Terms of M&A transactions to protect investor's interests: industry standard

Large M&A transactions are inextricably linked to significant, primarily financial, risks for the investor.

International practice knows a lot of mechanisms to protect the interests of investors and thereby encourage them to invest in the project.

The experts of REVERA international legal group have prepared for you this check-list of M&A transactions conditions and terms, which:

1. are aimed to protect investor's interests

2. meet the market standards of doing business

3. are most frequently encountered in transaction documents

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Right of first refusal (ROFR)

1

What is this?
The investor has the right to be the first to repurchase the company's shares when such shares are sold by the current shareholders

What is it for?
Blocking undesirable persons from entering the company, preserving the existing shareholders' structure

Pre-emption right

2

What is this?
The investor has the right to be the first to buy new shares when the company issues them

What is it for?
Maintaining or increasing the amount of the investor's share in the company in the new rounds of investment

Reserved matters

3

What is this?
The investor has the right to block decisions on a list of the most important issues for the company, such as:

- issue and sale of company shares
- large transactions
- IP alienation and other issues

What is it for?
Control over making key business decisions

Representations & warranties

4

What is this?
The investor has the right to obtain representations from the founders that there are no adverse circumstances regarding the company, including:

- the company is legally established and operating
- no tax debts exist
- no judicial disputes exist or any other representations

What is it for?
Reimbursement of the investor's losses by the founders if the representations prove to be untrustworthy

Drag along right

5

What is this?
The investor has the right to compel other shareholders to join in the sale of their shares in the company if the investor sells their own shares

*the drag along right is usually granted to shareholders who jointly own 80% or more of the company's shares

What is it for?
Protecting the investor from being blocked from selling the business on the part of minority shareholders

Tag along right

6

What is this?
The investor has the right to join the transaction for the sale of shares in the company in case of sale of shares by the other shareholders

What is it for?
Participation in the profit from the sale of the business. Guarantee of exit from the business in case of change of partners

Anti-dilution right

What is this?

The investor has the right to increase the number of his shares without additional payment, in case the company attracts new investments at a lower valuation than the investor entered (*down round*)

*The increase is due to the conversion of the investor's preference shares into a larger number of common shares

What is it for?

Protection against dilution of investor's share during down round

Are there any options?

Two main conversion standards are:

- full ratchet

  conversion price per share = price per share at down round

- weighted average

  conversion price per share = weighted average between the price per share at investor entry and the price per share at down round

Liquidation preferences

What is this?
The investor is entitled to priority (over the founders) payments in the event of the sale or liquidation of the company

What is it for?
Guarantee of return on investment

Are there any options?
Two main payment standards are:

- 1x participating

  Return on investment AND pro rata participation in the distribution of the remaining profits/property

- 1x - 1.5x non-participating

  Return of investment OR participation in the distribution of the remaining profits/property (choice on a "which is bigger" basis)

Different payout multipliers can be provided for both options: 1, 1.5, 2 and others

Options

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What is this?
The investor has the right to buy (call option) or sell (put option) their share in the company at a predetermined price in certain circumstances

What is it for?
There may be different purposes for the use of options:

- a way of gradually increasing the share in the company
- sanction for violation of shareholder obligations
- a way to resolve deadlocks, when shareholders with equal numbers of votes cannot agree on a solution

Vesting

10

What is this?
The investor has the right to grant a stake in the business to the founders in stages over a set period of time

*as a rule, in equal installments of the originally agreed number of shares over a four-year period

What is it for?
Retaining the team, an incentive for founders to stay in the business as long as possible and develop it

Non-compete & Non-solicitation

11

What is this?
The investor has the right to prohibit the founders from engaging in competing activities with the business and/or poaching key employees to other companies for a certain period of time

*as a rule, the prohibition is established for the period of participation in a joint business, as well as for a period of 1 to 3 years after the termination of cooperation

What is it for?
Protection against competition and maintaining a solid team of professionals

Lock-up

12

What is this?
The investor has the right to impose a ban on founders leaving the company for a certain period of time (usually 2-3 years)

What is it for?
Ensuring that founders are involved in the business and that they are involved in the development of the project

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