GRAVITAS LEGAL

A Guide to Share Purchase Agreements

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Share Purchase Agreement is an agreement entered into between the buyer and seller(s) of shares of a target company. Usually Share Purchase Agreements entail that the buyer would be taking over whole or significantly whole of the undertaking of the company. In such a scenario, the buyer would not only be taking over the assets but also the liabilities of a company. Hence any potential buyer needs to take proper stock of the company before entering into such a transaction.

Pursuant to this, a potential buyer would undertake due diligence of a company before investing in the same making it the first step of the process. The due diligence would vary depending on the nature, size and activities of the target company. Typically, the due diligence would involve looking into the business transactions, permits, licenses, authorizations, agreements, liabilities, assets, borrowings, etc. of the company. This would provide a proper idea of the functioning of the company as well as potential liabilities which may arise for the buyer in the future. This will also help determine the purchase price of the shares of the company. Further, the findings of the due diligence would be addressed under the Share Purchase Agreement. Any action that needs to be taken by the company or the sellers in the near future would be listed. Similarly, any potential liabilities that are foreseen would be listed out and the sellers would provide an indemnity against the same.

Prior to drafting a Share Purchase Agreement, the parties should negotiate and draw up a term sheet which would address the key terms of the Share Purchase Agreement. This would help ease the drafting and negotiations of the Share Purchase Agreement as all the material terms would already be agreed to between the parties.

While this article aims to provide a clarity on the main clauses of a Share Purchase Agreement, the same is in no way exhaustive.

Sale and Purchase of Shares

A key clause of the agreement, this clause lays down the number of shares that are being sold to the buyer and the price of these shares. It further details the manner in which payment would be made as well as the timeline for the payment. This is important because generally there are obligations which the parties need to fulfil before the shares can be transferred, hence the payment and transfer of shares usually does not take place on the same date as when the Share Purchase Agreement is entered into. These obligations can be in the form of approvals, intimations, etc. that need to be sought by the buyer and seller from third parties.

Earn-Out and Holdback

Now, the purchase price can either be a fixed sum or it can be subject to adjustments, as per the terms agreed to between parties. A purchase price is fixed keeping in mind the financials of the past years and the performance of the company. However, during this incubation period till transfer of shares, the buyer would want the company to perform just as well, if not better, as its previous years. To ensure that this is achieved, the purchase price is fixed along with a scope of adjustment. These adjustments can be either in the form of ensuring similar performance as previous years or a reward for achieving some financial milestone by the company. These adjustments safeguard the buyer from any fluctuation in the value of the shares of the company. For example, the buyer proposing to pay an additional sum over the purchase price if the company earns a certain amount of profit in the next quarter before the transfer of shares is to take place.

The buyer may also consider withholding a portion of the purchase price until all post-completion conditions have been satisfied by the seller. Holdback helps ensure that the buyer is safeguarded against contingent acts. If any of the action promised by the seller does not materialise, a portion of the purchase price would be reduced. Another way to safeguard performance of sellers would be through indemnification, if holdback is not agreed to. For example, an outstanding payment due to be received by the company from its debtor. The money due is contingent upon payment, however, it is still money which would be received by the company in the ownership of the buyer in the future. The buyer in such instance would add a clause stating that if this money is not received by a particular date, the purchase price would be paid after deducting the amount due to be received.

Escrow

An escrow agent is appointed to hold the transfer shares and the purchase price as security and be responsible for ensuring that the actions and obligation of the parties are carried out. This is especially important when the transaction involves fluctuating purchase price due to adjustments, earn-outs and holdbacks. The parties enter into a separate agreement with an escrow agent giving it the power to carry out actions in the interest of both the parties and in the manner specified under the Share Purchase Agreement.

Representations and Warranties

Representations and warranties are assertion of facts made on a specific date to persuade the other party to enter into an agreement. Representations and warranties are a crucial part of any agreement, more so in the case of a Share Purchase Agreement where the parties are entering into the agreement to carry out an action in the future. In a Share Purchase Agreement, the company along with the seller gives representations and warranties about the business of the company and its dealings. Other representations and warranties would cover any disputes, litigations, tax status, and any other specific representation or warranty depending upon the business of the company and the need of the buyer.

The buyer on the other hand would provide representations about its ability to purchase the shares of the company and carry out other actions contemplated under the agreement. These representations and warranties are given till the date of closing and in some cases exceed the closing date too. It is important to cap the validity date of representations and warranties. They help protect a party against the other in case the assertions made by them turn out to be false because of which the transfer is not carried out. Representations and warranties are safeguarded by the indemnity and the termination clause in an agreement.

Pre-Closing Covenants

During the time period ranging from the execution of the Share Purchase Agreement to the actual transfer of the shares, the sellers would still be carrying out the business of the company. However, the value of the shares would have been decided beforehand based on the books of the company, yet, the company in the normal course of business would be using its assets and incurring liabilities. To ensure that the position of the company in the interim period does not differ, pre-closing covenants are built into the Share Purchase Agreement.

Pre-closing covenants sets out the actions that would be permitted to be carried out by the company in the ordinary course of business. Under this, the buyer shall fix the actions that can be carried out freely by the company without requiring its approval. Further, the buyer can cap the monetary value for transactions. This way major decisions and actions which would create a future liability and obligation on the company would require the buyer’s approval and in turn the buyer would be informed about actions that would affect the value of the company.

Any action taken in contravention of this clause would attract the indemnity and termination clause of the agreement.

Conditions Precedent and Closing Conditions

Conditions precedent are all actions that are required to be carried out by both the parties before the actual transaction of sale of shares occurs. For the seller, these conditions culminate out of the due diligence carried out by the buyer. The buyer generally does not have any conditions precedent which need to be performed by it, however, it depends on a case to case basis and on the mutual agreement of the parties.

Conditions precedent clause is however very important from the buyers perspective. These are those conditions which are necessary to be carried out before the transfer of shares actually takes place. For example, a lender of the company may have placed a restriction on the sale of shares, which would have to be resolved with the lender before such a transaction goes forward. Further, depending upon the business of the company, approvals, authorizations, permissions, etc. may also be required from third parties. This is just a general summation and would actually depend on a case to case basis and the due diligence carried out.

The party would inform the other party upon completion of these conditions, post which, the parties would go forward with the sale. If these actions are not carried out within the specified time period or to the other party’s satisfaction, the other party may seek termination of the Share Purchase Agreement due to lapse of time.

Indemnification

An indemnification clause specifies the liability for losses incurred by a party due to breach of any representation and warranty, covenant or obligation under the agreement. It may provide for an exclusive or non-exclusive remedy for claims. It further specifies the manner in which claims can be brought forth by either party, the time period, exclusions and limitations on claims.

Usually agreements provide for general indemnity clauses, however, based on the due diligence findings, specific indemnities can also be sought from the sellers.

Post Completion Actions

Even after the sale of shares is completed, there may still be actions which would be required to be carried out based on the agreement between parties. These vary from disposing off any pending litigation against the company to transferring documents in favour of the buyer. All of these actions can only be achieved once the transfer of shares is completed successfully. The parties need to clearly identify such actions and carry them out post transfer. These actions are safeguarded by the indemnity clause.

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