictions are not enforceable post-termination of employment, but Indian courts take into consideration reasonability of such restrictions while determining the scope and extent of its enforceability.

Apart from the above, there are no restrictions on the contents and enforceability of the shareholders' agreement. The AoA of the company incorporate the shareholders' agreement to extend dual protection *vis-à-vis* enforcement, in case of breach. At the time of the IPO, SEBI and stock exchange typically requires the termination of the shareholders agreement.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

The directors have a fiduciary duty towards the portfolio company under Indian laws. The Act makes directors of a company responsible for everyday affairs and management of the company. The Companies Act, 2013 has codified the liabilities of the directors in detail. Penalties prescribed for as a consequence for the breach of such duty in contravention of the Act ranges from 50,000 Indian rupees to 250 million Indian rupees. Certain offences in the Act are even punished with imprisonment, apart from monetary penalties. While a nominee director will hold a non-executive position on the board, he nonetheless is required to discharge and fulfil his fiduciary obligations.

Nominee directors are deemed to have knowledge of the proceedings of the board and they cannot recuse their liability on account of lack of knowledge of the contravention and express consent over such contravening act. Nominee directors are as liable as executive directors are in their fiduciary capacity to work in the best interest of the company, and not the nominators. Consequently, the PE investors are choosing to appoint a non-voting "observer" on the board, instead of appointing a director to ensure compliance with corporate governance.

From a process perspective, PE investors need to comply with the Act while appointing nominee directors. Directors are required to obtain director identification numbers before being appointed on the board of the portfolio companies. They are required to disclose interest at the time of appointment and any subsequent changes in their interest while holding that position in a company. The Act provides a list of disqualifications for the appointment of directors, which includes failure to procure a director identification number, a person being an undischarged insolvent, a person being convicted by a court for any offence involving moral turpitude or others, to name a few. In addition, the directors are not permitted to participate in meetings where a contract or arrangement in which such directors are interested in being discussed.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Directors of a company are bound to act in the best interest of the company, as they have fiduciary duty to do so under the Act. There could be a possible conflict of interest if a PE investor nominates a common nominee director on the board of two of its portfolio companies that are competing with each other or engaged in business transactions that are not on an arm's-length basis and in the ordinary course of business. In such scenarios, the nominee director typically steps down from the board of one of the companies to avoid conflict of interest.

It is fairly remote that interest of the company will be separate from that of the PE investor since the PE investor's investment is dependent on the growth and success of the company.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including antitrust and other regulatory approval requirements, disclosure obligations and financing issues?

The timeline for completion of PE transactions in India depends on a number of factors, including the sector of investment, antitrust issues, the nature of the transaction, size of the target's business, deal size, structuring and tax (both domestic and international) considerations. PE investments into a regulated sector or an investment in excess of the prescribed sectoral cap or an investment likely to affect the competitive market practices would require approval from the concerned regulatory authority or ministry/department through the Foreign Investment Facilitation Portal ("**FIFP**"). Accordingly, timelines of transaction would be affected if approval is required especially from the Reserve Bank of India ("**RBI**"), Security Exchange Board of India ("**SEBI**") in case of a PE investment into a listed entity, Competition Commission of India ("**CCI**") – the Indian antitrust regulator, the Insurance Regulatory Authority of India ("**IRDAI**") or other similar regulators. Consent from the CCI is becoming very critical in PE deals, especially given the nature and size of the deals. While the competition regulations do provide for certain exemptions from notifying the CCI, the CCI's decisions in the past have tended towards narrowing down the scope of these exemptions.

4.2 Have there been any discernible trends in transaction terms over recent years?

PE investments are structured by way of a subscription to equity, convertible preference shares or convertible debentures.

In terms of transaction terms, there has been significant changes in promoter protections typically extended. Caps on promoter liability, absence of joint and several liability with the company (especially where promoters hold a minority shareholding), promoters being given an exit in certain special circumstances such as change in control, sale to a competitor and promoters exercising veto over key decisions alongside the PE investors, are examples of such promoter rights being negotiated. This is a departure in the transaction dynamics as typically these rights were previously only extended to a PE investor and not to a promoter. Upside sharing structures are also becoming more common.

Tax indemnities continue to be negotiated in detail in the context of exit by a PE fund due to an increased tax burden under Indian laws (even where the buyer and seller entities are offshore companies but dealing with Indian securities). In case of sale by one offshore PE fund to another offshore entity, tax exposures and tax indemnities are being looked at more closely with a view to provide necessary comfort to the buyer entity. At the same time, such comfort is not drawn at the cost of an increased indemnity exposure for the selling of a PE entity. Consequently, tax indemnity insurances have gained popularity to help mitigate this risk.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

In India, PE investors are rarely party to public-to-private transactions. In addition, Indian exchange control regulators prohibit foreign investors from seeking guaranteed returns on equity instruments in exits.

A minimum of 25% of the share capital of a listed company is required to be publicly held (i.e., to be held by persons other than promoters/promoter groups). Depending on the rights available to the PE fund, the PE fund may be classified as a part of the public shareholding.

The SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**") governs the delisting of equity shares of listed companies. Under the Delisting Regulations, no company can make an application for delisting and no recognised stock exchange shall permit delisting of shares of a company in the following circumstances:

- pursuant to a buy-back of equity shares of the company;
- pursuant to preferential allotment made by the company;
- unless a period of three years has lapsed since the listing of that class of equity shares on any recognised stock exchange; or
- if any instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding.

Several other restrictions apply to a listed company proposing to delist, including minimal shareholding that a promoter needs to hold pursuant to the delisting and price determination for the delisting. Delisting is therefore not a preferred mode of exit for PE investors, who typically consider an initial public offer as a mode of exit from the portfolio companies and prefer the liquidity by way of listed shares. Consequently, PE investors invest at a time when the portfolio companies still have three to five years before listing and exit the company at the time of listing or shortly thereafter. Alternatively, PE investors invest in companies after listing. PE investors are, at times, limiting their equity exposure in Indian companies by investing through a combination of equity or preferred capital and listed non-convertible debentures ("**NCDs**"). Investments through listed and unlisted NCDs are less regulated and may be secured by Indian assets in favour of an Indian resident trustee. PE investors are able to structure their investments in a manner that maximises capital protection by stipulating a minimum return on the NCDs, while also participating in the risks and rewards of the portfolio company as a shareholder.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

In order to protect its investment, PE investors usually negotiate a shareholder's agreement and a registration rights agreement with the portfolio public company, in which the PE fund and management are invested. It is also possible for the transaction to be structured in a way that the portfolio company becomes the holding company or subsidiary of the listed entity, so as to give greater flexibility to the parties on the nature of rights that may be negotiated. A PE investor also typically seeks detailed representations and warranties on the business of the portfolio company as well as indemnity protections, and these serve to cap the fund's exposure.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

Cash consideration is the most preferred consideration structure. In certain transactions, the consideration is structured by way of swap or "in specie" distribution. On the sell-side, PE investors desire to complete the investment in one tranche. While on the buy-side, PE investors prefer a tranche-based consideration structure, although they are open to a single tranche consideration structure as well. Tranche-based consideration could also incorporate financial thresholds/milestones which may be tied to future operations of the company.

In case of tranche-based acquisitions, it is common to have the majority stake being acquired in the first tranche. In case of 100% acquisitions, it is common to devise a mechanism for retaining the management team. This could either be through deferred consideration payments which are linked to the performance of the target company or through promoter earn-outs/ratchets. However, in case of transactions coming under the ambit of foreign exchange laws of India (applicable where one of the parties to the transaction is not a resident), deferred consideration structures are also permitted subject to a maximum of 25% of the total consideration being paid by the buyer on a deferred basis and such payments being made no later than 18 months from the date of the share purchase. Also, it is possible to have escrow arrangements in place in connection with such deferred payments in such transaction involving offshore parties, subject to the above terms of 25% value cap and 18 months' time cap being adhered to.

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

Typically, a PE seller provides basic title and authority warranties to the buyer. Such title warranties include warranties on taxation position and anti-corrupt practices, in case of offshore parties. It is unusual for a PE seller to provide operational warranties in relation to the business of the portfolio company.

Consequently, the nature of indemnities offered by a PE seller is also limited to issues arising out of title and authority warranties. In the recent past, PE sellers, however, have shared indemnity liabilities arising out of operational warranties given by management shareholders, especially where the management shareholders are in minority.

There are a number of limitations to indemnity that are normally offered. Generally, these limitations are non-liability for indirect and consequential losses, limitations on survival period, caps on the amounts, *de minimis* thresholds and basket thresholds. These limitations, however, do not apply in case of fraud, wilful misconduct, gross negligence, or breach of fundamental warranties.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

PE sellers provide general covenants/undertakings for the completion of sale of the securities adhering to the applicable law and fixed timelines. It is common to see restrictive covenants being imposed on the promoters and the management team regarding non-compete, non-solicitation and confidentiality. This is with a view to enable better integration post-acquisition.

Buyers usually insist on the management team entering into necessary agreements to set out the terms of their engagement with the company. The scope and extent of indemnities provided by the PE seller are explained in question 6.2.

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

Representation and warranty insurance (**R&WI**) has become prevalent in India in the recent years. These are typically obtained by a PE investor to cover indemnity risks. The coverage limits of such R&WI is 10%–15% of the value of the transaction and the premium typically ranges from 3%–5% of the coverage limit of the R&WI for the transaction.

Considering that the R&WI is to minimise the risks, there are certain upfront exclusions provided for by the insurer. These exclusions include losses arising on account of anti-bribery and corruption, fraud by sellers and other transaction-specific exclusions.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

The scope of warranties provided by the seller are typically limited by the disclosure provided under the disclosure schedule. Additionally, liability for indemnities are subject to certain limitations as discussed in question 6.2.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

PE sellers seldom provide any security for warranties/liabilities. However, for specific indemnity matters, the parties usually agree to an escrow/retention mechanism under which a certain percentage of the total consideration is held in an escrow account for a certain time period and thereafter released, subject to absence of any indemnity claims.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain in the absence of compliance by the buying entity (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Buyers in a PE transaction provide for representations and warranties regarding their ability to fund the investment. In some cases, commitment letters, corporate guarantees or details of financial arrangements as a representation are also given by the buyer. Typically, the share purchase agreement would include a break fee as well as specific performance rights in case the buyer fails to comply with its obligations.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are not very prominent in Indian PE transactions. However, if a reverse break fee is provisioned for, it is generally limited to a certain percentage of the purchase price and the amount may be held in escrow till the expiry of the closing date.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

Exit by way of an IPO is rarely used by the PE investors though it is the preferred exit option for the investors.

The procedure involved in an IPO is governed by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**") and the IPO process is typically run by the company and its promoters in consultation with the PE investors. Once the shares of the portfolio company are listed then the entire pre-issue capital of the portfolio company is locked in for a period of one year. There are very limited exceptions to this rule. Further, one of the most important aspects to ensure in the IPO process is to ensure that the PE investor is not designated or identified as a "promoter". There are several obligations imposed on promoters at the time of listing (including disclosure obligations at the promoter group level) and post listing. Where the PE investors hold majority stake in the portfolio company, this issue becomes more critical. In the past, some of the investors have obtained specific exemption from being classified as a promoter. This is one aspect, which needs to be discussed with the merchant bankers upfront. Also, at the time of IPO, SEBI and the stock exchanges require that the shareholders agreement be terminated.

If the PE investor is also looking to exit by way of a secondary offer for sale, the investor will also need to review and negotiate all the IPO-related documents since it will need to sign off on these documents including provided indemnities. Further, the nominee director of the PE investor will also be required to execute the IPO-related documents including the prospectus.

A failed IPO can have an adverse impact on the valuation of the PEs. Therefore, IPO exits are only attempted where the company is confident of completing it successfully.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

PE investors with substantial stakes or considerable operational control may be named as "promoters" in the offer document. A "promoter" for the purposes of an IPO is subject to several responsibilities and obligations, including a three-year lock-in on 20% of its shareholding. Further, the entire pre-issue share capital is locked in for a period of one year.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Since PE investors tend to negotiate several exit channels, a dual-track exit process is very common. This allows PE investors to prepare themselves for an IPO even as they negotiate terms for a third-party sale. Private sales and IPOs are the preferred modes of exit for PE investors in India.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

Banks are not permitted to extend loans for funding an acquisition of shares in India except in relation to acquisitions in the infrastructure space subject to certain restrictions.. Therefore, PE investors rarely raise debt finance from banks for their investments in India. However, some investors do approach non-banking finance companies for financing acquisitions.

Foreign sources such as external commercial borrowings ("**ECBs**") including, privately placed NCDs (which are comparatively less regulated) are emerging as sources for funding.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

Other than the restrictions in loan extension by banks for financing acquisitions, the recent changes to the External Commercial Borrowing Master Direction of RBI (which regulates the international borrowing and lending transactions) has brought in both liberal and restrictive changes. The security package in relation to such funding will need to be appropriately structured given the restrictions under the Companies Act, 2013, especially in the case of public companies.

8.3 What recent trends have there been in the debt financing market in your jurisdiction?

Debt financing has been gaining maturity in the Indian market. Promoters looking to retain independence are looking to debt financing through mezzanine debt structures. In particular, venture debt and convertible notes have gained significant popularity amongst early growth stage companies.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

There are specific taxation provisions governing Indian companies and PE investors that require primary investments to be priced appropriately. From a target's perspective, if shares are issued to resident investors at a price higher than the fair market value, as determined on the basis of specific formulae prescribed by tax laws, the target will be charged (subject to certain exceptions) to tax on the excess so received as income in its hands. Lately, Indian tax authorities have been examining share premium charged by Indian companies on the allotment of shares to non-residents also, and are attempting to tax Indian companies on excessive share premiums.

A non-resident investor will be taxed in India, subject to relief as available under the relevant tax treaty between India and the country of residence of the investor. Under the Income Tax Act, 1961 ("**IT Act**"), income earned by a domestic fund registered with SEBI as a venture capital fund ("**VCF**") and certain categories of alternate investment fund ("**AIF**"), are not subject to tax as per Section 10 (23FB) and Section 10 (23FBA) of the IT Act. Such VCFs and AIFs have been granted pass-through status under Section 115U of the IT Act with respect to income other than business income. Business income of such AIF is taxable at the fund level, at applicable rates, and is exempt in the hands of the unit holder. However, no tax pass-through status is applicable to Category III AIFs. Further, Section 56(2) of the IT Act, exempts a VCF paying a share premium for subscription of shares of portfolio company from being taxed under the head "income from other sources".

While there are no specific tax exemptions available to FVCIs, as per Section 90(2) of the IT Act, the provisions of the IT Act apply to a non-resident investor investing from a country with which India has a tax treaty, only to the extent the provisions of the IT Act are more beneficial. Thus, an FVCI investing through a tax treaty jurisdiction can avail benefits under the relevant tax treaty. It is pertinent to note that India has amended its double tax avoidance treaties with Mauritius and Singapore taking away such tax benefits on and after April 1, 2017. However, investments through entities in Mauritius or Singapore, made before April 1, 2017, have been grandfathered. The GoI also introduced the Generally Anti-Avoidance Rule ("**GAAR**") with effect from April 1, 2017 with the aim of providing transparency in tax matters and to curb tax evasion. Where a transaction is structured, devoid of any business reason with the principal aim of obtaining a tax benefit, such a transaction is deemed impermissible for the purposes of such tax benefit. Consequently, GAAR does not apply if the jurisdiction of a foreign investor (including a FVCI) is finalised based on commercial considerations and the sole purpose of the arrangement is not to obtain tax benefit.

It is also important to note that a foreign company is to be treated as tax resident in India if its place of effective management ("**PoEM**") is in India. PoEM is "a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made". If the foreign company becomes resident in India, it would be taxed at an effective rate of 41.2%–43.26% on its global income in India. Accordingly, PE investors must exercise caution while structuring their fund management structures, and in some cases their investments, in Indian companies.

Offshore structures are still common, with respect to investments in to Indian portfolio companies.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

It is common to have both incentive shares as well as deferred/vesting arrangements, especially in the context of employee stock options, while structuring PE transactions. ESOP schemes cannot be made available to promoters, hence in such cases alternative incentive structures will need to be implemented.

9.3 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

Capital gains tax is one of the most significant considerations while exploring sale/roll over of investments into newer acquisition structures. Where an asset is held for less than 36 months (12 months in case of listed securities) before transfer, such transfer is eligible to short-term capital gains ("**STCG**") tax, whereas gains arising from the transfer of assets after 36 months are treated as long-term capital gains ("**LTCG**") and taxed accordingly. LTCG on sale of debt instruments will be taxed at the rate of 20% (both listed and unlisted instruments). Further, LTCG on the sale of equity instruments will be taxed at the rate of 10% (both listed and unlisted instruments). STCG on the sale of equity-linked mutual fund and securities is taxed at the rate of 15% (both listed and unlisted instruments).

However, the aforesaid may not apply in case the seller is an offshore entity in a jurisdiction having a double taxation avoidance treaty with India and entitled to benefits thereunder.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

The Government of India enforced the GST regime in 2017, unifying all indirect taxes under a single tax regime. The new regime provides for a single registration and will facilitate the setting-up of new businesses and the growth and expansion of existing businesses.

10 Legal and Regulatory Matters

10.1 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

The RBI in November 2017 issued the Foreign Exchange

Management (Transfer and Issue of Security by a Person Resident Outside India) Regulations, 2017 (FEMA 20) to replace, *inter alia*, the Foreign Exchange Management (Transfer and Issue of Security by a Person Resident Outside India) Regulations, 2000 (Old FEMA 20). The FEMA 20 introduced, for the very first time, the definition of "foreign investment" and categorised it into "foreign direct investment" and "foreign portfolio investment". This categorisation fundamentally changes the foreign exchange regime of India by making it an "investment-specific" regime, as compared to an "investor-specific" regime under the Old FEMA 20. By virtue of these amendments, a new route has also been made available for foreign investment by persons resident outside India in a listed Indian company up to a limit of 10%. The foreign exchange laws have also relaxed the framework for ECBs thus making ECBs an attractive route of investment.

On the regulatory front, the government and regulators have made several transformative policy changes that are helping to reshape the manner in which investments into India are structured. Some of these include:

- Resolution of the Mauritius tax conundrum: The amendment to the India-Mauritius Double Tax Avoidance Agreement ("**DTAA**") to provide a calibrated phase-out of the capital gain tax exemption, while grandfathering tax benefits to investments made until March 2017, provides certainty on an issue that has persisted for over two decades. The India-Singapore DTAA was also re-negotiated on similar lines.
- Introduction of a 10% tax rate on LTCG arising from transfer of equity shares of listed companies which reversed a tax policy that exempted such gains since 2004.

  Introduction of the GAAR and the concept of PoEM for determining the tax residence of foreign companies in India.
- Allowing foreign investment in the SEBI-regulated AIF under the automatic route with a liberal policy that allows AIFs, whose sponsor/fund manager are owned and controlled by resident Indian citizens, to make investments in India without attracting exchange control limitations.
- Gradual amendment in the domestic tax law to implement the actions agreed under the Base Erosion and Profit Shifting ("**BEPS**") project to curb tax evasion. India, as part of the BEPS project, has agreed to amend its tax treaties by signing the multilateral instrument ("**MLI**") along with 78 other jurisdictions.

The PE/venture capital industry in India is clearly in transition. The rules for investment into India have been changed to provide foreign investors a sense of certainty and clarity and at the same time ensure that India collects its fair share of tax on the income earned from investments in India. Going forward, this approach may provide a significant impetus to PE/venture capital activity and capital flow to India, which is sorely needed for growth of the Indian economy at large.

10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g. on national security grounds)?

Certain transactions may require regulatory scrutiny, owing to the sector of operations, size of the investment and such other similar considerations. Details of the same have been set forth in question 4.2. Apart from these there are no other peculiar regulatory scrutiny, especially on grounds of national security.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope etc.)?

The scope and extent of legal due diligence depends on the term of the operations of the company. Previously, due diligence was limited to examining traditional aspects of legal, tax and financial compliances. Particularly, legal due diligence was limited to examining issues of compliance such as review of the corporate records, approvals and licences, contracts of the company and compliance under various laws applicable to the business of the company. The process, however, has now extended to examining forensics, commercial, HR and IT issues. The investee or target company's competitive positioning, promoter integrity, management gaps and potential exit routes are also evaluated. Legal due diligence is most often conducted by external counsels and is completed within three to five weeks, depending on the scope of the diligence.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Anti-corruption laws and compliances thereunder, play an important role in PE transactions. The Prevention of Corruption Act, 1988, criminalises the receipt of illegal gratification by public servants in India. However, the legislation currently does not cover private sector bribery in India. An amendment to the act criminalising private sector bribery is pending approval by the Indian Parliament. Hence, given the gap in the scope of applicability of anti-corruption laws in India *vis-à-vis* private bribery in offshore jurisdictions, offshore PE investors specifically seek compliance with the more stringent/encompassing anti-bribery laws as applicable in their jurisdiction, by way of contractual undertakings.

PE investors seek warranties and covenants from the management team confirming compliance with anti-bribery laws including the Foreign Corrupt Practices Act, 1977 ("**FCPA**") and the UK Bribery Act, 2010 ("**UKBA**"). Breach of such warranties/covenants entitles the PE investor to seek an immediate exit, in addition to indemnity/damages as applicable.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

As a shareholder, a PE investor has negligible liability for any breach by a company. However, the nominee director may be subject to liabilities, especially in case of breach of his duties. There are very limited circumstances where the corporate veil of the company is pierced by Indian courts.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Adversarial dispute resolution through the courts in India pose challenges in terms of the time and costs involved. Therefore, we recommend incorporation of institutional dispute resolution mechanisms such as arbitration in agreements which are proposed to be executed by PE funds with portfolio companies. While a robust legal framework for conduct of arbitrations is evolving, at present, overseas institutional arbitrations such as the Singapore International Arbitration Centre, is preferred for resolving disputes effectively and in a commercially savvy manner.

The threat of initiation of actions under the FCPA and the UKBA are an area of increasing concern for PE funds. The aforesaid laws expose PE funds to liabilities in the event their associates or employees in foreign countries engage in corrupt practices. Such laws make it critical for PE funds to conduct adequate anti-corruption due diligence in connection with their investments and conform to adequate safeguards against corruption throughout. Failure to do so exposes the funds to potential successor liabilities, which can result in huge fines and penalties, often for months or years after a deal is closed.

Tax and regulatory bottlenecks do pose a few challenges to PE investors, especially those offshore. To this extent, the government has taken note of these concerns and is implementing steps from time to time, to mitigate such concerns.

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Vineetha has extensive experience in advising clients on PE investments and venture capital. Vineetha represents and advises various PE investors including *Government of Singapore Investment Corporation, New Silk Route*, *Morgan Stanley Infrastructure Fund*, *Cerestra Advisors, Sequoia Capital*, *ICICI Ventures and IDFC Investments* in relation to their investments in India, in both listed and unlisted companies, as well as on exits from such investments. Vineetha has also represented and advised *Warburg Pincus, IDFC Private Equity* and *SBI Macquarie* in relation to their investments and exits in India.

Vineetha has been awarded "*Most Influential Woman in Private Equity Investments 2018 – India*" by *Acquisition International – The Voice of Corporate Finance*.

Vineetha has been recognised by *Insight Success* magazine as one of "*The Top 10 Powerful Lawyers in 2018*".

Vineetha is ranked Band 2 in Banking & Finance and Band 3 among PE lawyers in India by *Chambers & Partners* 2019, 2018 and 2017 and sources consider her "*one of the most active private equity professionals in the market*", adding that "*she is a very knowledgeable and constructive presence at the table*".

Vineetha "*is frequently engaged by private equity investors and has extensive experience of fund-raising work*" (*Chambers & Partners Asia-Pacific* 2016).

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Ashwini has more than a decade's experience in advising on PE and venture capital transactions and has been instrumental in the establishment of the New Delhi office of the firm. She is an established name in the PE and venture capital industry and has acted for a broad spectrum of clients that include PE investors, mid-to-late stage companies receiving PE investments, existing venture capital investors, as well as promoters and start-ups. Her clients in this area include Delhivery, PolicyBazaar, PaisaBazaar, Zomato, Fundamentum, Times Internet, EightRoad Ventures, Aujas and Zap. She has represented different stakeholders across the entire lifecycle of a transaction – right from an early stage investment, to co-investment, mid-to late stage investments, negotiation of non-participating investor rights, as well as investor exits, giving her a holistic and practical approach at the negotiation table to balance rights of diverse stakeholders.

Ashwini works extensively on PE, venture capital, cross-border M&A and joint ventures, as well as acqui-hires, business restructures and other acquisitions. Her expertise extends to strategic investments/acquisitions as well as those involving financial investor exits and promoter buyouts. Ashwini is also an established practitioner in employment law and draws on this expertise in structuring transactions.

In addition to co-authoring, with Vineetha M.G., this present chapter for *The International Comparative Legal Guide*, Ashwini co-authored a chapter on "Employment laws in India" in *Getting the Deal Through*, among several other publications.

She is recommended by All China Lawyers Association as one of the leading lawyers in Belt and Road region.

Ashwini is admitted to practise law in India. Ashwini Vittalachar is recommended practitioner for Labour & Employment (*The Legal 500* 2019, 2018, 2017 and 2016).

Ashwini Vittalachar has played a key supporting role in many of the firm's recent M&A deals. This has included acting on cross-border M&A deals in the life sciences and automotive sectors. (*Chambers & Partners* 2015).

Ashwini is singled out by clients for her "*communication skills, quick understanding of key business issues, and negotiating ability*". She has acted on several mandates for clients in the automotive and pharmaceutical sectors of late (*Chambers & Partners* 2014).

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