A PRIMER ON SHARE PURCHASE AGREEMENT*

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A Share Purchase Agreement ("**SPA**") is the fundamental document of a transaction which pertains to transfer of undertaking through acquisition of shares. The essential clauses along with their rationale are explained below:

PARTIES

In order to identify the appropriate parties to the transaction and to establish their respective capacity to contract, the clause describing parties to the share purchase agreement is important.

In plain vanilla share purchase transactions, there may only be two parties to the share purchase agreement, that is the seller and buyer. This will generally be the case where the target company is to pass from being a wholly-owned subsidiary of one company (the seller) to being a wholly owned subsidiary of another party (the buyer). In such cases, it is advisable for the buyer to inspect the register of members of the target company and its subsidiaries and check their latest annual returns as part of its due diligence exercise to confirm that the seller is the legal owner of the entire issued share capital of the target company, and that the target company owns the shares in the subsidiaries. The buyer should also establish whether the registered holder is also the beneficial owner of the shares in the target company, or whether it holds the shares in some other capacity for example, as nominee or trustee. Where the seller is a trustee, it will be necessary to establish whether it has the requisite power under the relevant trust instrument to enter into the share purchase agreement, and to perform its obligations under the agreement.

In certain circumstances, the buyer or the seller may require the obligations of the other party to be guaranteed by a third party, such as a bank or a parent company. For example, sometimes it may be advisable for a buyer to seek a guarantee in respect of the seller's liability under the warranties and/or any indemnities in the share purchase agreement where the seller is a subsidiary of a more substantial parent company. It is common practice in these circumstances for the parent company to be joined as a warrantor, or to guarantee the obligations of the selling subsidiary. If it is agreed that a party's obligations will be guaranteed, the guarantee may be incorporated in the share purchase agreement and the guarantor may be added as an additional party to the agreement.

Since the buyer's key obligation to pay the purchase price will more often than not be discharged on a simultaneous signing and completion of the share purchase agreement, the seller's ability to obtain redress from the buyer is less of a concern in such cases. However, in case there is a time-lag between signing and completion or if the consideration is to be rendered in the form of deferred payment or there are significant post completion obligations on part of the buyer then the seller may want to secure its ability to obtain redress from the buyer in the form of a third party guarantee. It is important for a party relying on the guarantee to satisfy itself that the guarantee will be enforceable.

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The situation can be more complex if the transaction involves multiple sellers, that is, there is more than one exiting shareholder in the target company. Each of the sellers will need to enter into the agreement to sell the shares that it holds in the target company. Parties may also decide to appoint one of the sellers as an agent of the other sellers in order to streamline communication between the buyer and sellers.

Generally, the target company or its subsidiaries are included, if at all, only as a conforming party in the share purchase agreement to fulfil procedural compliance obligations. However, if assets need to be transferred into the target company by any member of the seller's group, or extracted from the target group prior to completion of the share purchase, it may be necessary to include the target company as a party in order to transfer title or take title to the asset being transferred. The alternative is for the transfer to be treated as a completion matter and a separate transfer agreement entered into by the target company on completion.

Lastly, if the share purchase agreement places obligations or confers rights on other parties apart from the buyer, seller and guarantor, they may be added as parties to the share purchase agreement based on specific circumstances of the case.

RECITALS

The recitals set the context for an agreement and are pertinent to its interpretation. Recital clauses are often also referred to as the preamble to an agreement and are traditionally preceded by the word 'WHEREAS'.

Recitals assist in understanding the nature, purpose and basis of the share purchase agreement at hand. Examples of important facts that form part of the clause are:

- the relationship and goals of the parties
- the nature of the transaction; and
- other documents associated with the transaction.

In a share purchase agreement, the recitals merely 'set the stage' or 'describe the background' of the transaction. They are generally not considered an operative or integral part of the share purchase agreement and are not binding on the parties. However, the parties may agree and stipulate expressly that the recitals are an integral part of the share purchase agreement and make them binding on parties thereby.

Generally, the recital clause states what happened in another agreement or at an earlier time and it also depicts what the parties are trying to achieve *via* the agreement at hand.

It must be ensured by the parties that the information provided in the recitals is not deceptive as they may be crucial in interpreting the intended meaning of the share purchase agreement. Furthermore, the recitals can neither be violative or contradictory to the other provisions of the share purchase agreement nor can they create such obligations as have not been intended by the parties.

DEFINITIONS AND INTERPRETATION

DEFINITIONS

The purpose of the definitions clause is to set out terms or concepts that are repeated more than once in the share purchase agreement and to ensure that each such term/concept will be given the same meaning (as set out in the definition clause) each time it is used in the agreement.

Usually, defined terms are set out alphabetically in a separate section located at the beginning of the share purchase agreement or in a separate annexure to the share purchase agreement. At times, terms may also be defined in the place where they first occur in the share purchase agreement. The most common way to differentiate a defined term from a common word is by using capital letters and treating it as a proper noun. Definitions may be either inclusive or exclusive.

Various legislations and other statutes contain a number of definitions that may be useful to incorporate by reference, in the share purchase agreement. However, it is generally unwise to include a provision incorporating all definitions used in a particular legislation, since some of these may have a wider meaning than what the parties intended. A risk in using terms as defined by statute (and not by the parties) is that the courts may interpret the statutory definition in a manner which may not be the same as what the parties intended.

INTERPRETATION

The interpretation clause is used in order to reduce repetition within the body of an agreement and to make it easier to read. It also gives specific context to particular words used in the agreement.

The interpretation section of a share purchase agreement, much of which is standard, can nevertheless contain helpful and significant pointers for reading of the agreement. By way of illustration:

- where there are multiple sellers or warrantors, the interpretation clause may provide that any covenant, representation, warranty, undertaking or liability arising under the share purchase agreement on the part of two or more persons shall be deemed to be made or given by such persons 'jointly and severally';

- interpretation clause may specify that generic term of 'sellers' or 'warrantors' shall include each of them severally;

- where the target has subsidiaries, references to 'the Company' shall mean and include each of the companies which are part of the target group for the purposes of the warranties schedule. This means that each warranty will apply separately to every company in the target group.

OPERATIVE CLAUSE

The operative clause in a share purchase agreement is usually the shortest and simplest clause in the agreement, even though it has a direct bearing on the sale and purchase of the shares in question. This clause is usually structured in a manner so as to grant the full title of the shares to the purchaser. It usually also specifies that the shares shall be transferred free from all encumbrances. The exact description of the shares being sold and purchased pre and post closing of the transaction is often listed out in a schedule at the end of the agreement, with such a schedule being cross-referred to in the respective clauses. The clause should also incorporate the waiver of any right(s) of pre-emption held by the vendor. Further, as is the usual practice in any sale/purchase or transfer agreement, the clause usually specifies that any rights (such as dividends) attached to the shares being transferred shall vest in the purchaser after the sale is completed.

Another important part of this clause that seller and purchaser incorporate at times is the condition is that the obligation to complete the sale and purchase of the shares under the share purchase agreement shall not be mandatory unless the sale and purchase of all such shares is completed simultaneously. This clause is particularly important in cases where there is more than one seller. Further, the intention is to discourage piecemeal transfer of shares, and to encourage the sale and purchase of all the shares contemplated to be transferred under the share purchase agreement to take place simultaneously in order to avoid any difficulties at a later stage (such as the interpretation that certain shares contemplated to be transferred under the agreement fall outside the purview of the agreement solely because their sale was not completed at the same time as that of other shares).

This clause is usually one of the most standardized clauses in a share purchase agreement, with minor variations, if any, usually based on the jurisdiction in which the agreement is being executed. However, the buyer and seller should exercise caution while negotiating this clause. It should be adequately clear to both the parties as to what is the exact meaning of the transfer of full title without encumbrances and also the implied covenants attached, for any misunderstanding might lead to unnecessary litigation at a later stage.

CONDITIONS PRECEDENT

Consensus ad idem is the fundamental principle that governs a contractual relationship. The meeting of minds is intrinsic to any exchange. Agreements for the sale and purchase of shares of a company are no different.

Ideally, share purchase agreements, like most other agreements, should be signed and completed simultaneously. However, generally, there is a time lag between signing of a share purchase agreement ("**Signing**") and completion of the sale and purchase of shares thereunder ("**Completion/Closing**"). This time lag is usually owing to factors such as completion of satisfactory due diligence by the buyer, obtaining regulatory consents that are required to proceed with the Completion, the buyer being able to mobilize adequate funds for making the payment to the seller, etc.

Consequently, in such cases, the meeting of minds may become a contentious issue between the parties to a share purchase agreement, as the circumstances that existed at the time of the Signing may (and in most cases, do) differ from those that exist at the time of the Completion.

Therefore, in order to maintain a state wherein both parties are equally incentivized to close the transaction, an obligation is put on both the parties to ensure the fulfilment of certain conditions. These conditions that precede the conclusion of the Completion are termed as Conditions Precedent ("**CPs**"). CPs vary from transaction to transaction depending on the facts and circumstances of each case.

Where a share purchase agreement contains CPs, it will usually commit the parties to proceed with the Completion provided that the CPs are fulfilled by a specified longstop date. If the CPs are not fulfilled by the longstop date, the parties have the option to either waive or renegotiate terms of the share purchase agreement, failing which the share purchase agreement may lapse.

Following are examples of the various instances in which CPs are resorted to:

- *Existing shareholders' approvals*: A private company by definition is required to restrict transferability of its shares. Further, at times, there are transfer restrictions such as pre-emptive rights of existing shareholders, right of first refusal (ROFR), right of first offer (ROFO), and put/call options, etc., attached to the sale shares. Accordingly, as a CP, approval is generally obtained from the shareholders who have rights in relation to the transfer of sale shares.

- *Regulatory clearances*: The regulatory permissions to be sought before proceeding with the Completion depend on the nature of the parties and the transaction. For instance, prior approval of the Competition Commission of India is required if the transaction meets the requirements set out under the Competition Act, 2002 and the regulations made thereunder. Similarly, the approval of the Foreign Investment Promotion Board may be required if the transaction breaches the sectoral caps or conditionalities as specified under the Consolidated FDI Policy. Further, approval of the Reserve Bank of India may be required if any aspect of the transaction is not permissible or is permissible subject to approval under the Foreign Exchange Management Act, 1999 and the regulations made thereunder. In addition, depending on the sector, regulators like the Telecom Regulatory Development Authority or the Department of Telecommunications also mandate prior permission for certain transactions. Lastly, permission from overseas regulators may also be required, for instance, the Securities Exchange Commission if the securities are listed in the United States and breach the applicable thresholds for approval under the applicable US law.

- *Due Diligence*: Information asymmetry is the antithesis to full disclosure. Due diligence is an exercise (which could be financial, accounting and/or legal) which assists in ascertaining the other party's good standing and discovering facts that may have an impact on negotiations. Parties must disclose all material information that may affect the other party's judgment to go forward with the deal. However, primarily it is the endeavour of the buyer to ensure the complete truth of what he is set to purchase and also of the seller to ascertain the buyer's capacity to buy the same. Therefore, in case the due-diligence exercise cannot be completed prior to the Signing, the buyers typically insert a CP which makes the buyer's obligation to purchase the sale shares subject to the satisfactory: (a) completion of due diligence by it; and (b) remedying of the issues noticed by it during the due diligence.

- *Third Party Consents:* Often, licenses obtained by the target company from government bodies and contracts of the target company with certain third parties (such as key suppliers, lenders and customers) put an obligation on the target company to obtain prior approval of (or intimate) such government bodies/third parties for any change in control of the target company. Accordingly, if the Completion is expected to result in a change in control of the target company, then a CP is generally inserted in the share purchase agreement that such approvals be obtained (or intimations be made) prior to the Completion.

- *Material Adverse Change:* The subject matter of the share purchase agreement is not only the shares but control over the assets, liabilities and functioning of the target that is vested with the shares. Hence, it is vital that the party in control of the target prior to completion of the transaction does not rip it off its assets, cause damage to the company's tangible as well intangible assets or manipulate the business of the target in a manner that is prejudicial to the interest of the other party. Thus, a CP to ensure that there is no material adverse change to the business of the target assumes an integral role in a share purchase agreement. Breach of this condition may have a bearing on the value of the target's business and consequently on the decision to proceed with the deal.

- *Correctness of representations and warranties:* The representations and warranties given by the seller in relation to the sale shares and the business of the company on the Signing are generally repeated on the Completion. Accordingly, a specific CP is generally inserted in the share purchase agreement that the representations and warranties must be true and correct at the Completion.

The fulfilment of CPs is typically confirmed by each party by delivering a written certificate to this effect to the other party.

Parties should internally discuss the extent and degree of the likelihood of a breach of an obligation and the consequences thereof in order to effectively categorize it in the form of a CP, condition subsequent, representation or warranty. This is to say a matter which could easily be placed as a condition subsequent should not be forcibly inserted in a CP because a breach and the consequence in the former case shall differ from the later in terms of the scope of an exit. It is recommended that only if the change resulting from a breach is so serious that it potentially renders the entire deal futile should a CP be used.

It is also important to include a provision that enables waiver of a CP by the parties at their volition so as to leave room for renegotiation.

TOTAL CONSIDERATION

The consideration is one of the most vital and contentious issue in negotiations between a buyer and a seller and is most likely the last piece of decision taken. The reason is that consideration is generally adjusted according to what the buyer is paying for, which could be just the assets or the company as a going-concern, aberrations being permitted. Capturing the arrangement in relation to payment of consideration in the share purchase agreement at times becomes tricky and particularly so, in case of multiple sellers.

TYPE OF CONSIDERATION

Once the parties have agreed upon a valuation, the next logical step is to decide how the buyer meets the valuation. The obvious route is to pay in cash and settle the deal. However, in certain acquisitions, the buyer may not have the entire consideration amount in cash to bring to the deal. In such circumstances, the buyer may turn to non-cash considerations (such as its own shares, if the buyer is a company).In some cases, clever structuring (such as share swaps) may result in tax benefits for either or both the parties.

DEFERMENT OF CONSIDERATION

Since the target is a new entity for the buyer (other than aspects discovered by the buyer during the due diligence process), it may want to ensure that the deal is actually sweet (*i.e.*, the target is what the seller claims it to be). In a market governed by the principle of caveat emptor and driven by notions of scepticism, it is imperative that apart from providing for warranties and indemnities, the buy-side would want more protections. Accordingly, the payment of consideration may be structured in a manner that part of the consideration is deferred to a later time and made conditional upon the target crossing certain agreed benchmarks (of course, to the extent permissible under law).

Generally, there is always an element of doubt in the minds of both the buy and sell side – while the buyer has his fingers crossed as to the value of the target, the seller is conscious of the resulting loss of a cash cow. Thus, deferment of consideration in such acquisitions could then be the best lifeboat to save the deal. Similarly, if the buyer wants the seller to stay on board (as an employee/director) post acquisition, the deferred consideration acts as a carrot to performance.

Whatever the type of consideration (or its payment mechanism) may be,prior to drafting of a consideration clause, it is important to have combed through the structure, conditions precedent, conditions subsequent, the rights of the shareholders and determination of the value and number of shares in order to ensure compliance with applicable law as well as suitability to the deal.

FORMS OF DEFERRED PAYMENTS

One form of deferred payments is that of the escrow arrangement; another may be through a predetermined time based schedule of payments; and another by structuring earn-outs.

An escrow is a financial instrument held by a third party escrow agent (generally, a bank) on behalf of the parties to a transaction. The funds are held by the escrow agent until it receives the appropriate instructions from the parties or until obligations have been fulfilled. The drawback of an escrow structure is that an escrow account is generally a non-interest bearing account, making it an economically disadvantageous arrangement. However, in exigencies where the negotiation is at a deadlock, providing for an escrow arrangement makes economic sense for the buyer if it has reason to believe that the target's account or upkeep is not in order or that recovery against the seller shall be difficult either due to its non-existence or jurisdictional enforceability issues at a later date. Even for the seller, an escrow provides assurance that the money shall be received at a pre-determined date. Drafting an escrow clause includes determining who the escrow agent would be, what would be the timelines and triggers for release and interest, if any accrued. Further, an escrow agreement detailing the escrow arrangement is required to be drafted so as to ensure that the escrow agent is also a party to that specific agreement.

OTHER ASPECTS OF CONSIDERATION

The structure of the consideration also determines the tax, stamp duty requirements and other fees(including lawyers' and bankers' fees) – all of which would generally amount to significant expenditure. Therefore, to avoid any dispute as to such expenditures, consensus as to who would bear the expenditure must be clearly spelt out in the share purchase agreement.

REPRESENTATIONS, WARRANTIES AND INDEMNITIES

Although, the contractual principles of law incubate the buyer with the principle of *caveat emptor* (let the buyer beware), this principle has certain exceptions. In Indian jurisprudence, it does not apply to cases where the seller has perpetrated a fraud to induce the buyer to accept the terms of sale; or when the buyer even after reasonable exercise of diligence could not have detected the defect and if there was no disclosure by the seller to that effect. Given the aforesaid standing of law, a case may be made that is it unnecessary to include the terms of representations, warranties and indemnities in a share purchase agreement. However, this cannot work in practice, as a buyer investing money, time and other resources would want certainty of the terms to which he would be bound. Moreover, the inclusion provides an opportunity to the buyer to negotiate better terms of warranties and indemnities.

Representations, warranties and indemnities are one of the most illustrative clauses in commercial contracts. These provisions perform the two-fold function of outlining as well as limiting liability.

REPRESENTATIONS AND WARRANTIES

Representation is a statement made in the contract enunciating the state of affairs (as on date) of the company whose shares are being transferred. Representations and warranties are largely informational in nature and provide the buyer with an insight into the seller's business prior to entering into a commitment. Typically, representations and warranties provide a snapshot of the target company at both, the time of Signing and Completion (through a bring down on representations and warranties).

Some examples of representations and warranties include:

- Title to sale shares without any encumbrance
- Possession of all requisite authorizations to enter into and give effect to the share purchase agreement
- Accuracy of financial statements and accounts
- Compliance with applicable law and contracts while conducting business
- Proper ownership rights over the properties (tangible and intangible)
- Status of litigations against the target company

Representations and warranties are encapsulated to provide contractual protection to the buyer, as there is very little statutory protection available to the buyer otherwise. An award of damages for breach of warranty aims to put the claimant in the position it would have been in had the warranty been true, subject to contractual rules on mitigation and remoteness whereas a breach of the representation clause entails a claim for misrepresentation. It must also be noted that issues disclosed in the Disclosure Letter act as exceptions to the warranties.

INDEMNITIES

Whilst warranties and indemnities are both devices to protect the buyer against probable loss they are legally distinguishable from each other. An indemnity according to Section 124 of the Indian Contract Act, 1872 is a "promise to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person". A warranty on the other hand is a statement by the seller about a particular state of affairs of the company or business. While an indemnity allows the buyer to recover the loss occasioned in the respect of the indemnified event; a breach of warranty would translate to a claim in damages. It is common to include a specific indemnity provision whereby the defaulting party is obligated to indemnify the other party for losses arising from a breach of warranty claim. This is done because it is relatively easier to establish a case in court and recover losses protected by an indemnity than it is to prove a case for damages due to breach of a warranty.

Sometimes, indemnities are included only due to possible prior knowledge of the impending loss that may be occasioned to the buyer, which then would defeat a claim for warranty – as such prior knowledge is a defence against warranties.

Generally, the most common subjects covered by indemnities are: (1) Unresolved and Potential litigation; (2) Taxation; (3) Environmental risks; (4) Doubtful debts; and (5) Labour claims.

With respect to the timing of commencement of liability of the indemnifier in case of liability, there is a conflict in the position of law. The common law position is that indemnity is payable to the indemnity-holder only once the actual loss has been suffered. However, in the recent case of *The New India Assurance Company Ltd.* v. *The State Trading Corporation of India Ltd. and Anr.* (MANU/GJ/0001/2007), the Gujarat High Court held that if the indemnity holder had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and pay it off.

In view of this uncertainty over the commencement of liability, coupled with doubts about the creditworthiness of the seller and possible complications of execution of an indemnity against the seller at a later date, once the shares have been transferred, share transfer agreements may provide for security, which may be common for both breach of warranties and indemnities. The most common methods of securing against liability include – (1) obtaining a bank guarantee from the seller or a guarantee from the seller's parent company; (2) using an escrow account; or (3) retention of a certain part of the purchase consideration till a pre-determined period of time (Retention clauses).

The drafting of a share purchase agreement would require further detailing if there are multiple sellers involved in the transaction. While, the buyer would prefer to hold the sellers jointly and severally liable, negotiations may result in less onerous alternatives. From the sellers' point of view, it is important that the sellers determine upfront, the exact ratio of their share of losses. This may be either specified in the share purchase agreement itself or in a separate agreement entered into amongst the sellers.

LIMITATIONS IN SELLER'S LIABILITY

Representations and warranties cover a bundle of issues pertaining to legality and authority to enter into the transaction; probable tax implications; intellectual property rights, financials, transaction specific aspects etc. and are inexplicably linked to the definition clauses in the share purchase agreement. For example, if the share purchase agreement contains a warranty for protection of intellectual property rights, it is the definition of 'intellectual property', which will determine the scope of the warranty. Therefore, sellers may limit their liability by negotiating exclusive and narrow definitions.

Sellers may also limit liability based on materiality, monetary thresholds and time and knowledge qualifiers by adding phrases such as 'to extent seller may be aware' or 'to the extent of ownership' so that they are not liable for breaches beyond their knowledge and control. Sellers can also carve out certain exceptions like changes in the law or industry practice etc.

Warranties and representations survive the termination of contract and hence need to be carefully tailored to avoid lingering liability. The party making such warranties sometimes prefers to include such clauses in the condition precedents itself so that consequences of breach of warranty do not impede the smooth operation of the share purchase agreement later. Even otherwise, parties usually include a statement of correctness / accuracy of warranties in the conditions precedent itself. In case of breach of warranty, the buyer generally has a right to walk out prior to Closing and indemnification post Closing.

Increasingly, sellers are resorting to warranty and indemnity insurance to mitigate risks arising from these provisions. Reference to such insurances can be made in the share purchase agreement itself. Sellers can also mitigate risk by disclosing all requisite risks in the disclosure letter thereby placing those matters outside the purview of warranties. In order to deal with exogenous circumstances, sellers may consider carving out market volatility as an exception to warranty claims. Sellers also tend to include anti-sandbagging provision in the contract to insulate them against certain indemnification claims. An anti-sandbagging provision prohibits the buyer from bringing an indemnification claim based on an inaccuracy or breach of a representation or warranty that the buyer knew about before the Closing if the buyer chooses to proceed and close the transaction despite the inaccuracy or breach of the representation. This provision provides the seller with an affirmative defense against an indemnification claim.

English law has traditionally taken a restrictive approach to the construction of exemption clauses and clauses limiting liability for breaches of contract and other wrongful acts. However, in recent years it has been recognized that parties to commercial contracts are entitled to apportion the risk of loss as they see fit and that provisions which limit or exclude liability must be construed in the same way as other terms. In India also there has been an increasing trend to let the parties apportion risk according to their own commercial reasons.

RESTRICTIONS ON SELLER'S AND BUYER'S ACTIVITIES

Share purchase agreements typically impose restrictions upon the ability of both, the buyer and the seller, to carry on certain activities in a manner that would adversely affect the rights of the other party under the agreement. These are termed 'restrictive covenants' or 'negative covenants' for the function they serve.

Restrictive covenants may restrict the actions of parties both, before and after the Closing date. More specifically, the restrictive covenants binding on the seller would generally include the following:

- *Non-compete provisions*: As the name suggests, the non-compete clause in a share purchase agreement is incorporated to restrain the seller from carrying out any independent activity in competition to that of the target company. Buyers usually want to eliminate or, at least, minimize the possibility of competition from the exiting shareholder(s).

- *Non-solicit provisions*: The non-solicitation clause restricts the seller from soliciting customers, employees, business opportunities of the target company, etc. for a specified period of time. This enables the buyer to protect the commercial interests of the target company.

- *Exercise of voting-rights*: This clause restricts the seller and the directors on the board of the target company nominated by the seller, to exercise their voting rights in a manner that would prevent the target from giving full legal effect to the terms of the share purchase agreement.

- *No-shopping obligations*: This clause is used to restrict the target company and the sellers from selling the shares of the target company to a potential purchaser at a price lesser than the price agreed under the share purchase agreement. They are also restricted from providing more favourable rights to potential purchasers, than those granted under the share purchase agreement (including voting rights and entitlement to dividend).

The use of restrictive covenants with respect to the activities of the buyer is relatively uncommon but not entirely unheard off.

In effect, restrictive covenants function as a risk-allocating device. The binding nature of these covenants is meant to dis-incentivise parties against a breach of covenants applicable to them. Usually, all costs arising out of a breach are borne by the breaching party and there may be a penalty including monetary damages and cancellation of the share purchase agreement.

Restrictive covenants are fundamental to a transaction and therefore, usually the consideration amount reflects the value that the buyer assigns to the restrictive covenants. It is therefore of utmost importance that these restrictions are tailored to suit the specific needs of the parties. There cannot be a one-size-fits-all approach.

Typically, these clauses are pro-buyer and the seller has limited flexibility in the design of restrictive clauses. However, depending upon the specific circumstances of the transaction, the seller may be able to extract at least two flexibilities: one, an enhancement in the consideration amount on the ground that the offered amount does not reflect the covenants being bargained for; and two, negotiate the scope and ambit of the restrictive covenants.

LEGAL ISSUES WITH RESTRICTIVE COVENANTS

Parties must make judicious use of restrictive covenants as provisions which are far too onerous or restrain the autonomy of a party to an unreasonable extent may not be upheld by courts of law. For a restrictive covenant to be enforceable it must be reasonable and the restrictions to be imposed must be concomitant with the legitimate business interests of the parties. In order to avoid ambiguity in interpretation of restrictive covenants, the following must be specifically mentioned:

- period of validity of the restrictive covenant

- scope of activities to which the restriction applies and

- geographical boundaries, demarcating the specific market, within which the restrictions are to be operative

Broadly speaking, the legal test that courts follow in determining the validity of a restrictive covenant can be summarised as under:

- Does the party protected by the restrictive covenant have a proprietary interest entitled to protection?

- Are the restrictions sought to be applied too broad?

- Is the covenant a restriction against competition generally?

The duration of a restrictive covenant is something that is heavily negotiated in a share purchase agreement. What qualifies as a 'reasonable' duration is a matter of subjective interpretation. Generally, courts interpret such covenants by reference to various governing factors and most importantly, to the 'interest' which the covenants seeks to protect.

ENFORCEABILITY OF NON-COMPETE CLAUSES IN INDIA

The inclusion of a non-compete clause is a common practice in most acquisition deals in India. However, the enforceability of non-compete provisions remains controversial. Non-compete provisions that have the effect of restraining trade or profession are void, under the provisions of Section 27 of the Indian Contract Act, 1872 ("**Contract Act**"). The prohibition on such agreements is absolute, unless they fall within the specific exceptions to Section 27 of the Contract Act.

Indian courts have consistently refused to enforce post-termination non-compete clauses with respect to employment contracts. These restrictive covenants qualify as restraint on trade impermissible under Section 27 of the Contract Act. The Supreme Court, in *Percept D Mark (India) Pvt Ltd* v*. Zaheer Khan*[1], held that under Section 27 a restrictive covenant extending beyond the term of the contract is void and unenforceable. Moreover, the doctrine of 'restraint of trade' is not confined to contracts of employment only, but is also applicable to all other contracts with respect to obligations after the contractual relationship is terminated.

However, in the context of acquisitions, in *Tata Tea Ltd.* v*. Securities and Exchange Board of India*[2], the Appellate Tribunal observed that in cases where the outgoing sellers could potentially misuse their specialised knowledge of the business of the target company, including offering competition to the business being taken over, "it would be legitimate for the acquirer to enter into a non-compete agreement with the promoter sellers if he feels threatened by a lurking fear of competition from them". The Tribunal held that it was the right of the acquirer to protect his investment/business from competition by a seller of the business. Section 27 of the Contract Act recognises that non-compete agreements are not in restraint of trade if the restrictions are reasonable. Thus, there still remains certain uncertainties as to the enforceability of non-compete clauses in India.

In addition to the Contract Act, the validity of non-compete clauses may also may be challenged under certain other statutes in force in India such as the Competition Act, 2002. Further, sector specific restrictions may also be prevalent in certain cases (for instance, the FDI Policy of 2014 which lays down the guidelines for the transfer of shares between resident and non-resident entities disallows the use of a non-compete clause in the case of the pharmaceuticals sector except in special circumstances with the approval of the Foreign Investment Promotion Board).

CLOSING

Closing or Completion under a share purchase agreement may either take place simultaneously with its Signing, or be deferred to take into account fulfilment of certain conditions, i.e. Conditions

[1] AIR 2006 SC 3426
[2] [2010] 103 SCL 140

Precedent or CPs. Usually, CPs include regulatory clearances, board/shareholder approval, third party consents, etc. Given their nature, CPs are largely identified during the due diligence process.

Most share purchase agreements also set out the Closing process in detail, including time and place of and each party's obligation (such as handing over the necessary documents, remitting the purchase consideration, resignation and appointment of directors, convening necessary board and shareholder meetings, notifying the relevant authorities, etc).

A clause stating that all actions on Closing shall deemed to have taken place simultaneously, and in case any such action is not completed then all completed actions shall be reversed is also usually included in most share purchase agreements.

CONDUCT BETWEEN SIGNING AND CLOSING

To ensure that there are no significant changes in the business operations, financial position and capital structure of the target company between the date of Signing and Closing, the buyer usually requires the seller to ensure that during such duration, the business of the company is run in the ordinary course consistent with past practice.

Further, certain share purchase agreements also set out a list of key items on which no action can be taken by the target company between Signing and Closing without the buyer's prior written consent. This protects the buyer from various unwanted situations (for instance, where the seller and the target company may issue further shares to the seller post-signing, thereby bringing down the value and the percentage shareholding of the shares proposed to be sold to the buyer).

Also, during such period, the buyer (who otherwise has no rights vis-à-vis the target company) is given certain access and information rights in the target company. That is, the seller ensures reasonable access to the buyer and its authorized representatives to visit, examine and inspect the target company's properties, and records. The cost incurred during the period of access rights is usually borne by the buyer.

CONFIDENTIALITY

The confidentiality clause in a share purchase agreement precludes a party to the agreement from disclosing information to a third party without the consent of the other parties to the said agreement unless there are exceptional circumstances such as statutory requirements. In certain highly sensitive cases, leakage of information may be a ground of termination of the share purchase agreement. Needless to specify, the confidentiality clause assumes increased significance when dealing with a public listed company.

Parties may also enter into a separate confidentiality agreement also known as a non-disclosure agreement whereby undertakings are signed by bidders in the initial stages of exploring a potential deal. The primary purpose is to prevent leakage of sensitive information disclosed to bidders about the target company.

There are two key aspects that need to be borne in mind when drafting and negotiating a confidentiality clause:

- the scope of information to be kept confidential; and
- various exceptions that may be invoked by a transmitter/ recipient of information.

The seller's obligation under a confidentiality clause extends to trade secrets and other confidential information of the target group. If the seller is part of a larger corporate group, the buyer must ensure that seller's obligations apply, as far as possible, to the other group companies as well. If the seller has a parent company then the buyer should consider requiring the parent company to be joined as a party to the confidentiality agreement.

Further, if consent of third parties, such as customers, creditors or suppliers is to be sought for the acquisition then it is advisable to enter into a confidentiality agreement with such parties as well so as to ensure confidentiality prior to signing the definitive documents.

Many a times the obligations flowing from a confidentiality clause in a share purchase agreement are not reciprocal. However, recently, while interpreting a confidentiality clause, a Delaware Court in the US has ruled that what is good for one party will also be good for the other and therefore, one must be prepared to be bound by the same terms that are useful to oneself[3] even when the clause does not expressly impose reciprocal obligations. However, in order to be certain, if the buyer obtains any information related to the seller that can be called confidential as part of the sale process, the seller should consider making the confidentiality undertakings mutual.

It may be noted that more often than not the remedy for breach of confidentiality is an injunction prohibiting disclosure which is often of little use once information has been leaked. Further, even monetary damages may not provide adequate compensation in certain cases where the damage caused is commercially irreparable.

ASSIGNMENT

In a share sale, each party wants to be able to freely assign its rights and obligations. At the same time, each party also wants to have the freedom to choose as to who it should do business (read, transaction of share sale) with.

Consequently, assignment of rights and obligations under a share purchase agreement can, at times, be a very contentious issue while drafting/negotiating. Whilst a seller may consider the request of a buyer to assign the latter's obligations to another person/entity, a buyer would almost always insist on the obligation of the seller (to sell the shares held by it) being characterised as un-assignable.

To take an example, if 'A' agrees to buy 10 shares from 'B' for Rs. 10 per share, 'A' might have done so largely because of the clean title that 'B' has on its shares. Consequently, 'A' would not want 'B' to assign his right (to receive the purchase consideration) and obligation (to sell the shares) in favour of 'C', as 'C' may not have a clean title to the shares held by it (because of which, 'A' may not have offered more than Rs. 7.00 per share to 'C').

Similarly, in the same example, 'B' might have agreed to sell its shares to 'A' based on the assumption that the financial status of 'A' is strong (and that 'A' has enough cash available to make the payment of the purchase consideration upon closing). Accordingly, 'B' would not want 'A' to assign his right (to receive the shares) and obligation (to pay the purchase consideration) in favour of 'C', as 'C' may not have sufficient cash available (because of which, 'B' may not have agreed to sell its shares to 'C' without 'C' first furnishing a third party guarantee to back its obligation to pay the purchase consideration). However, since the financial position of the buyer in a share sale transaction is seldom questioned, sellers are generally willing to let the buyer assign its rights and obligations in favour of a third party.

Therefore, share purchase agreements generally mandate that prior written consent of all parties is obtained before assign any rights and obligations flowing from the share purchase agreement.

ENTIRE AGREEMENT

Entire agreement clauses, also called 'integration clauses' or 'merger clauses', stipulate that the share purchase agreement constitutes the entire agreement between the parties and precludes the parties from relying on any pre-contractual representations. Such a clause declares the share purchase agreement to be the final agreement between parties and supersedes all previous negotiations. It basically asserts that to decide any dispute between the parties, only the terms of the share purchase agreement should be relied on. In any case, such an entire agreement clause cannot exclude a defaulting party's fraudulent pre-contractual representations. The parties must consider the effect of such clauses, since they expressly exclude pre-contractual negotiation. This clause is of particular

[3] *Martin Marietta Materials Inc.* v. *Vulcan Materials Company*,C.A. no. 7102-CS, 56 A 3d 1072, 1076-77 (Del. Ch. 2012); aff d. 2012 WL 2783301 (Del Jul 10, 2012)

use while interpreting the agreement in case of a dispute, since it clarifies that the share purchase agreement would be the final and binding agreement between the parties.

WAIVER

A waiver clause usually provides that a party's failure to enforce its contractual right, whether intentionally or otherwise, would not operate as a waiver by the party of such right.

This clause is essential since it ensures that, on the occurrence of a later breach, even if a party had earlier overlooked a breach of the share purchase agreement by another party, the latter is unable to take recourse to such prior failure of the former to enforce its rights for establishing a pattern, intention to waive or implicit waiver of its rights.

The clause typically requires any waiver of rights to be in writing.

Further, even if a party waives its rights with respect to a particular breach, the clause generally provides that such waiver would not operate with respect to other terms of the agreement.

Thus, this clause protects the parties' right to enforce contractual provisions. Conversely, it is also useful when in the course of business dealings, a party fails or expresses inability to strictly comply with particular provisions of the share purchase agreement and the other party for its own reasons decides to forego the non-compliance.

AMENDMENT

Parties to a contract, reserve the right to amend it as and when the need arises. The amendment clause in a share purchase agreement generally provides the terms and the method of modifying the terms of the agreement.

Provision of this clause is essential since it usually avoids oral amendments, amendments made without informing the other parties, etc., thereby ensuring that any variation in the terms of the share purchase agreement is made according to a process defined and agreed upon at the stage of entering into the agreement itself.

Generally, a clause that provides for unilateral amendment, i.e. vesting the power of amendment in one party alone, is not upheld in courts, nor is it desirable to provide for such a clause. A model clause would provide that any variation in the terms of the share purchase agreement be effected through a consensual procedure.

NOTICE

This provision in a share purchase agreement is crucial as it determines the notice requirements for the rights and obligations under the agreement which may be triggered upon service of notice. It also generally prescribes *inter alia* the mode of dispatch of notice i.e. in person or *via* post or e-mail, the notice period, acceptance and deemed acceptance of notice, consequences of failure to send notice. While drafting this provision one needs to be careful as to whether the notice is mandatory or permissive. In international transactions, the language of notice is important and must be mentioned in a separate schedule to the share purchase agreement.

SEVERABILITY

The severability clause states that each clause in the agreement is independent, so that even if a court declares that a particular clause is void, unconstitutional or fraudulent, rendering such clause unenforceable, the other clauses continue to operate and remain enforceable. This clause is of particular importance, since it stipulates that merely because one clause is declared unenforceable, the entire share purchase agreement does not cease to be operative. While drafting a share purchase agreement one may further clarify this clause by laying down how parties can amend the agreement in case a particular clause is declared unenforceable by a court. The key point is providing for continued smooth operation of the share purchase agreement even if a certain clause is held illegal.

DISPUTE RESOLUTION

In most share purchase agreements, the clause governing dispute resolution between the parties, despite being one of the most important clauses, turns out to be the most ignored one. The survival clause in a share purchase agreement usually provides that the dispute resolution clause survives even if the agreement is alleged to be void, or brought into dispute in any manner, so we are sure that even in case of conflicting interpretations of the share purchase agreement, this clause shall survive. Locking down on a dispute resolution clause which fulfils the three C's – Communication, Convenience and Clarity, avoids long drawn-out negotiations for choosing the method of dispute resolution.

The dispute resolution clause contains extremely important information: firstly, the kind of disputes subject to this clause; secondly, the method of dispute resolution parties wish to adopt – mediation, arbitration, litigation (and their order, if more than one); and thirdly, the chosen forum for adjudicating disputes. Aiming to keep these three vital points as clear as possible, a drafter begins his task. While at first sight, a drafter may be tempted to choose one of several boilerplate clauses, it is advisable to give due consideration to this clause.

Generally, parties stipulate that all disputes arising in connection with the agreement will be governed by this clause. Providing for separate methods of dispute resolution for different kinds of disputes may lead to complex issues of interpretation of the dispute resolution clause.

Parties must also choose which method of conflict resolution they wish to adopt. While litigation is the traditional choice, the complications involved in litigation, such as prolonged proceedings, expenses and the sheer effort involved are major cons. Another option available is mediation, wherein parties agree to engage in discussions with a third-party mediator, to arrive at a virtually painless compromise without the involvement of a court / arbitrator. However, parties generally choose to adopt the very popular course of arbitration, wherein they agree to submit to arbitral proceedings, which are final and binding, with limited scope of frivolous appeal to courts. Arbitration provides an expedited process of resolving disputes, and is arguably the most used course of conflict resolution today. Even though arbitration nowadays entails high costs, prolonged proceedings and is far from the alternative method of dispute resolution envisaged under the UNCITRAL Model Law, it is often preferred over litigation. Arbitration and mediation provide a certain degree of privacy/confidentiality in proceedings, and have the advantage of engaging industry experts as mediators/arbitrators to guide the dispute resolution process, compared to court proceedings, where it is not guaranteed that a judge will be well-versed in the minutiae of commercial transactions. Further, a combination of methods may be adopted, for example, parties may provide for mediation proceedings in advance of arbitration. Parties may also provide for mutual consultation (a cooling-off period) before proceeding with arbitration/mediation.

Choosing arbitration as a method of dispute resolution entails deciding the composition of the arbitral panel, the governing law, the seat and venue of the arbitral proceeding. While deciding on these aspects, parties must understand their repercussions as well. Especially in the case of international commercial arbitrations, the enforcing courts' attitude must be kept in mind. Consider the Supreme Court of India's judgment in *Bharat Aluminium Co.* v. *Kaiser Technical Services*,[4] wherein it was held that Part I of the Arbitration & Conciliation Act, 1996 is applicable only to arbitrations in India. Thus, in case of an international commercial arbitration, if the seat of arbitration was outside India, no interim relief would be available in India. As to the matter of the law of the seat of arbitration versus the governing law, the Hon'ble Supreme Court of India has held that it would only be a matter of construction of the agreement. This judgment was seen as an encouraging step since it overruled the previous principle laid down in *Bhatia International* v. *Bulk Trading SA*[5] that the provisions of Part I of the Arbitration Act would apply to international arbitrations held outside India, unless excluded explicitly or impliedly by the parties.

[4] (2012) 9 SCC 552.
[5] (2002) AIR SC 1432.

Thus, choosing the forum, jurisdiction and governing law is of utmost importance, especially, in international commercial arbitration, since it decides under which law the parties would be bound. Parties must also clarify the composition of arbitral panel, and the qualifications of the arbitrator. The clause also may also provide for award of costs by the arbitrator.

The consequences of choosing a particular country as the seat of arbitration require careful consideration. A drafter must, therefore, avoid at all costs, drafting the arbitration clause as the 'midnight clause', *i.e.*, a clause left out to be finalised at the end of negotiations. A dispute resolution clause must be tailored to meet each party's specific needs and convenience. The focus must be on minimising clause-related ambiguities, to avoid unnecessary combat. Only by such meticulous preparation, can parties avoid costly surprises later on.

STAMP DUTY

Stamp duty is the amount payable to the government in case of execution of certain documents. Stamping apart from being a tax on transfer also provides an evidentiary value to the said document. In India, stamp duty is applicable as per state enactments and hence depending on the registered office of the parties, they need to decide on the jurisdiction for payment of stamp duty and the rate as applicable.

PUBLIC ANNOUNCEMENTS

Most successful merger and acquisition deals have ensured that the deal's announcement is made at the right time and in the right manner with consent from all parties. Also, for listed companies, share price is sensitive to such announcements and hence great care needs to be taken.

This clause provides for the modalities that are required to be complied with before making an announcement or public disclosure. Also, exceptions to the disclosure requirements by regulatory authorities, courts etc. are carved out in this clause of the share purchase agreement.

COSTS

The general proposition is that parties themselves bear the cost of negotiating and closing the share purchase agreement. However, in case of any deviation, such as one party bearing the costs or third parties bearing the costs, an express statement to this effect may be provided in this clause of the share purchase agreement.

SCHEDULES

TAX DEED

Tax liabilities arise in most acquisitions and owing to the sums involved the determination of the same is very crucial. Hence, parties usually prefer to demarcate the incidence of pre-completion tax liabilities by way of a tax covenant, generally given by the seller in favour of the buyer. In practice, this tax covenant is annexed as schedule to the share purchase agreement, referred to as the Tax Deed.

A tax deed sets out indemnities/warranties relating to tax liabilities. The tax deed may spilt the pre-completion period into two – one consisting of tax liabilities upto the date of last audited accounts of the target company and the other the tax liabilities arising from the date of last audited accounts upto completion which covers tax liabilities arising outside the 'ordinary scope of business'. Ordinarily, these shall be the seller's liability unless anything to the contrary is stipulated. Thus as a drafting point, one needs to be mindful of defining the scope and meaning of the term 'ordinary course of business' in order to avoid ambiguity at a later stage.

The purpose of the tax deed is to protect the buyer of the target company from any tax liabilities that pertain to the period before the buyer purchased and became responsible for the target company. Typically, advice of a taxation expert is taken while drafting and negotiating the Tax Deed.

DISCLOSURE LETTER

While negotiating a share purchase agreement, customarily the buyer will put in all efforts to ensure that the scope to hold the seller liable is maximized by demanding a long list of representations, warranties and indemnities whereas, the seller will make best efforts to restrict its liability through various means. The disclosure letter is one such contractual device employed by the seller which discloses specific facts and circumstances and thereby absolves or limits the liability of the seller for certain breaches of representations, warranties and indemnities. Share purchase agreements usually encompass a provision stating that all matters enlisted in the disclosure letter shall not constitute a breach of any representations, warranties and indemnities.

A disclosure letter is usually annexed as a schedule to the share purchase agreement and is signed by both the parties. Typically, the disclosure letter is updated at the time of closing of the transaction.

From the buyer's point of view also a disclosure letter serves a dual purpose - firstly, it brings to the fore important information which the due-diligence exercise could not flush out and secondly, it assumes significance from the point of view of risk allocation and renegotiation of the purchase price and other terms of the share purchase agreement.

A good advice to the seller would be to disclose all material information in the disclosure letter in order to insure itself from future liability; the buyer should on the other hand constantly compare the contents of the disclosure letter with that of the due-diligence reports and not wait for the day of Signing or Closing in case of an updated disclosure letter.

CONCLUSION

Those explained above are template clauses which will vary from case to case depending on the structure of the transaction. However, most them appear in an SPA. The aim of this exercise remains in lucidly explaining the clauses along with the reasons for incorporating these clauses in a SPA.