

C L I F F O R D
C H A N C E

FUNDAMENTALS OF PRIVATE CAPITAL AND M&A TRANSACTIONS
SINGAPORE | WEDNESDAY, 4 SEPTEMBER 2024

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SHAREHOLDERS' AGREEMENTS

WESLEY TAN & DENZYL ANG

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TYPICAL CONSIDERATIONS



Governance/ Minority Protection

- Rights to appoint directors/commissioners/observers
- Typical veto rights over reserved matters
- Class of shares
- Information/audit rights
- Deadlock



Financials/Funding

- Debt vs equity funding
- Anti-dilution
- Dividend policy



Termination/Exit

- Transfer of shares/interest
- Termination events
- Options upon termination/exit



GOVERNANCE/MINORITY PROTECTIONS

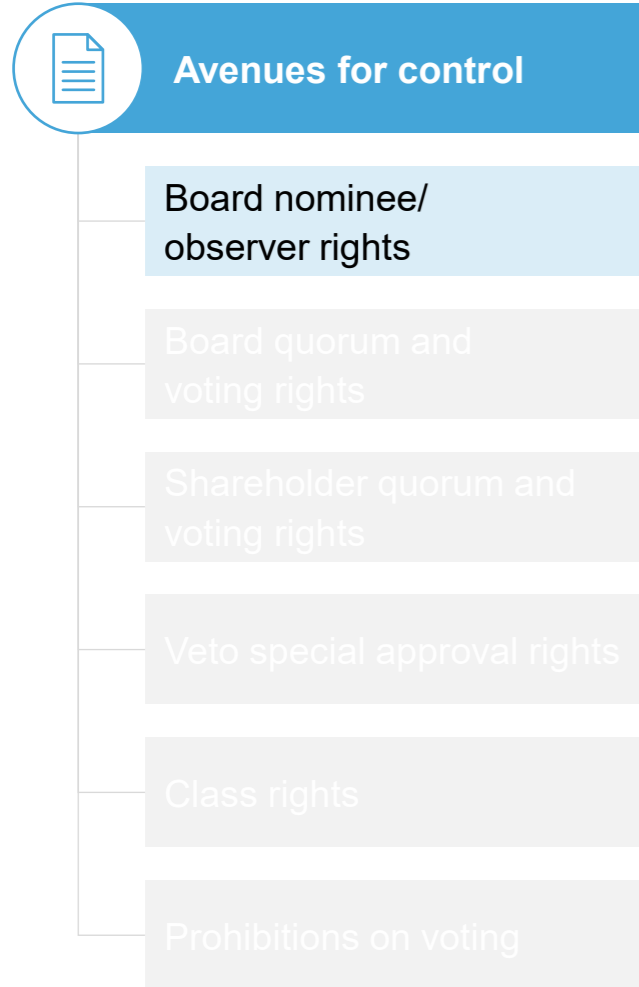


MINORITY PROTECTIONS

CONTROL RIGHTS



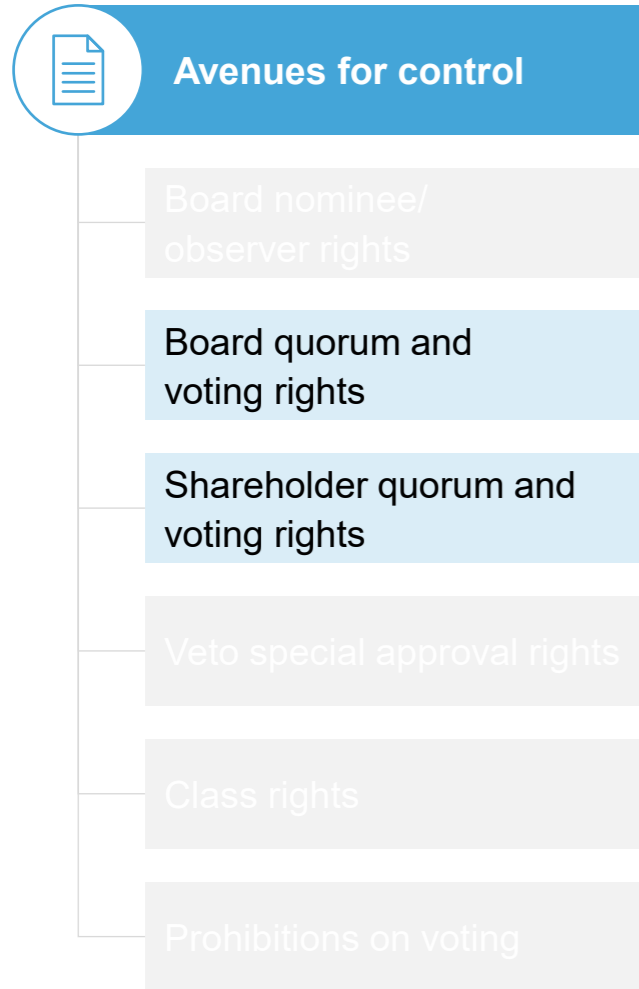
MINORITY PROTECTIONS



- Appointment of directors (pegged to shareholding?)
- Appointment of chairman (with casting vote?)
- Observer rights
- Rights may apply at both the board level, at sub-committees and boards of subsidiaries
- Key management positions

MINORITY PROTECTIONS

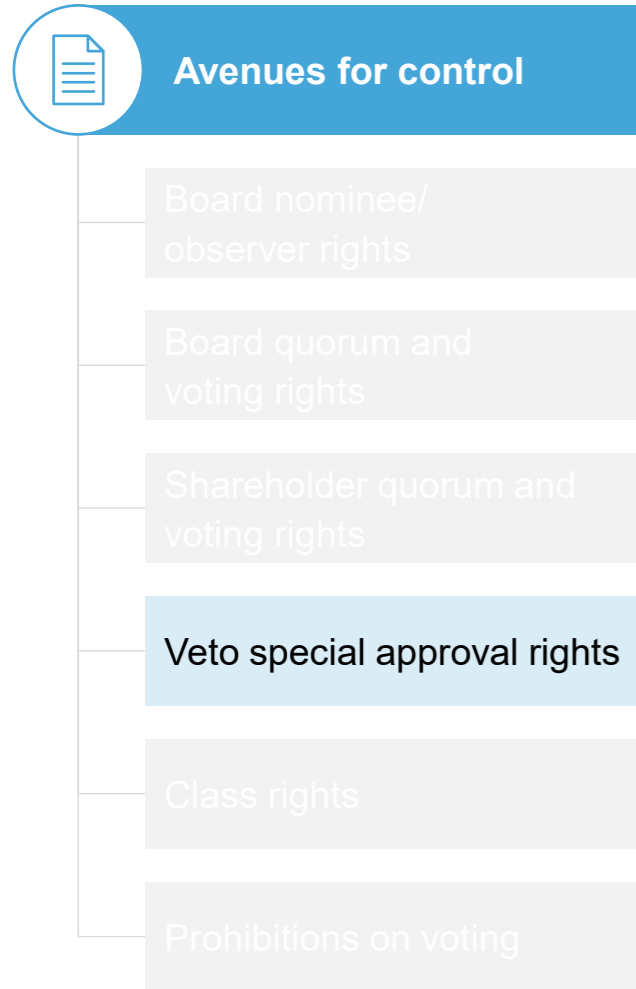
CONTROL RIGHTS – BOARD (CONTINUED)



- **Board meetings**
 - Reasonable notice of board meetings
 - Receipt of board papers
 - Right to be included in the quorum
 - Approval required for certain reserved matters
- **Shareholder meetings**
 - Considerations similar to those for board meetings

MINORITY PROTECTIONS

CONTROL RIGHTS – VETO RIGHTS



- Reserved matters
 - Key matters of the business over which shareholders have veto rights
 - Protections for minority investor and operational controls for majority investor.
- Shareholder level or board level
- Varying voting thresholds
 - Simple majority
 - Super majority (for shareholders)
 - Simple/super majority provided it includes specific directors/shareholders
 - Unanimity

GOVERNANCE/MINORITY PROTECTIONS

RESERVED MATTERS

The requirement for consent for undertaking certain acts is often subject to exceptions such as: (i) matters approved in the Budget or Business Plan; and (ii) matters where the impact will not be materially prejudicial to any specific shareholder or where all shareholders are treated equally. In addition, specific reserved matters are often subject to “ordinary course” or “arms’ length” carve outs or materiality thresholds.

Fundamental reserved matters		
Amendments to the articles or other constitutional documents.	Amending the terms attached to a share class.	Issuance of additional securities [on non-pro-rata basis] (note dilution protection may be achieved using other methods outside the reserved matter regime) subject to an exception for emergency funding
Reduction or redemption of share capital.	Winding-up/liquidation of a material Group Company.	Material change to the nature of the Group’s business or cessation of a material part of the Group’s business.
Related Party Transactions (between a shareholder and a member of the Group) not on arms’ length terms.	Merger or consolidation or transfer of shares in any Group Company.	Changing the: (i) regulatory status; (ii) tax residence of the Group; or (ii) tax domiciliation of Topco.

GOVERNANCE/MINORITY PROTECTIONS

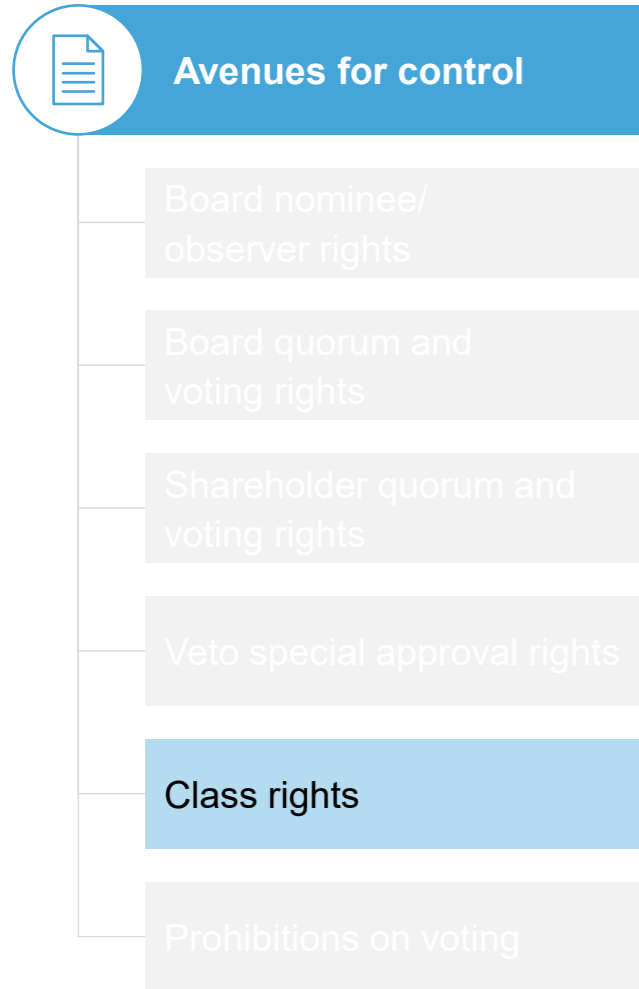
RESERVED MATTERS (CONTINUED)

The requirement for consent for undertaking certain acts is often subject to exceptions such as: (i) matters approved in the Budget or Business Plan; and (ii) matters where the impact will not be materially prejudicial to any specific shareholder or where all shareholders are treated equally. In addition, specific reserved matters are often subject to “ordinary course” or “arms’ length” carve outs or materiality thresholds.

Negotiated Reserved matters		
Approval of the Business Plan and Annual Budget and material amendments to such documents*	Appointment and termination of Senior Management (CEO, CFO, COO, others)*	Approval of or amendments to the distribution policy.
Material acquisitions or disposals.	Entry, termination, amendment, the granting of consents or waivers under any material agreements, and key project contracts (e.g., O&M)	Incurring CAPEX, OPEX in excess of budgeted CAPEX, OPEX.
Incurring financial indebtedness above a threshold.	Granting of security by a Group Company.	Commencement or settlement of material litigation.
Formation of new board committees; delegation of decision making power to board committees.	Entry into non-arms’ length/outside of the ordinary course transactions	The adoption or variation of employee incentive schemes.
Commencement of an exit process or refinancing	Entry into partnerships or JVs.	Approval of material Group Policies (e.g., Anti-bribery, AML or HSE).
Amending the name of a Group Company	Change of auditor	Changes to the accounting reference date or accounting policies of the Group

MINORITY PROTECTIONS

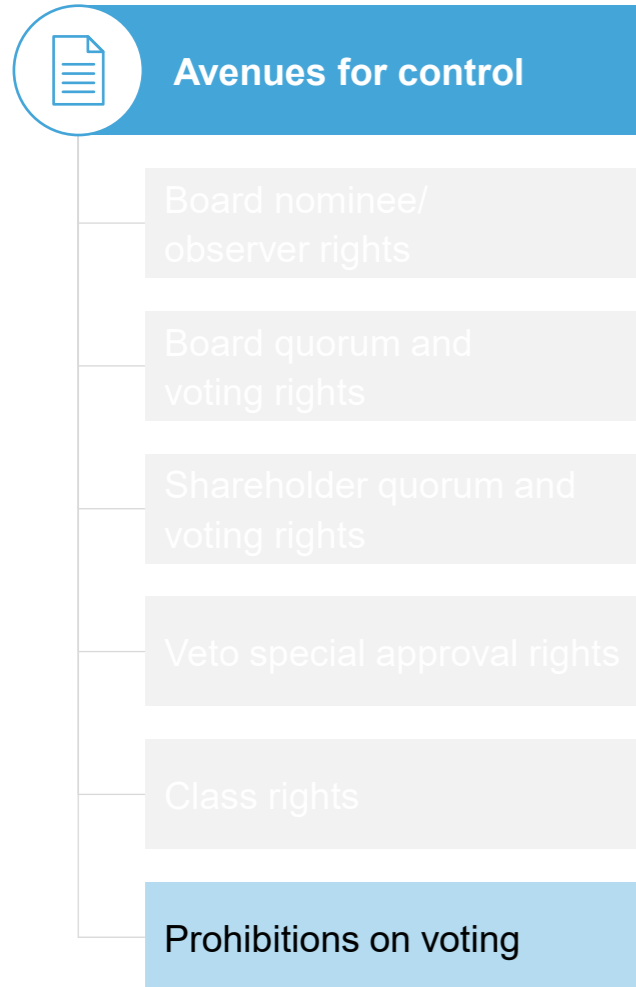
CONTROL RIGHTS – CLASS RIGHTS



- Voting/non-voting shares
- Special voting rights
- Special rights to income and distribution (on winding up or otherwise)
- Liquidation preference and waterfall

MINORITY PROTECTIONS

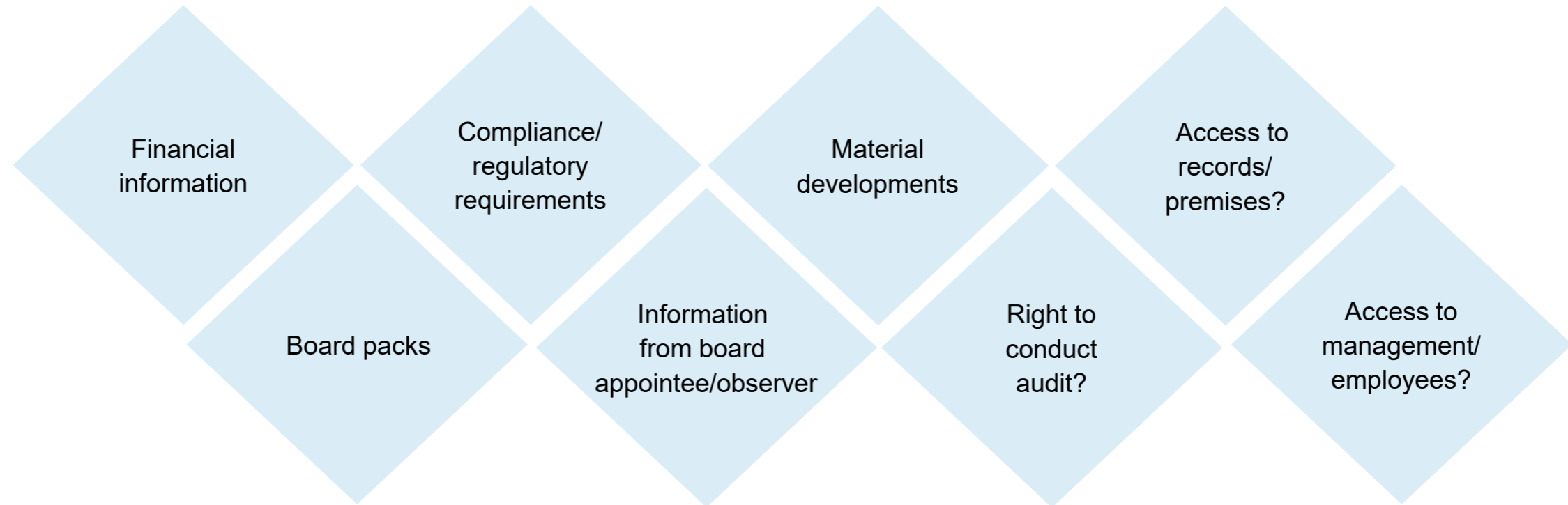
CONTROL RIGHTS – BOARD



- Conflict situations
- Exercising rights against a majority shareholder
- Remedies for conflicts
 - Suspension of voting rights
 - Removal from meetings (or part)
 - Internal information barriers
 - Quorum requirement suspension

GOVERNANCE/MINORITY PROTECTIONS

INFORMATION/ACCESS RIGHTS



GOVERNANCE/MINORITY PROTECTIONS

OTHER RIGHTS



Placing secondees at the target's operations



Upfront agreement on key matters

- Definition of scope of business
- First business plan/budget or ongoing approval and oversight of business plans/budgets (consider “fall back”)
- Dividend policy



Non-compete/non-solicit

- No carrying on of competing business
- Non-solicitation of customers/suppliers
- Non-solicitation of employees

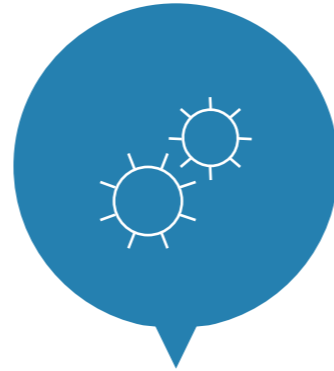
GOVERNANCE/MINORITY PROTECTIONS

DEADLOCK



No fault – stalemate or disagreement, e.g.:

- Repeated failure to agree on a shareholder/board reserved matter
- Inability to hold board/shareholder meetings due to lack of quorum



Resolution mechanisms

- Escalation to senior management/CEO
- Buy/sell process – “Russian roulette” or “Texas shoot out”
- Winding up
- Independent expert/arbitrator
- Status quo



Mitigants

- Consider if inclusion of ‘materiality’ thresholds is appropriate
- Include language to fallback on e.g. last year’s business plan (if cannot agree on business plan) and operate in ordinary course

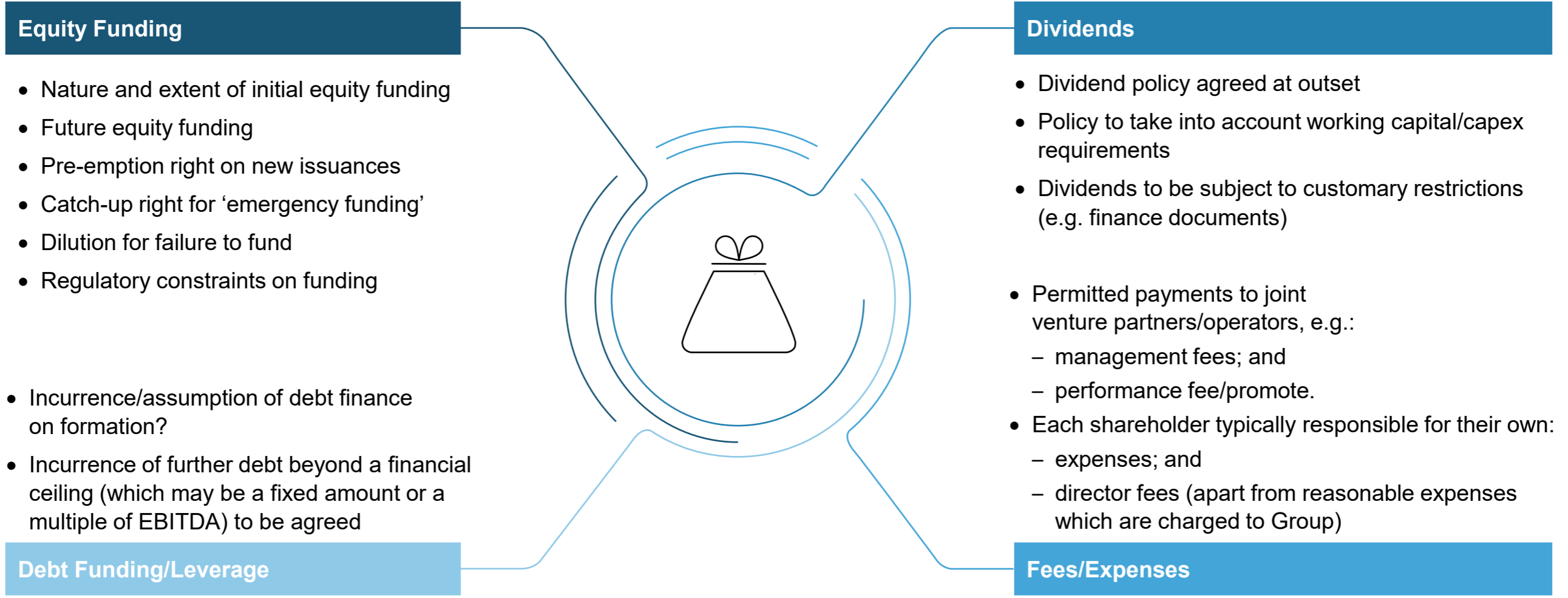


FINANCING/FUNDING



FINANCING/FUNDING

FUNDING AND CASH EXTRACTION



Equity Funding

- Nature and extent of initial equity funding
- Future equity funding
- Pre-emption right on new issuances
- Catch-up right for 'emergency funding'
- Dilution for failure to fund
- Regulatory constraints on funding

- Incurrence/assumption of debt finance on formation?
- Incurrence of further debt beyond a financial ceiling (which may be a fixed amount or a multiple of EBITDA) to be agreed

Debt Funding/Leverage

Dividends

- Dividend policy agreed at outset
- Policy to take into account working capital/capex requirements
- Dividends to be subject to customary restrictions (e.g. finance documents)

- Permitted payments to joint venture partners/operators, e.g.:
 - management fees; and
 - performance fee/promote.
- Each shareholder typically responsible for their own:
 - expenses; and
 - director fees (apart from reasonable expenses which are charged to Group)

Fees/Expenses

FINANCING/FUNDING



Priority of fund raising

Typical:



Internal cash reserves

Third party financing

Shareholders equity



Third party injections

- Subject to agreement of partners
- Restrictions (issuances to competitors?)
- New shareholder to become a party to existing shareholders' agreement – does this work in practice?
- Anti-dilution triggered in the event of a down-round



Anti-dilution

- Rights on issuance of equity and equity-linked instruments
- Consent right or 'put up' (inject capital) or 'shut up' (and get diluted)
- Practical considerations – balance of power may rest with partner who has deepest pockets



LIQUIDITY AND EXIT



EXIT

RESTRICTIONS ON TRANSFER



Which transfers are restricted?

- Transfer of an interest (direct/indirect) in shares
- Encumbrances (i.e., pledges, charges, options) over shares
- Change of control of shareholders
- “Blacklist”
- Partial sales



Which transfers are permitted?

- With consent of other shareholders
- Internal restructuring – to “Affiliates”



Restrictions

- Lock-ups
 - On a JV partner or on founders of a portfolio company
 - What is a reasonable lock-up period?
 - Mutual lock-up?
- ROFO/ROFR
- Tag/drag

LIQUIDITY, DEADLOCK AND DEFAULT

RESTRICTIONS ON TRANSFER



Which transfers are restricted?

- Transfer of an interest (direct/indirect) in shares/other securities
- Encumbrances (i.e., pledges, charges, options) over shares
- Change of control of shareholders
- “Blacklist”
- Minimum shareholder requirement



Restrictions

- Lock-ups
 - Fixed period?
 - Specific trigger linked to underlying asset?
- Pre-emption
 - Right of First Offer (ROFO)
 - Right of First Refusal (ROFR)
 - Right of Last Look (ROLL)?
- Stapling



Which transfers are permitted?

- With consent of other shareholders
- To “Affiliates”
 - Who is an Affiliate?



Consequences of breach

- Remediation/cure period
- Transfer back requirement
- Suspension of rights attaching to shares – voting and/or economic?
- Compulsory transfer to other shareholders – FMV or discount?

LIQUIDITY, DEADLOCK AND DEFAULT

PRE-EMPTION RIGHTS



Right of First Offer (ROFO)

What is a ROFO?

- **Offer:** made by non-selling shareholders
- **Process:**
 - selling shareholder informs the other shareholders that it wishes to sell
 - other shareholders may make an offer to acquire the selling shareholder's shares specifying price and key terms
 - selling shareholder may accept offer or sell to a third party at the same/higher price and on no more favourable terms within a defined period
- **Pricing:** non-selling shareholder sets price

Key Characteristics

- Encourages non-selling shareholders to make a credible offer
- Customary where there is a clear majority shareholder (as it offers most flexibility to both sides)
- Conducive to liquidity



Right of First Refusal (ROFR)

What is a ROFR?

- **Offer:** made by selling shareholder
- **Process:**
 - selling shareholder offers its shares to non-selling shareholders specifying price and terms
 - if offer not accepted, selling shareholder can sell to a third party at the same/higher price and on no more favourable terms within defined period
- **Pricing:** selling shareholder sets price

Key Characteristics

- Selling shareholder must determine an achievable sale price upfront:
 - if too high: selling shareholder loses exit opportunity
 - If too low: risks leaving value on the table when exiting to other shareholders



Right of Last Look (ROLL)

What is a ROLL?

- **Offer:** made by third party to selling shareholder
- **Process:** selling shareholder receives a binding offer from a third party. Other shareholders have right to buy at the same price and on the same terms
- **Pricing:** third party sets price

Key Characteristics

- Prevents an effective third-party sale process as bidders reluctant to participate – potential fear of being 'trumped' and broken deal costs
- Discounted sale to other shareholder(s) is most likely outcome
- Worst outcome for selling shareholder – not acceptable for any significant stake

EXIT

ROFO – EXAMPLE CHRONOLOGY

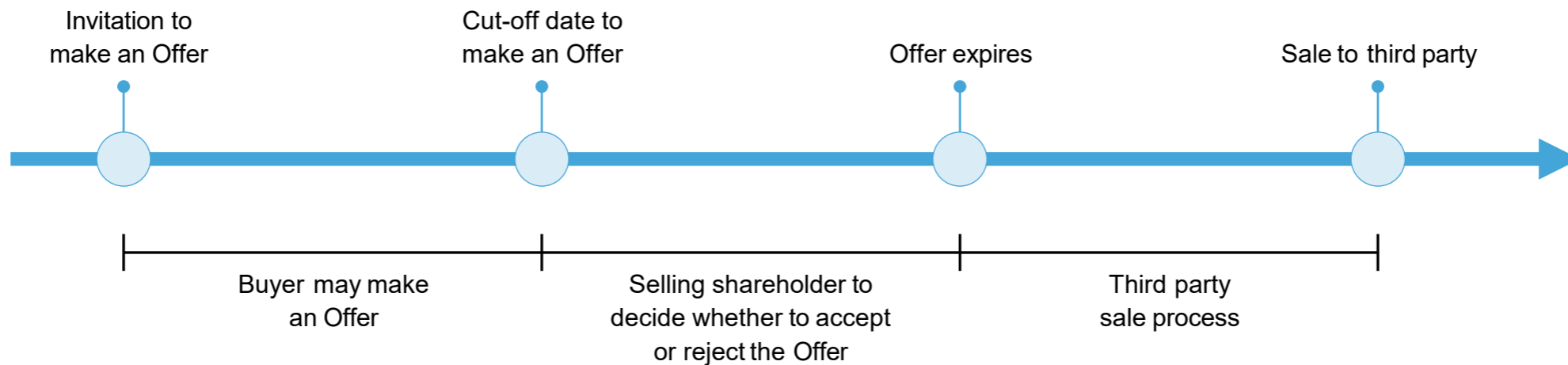
Notice from selling shareholder to non-selling shareholders that have ROFO rights (each a “**Buyer**”):

- stating the number and type of securities to be transferred
- inviting each Buyer to make an offer to buy the securities.

Prior to a set date, the Buyers may make an offer to acquire (some or all of) the securities and specifying price and material terms of the offer (an “**Offer**”). If a Buyer does not make an offer it is deemed to have waived their right to make an Offer

If a Buyer offers to buy all the securities, and not only their equity proportion (although some ROFOs only allow a Buyer to offer to buy all the securities), they typically have to buy the additional securities if other Buyers don’t make an Offer

An Offer remains open for a certain period, within which the selling shareholder must decide whether to accept the Offer or to reject it and sell to a third party at the same or higher price and on terms no more favourable to the third party



EXIT

ROFR – EXAMPLE CHRONOLOGY

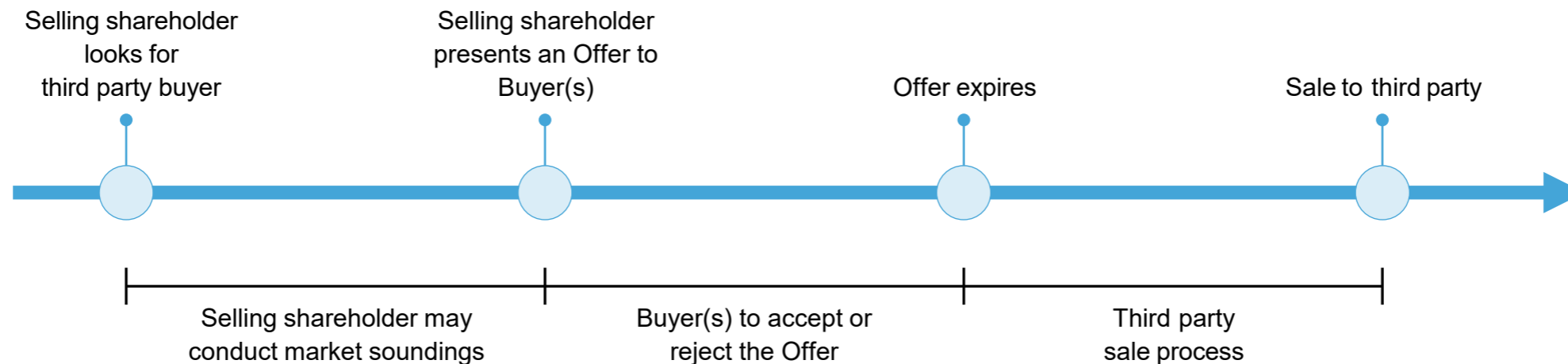
Notice from selling shareholder to other shareholders that have ROFR rights (each a “**Buyer**”), presenting an offer (the “**Offer**”) with:

- the number and type of securities to be transferred
- the price and material terms of the transfer

Prior to a set date, notice from each Buyer is given, accepting or declining the Offer. If such notice is not provided, the Buyer is deemed to have declined the Offer. Sometimes called ‘kill or fill’

If a Buyer agrees to buy all the securities, and not only their equity proportion (although some ROFRs only allow a Buyer to agree to buy all the securities), they may have to buy the additional securities if other Buyers decline the Offer

If the Buyer declines the Offer or is deemed to have declined the offer, the selling shareholder can sell to a third party at the same or higher price and on terms no more favourable to the third party



LIQUIDITY, DEADLOCK AND DEFAULT

TAG, DRAG AND EXIT

Tag right	Drag right	Exit Provisions
<ul style="list-style-type: none">• Ability for minority investor to sell shares on the same price and terms as selling shareholder• Minority protection – inappropriate in 50:50 joint ventures• Can be pro-rata or full tag on sale of 50+%• Tagging seller receives same price/terms as selling shareholder• Warranties given should be limited to title and capacity• Should tag election increase the amount of shares the third party buys or decrease the number of shares sold by the selling shareholder?• Inter-relationship between tag and pre-emption right – should tag apply if pre-emption has been followed?	<ul style="list-style-type: none">• Ability to force minority investor to sell all/equivalent proportion of shares on the same price and terms as the selling shareholder• Majority protection – rare in 50:50 joint ventures• Triggered by sale of 50+% – typically full but can be proportionate• Minimum price/IRR/MoM hurdle?• Drag terms/price same as majority investor• Drag enforcement	<ul style="list-style-type: none">• Who initiates?• Exit planning and communication• Exit committees• Form of exit (e.g. auction, IPO, dual track and recap)• Application of pre-emption rights?• Shareholder cooperation obligations, soft/hard

EXIT

TERMINATION

Termination events	Options upon termination	Default put option/call option
<ul style="list-style-type: none">• Non-fault situations<ul style="list-style-type: none">– Termination for convenience– On expiry of “fixed term” joint venture or planned exit– Deadlock• Fault situations<ul style="list-style-type: none">– Material breach of SHA– Insolvency– Change of control	<ul style="list-style-type: none">• One partner buys the other partner out (default put/call option) <p>Price:</p> <ul style="list-style-type: none">• call option for non-defaulter to acquire at discount (except for insolvency which is typically FMV)• put option for the non-defaulter to sell at premium• Third party buys out one party• Sale of joint venture to third party• Winding up of the joint venture (liquidation)	<ul style="list-style-type: none">• Often seen in fault-based termination events• Non-defaulter elects to buy or sell• Price<ul style="list-style-type: none">– Fair market value (FMV) at time of sale or pre-determined price?– Often at a premium/discount to FMV to recognise the impact of the default• Practical risks, particularly for put options

PLEASE GET IN TOUCH AND CONTINUE THE CONVERSATION

Feedback Survey



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