TRAVERS SMITH

# Minority investments.

PRIVATE EQUITY & FINANCIAL SPONSORS

traverssmith.com

# How minority investors can protect their interests

**We anticipate that private companies will increasingly look to raise capital from minority investors to enable otherwise robust businesses to grow or ride out the ongoing Coronavirus pandemic. Investors should take care to understand the rights that may and may not be available to them. The foremost challenge for a minority investor is balancing:**

- the majority shareholders' desire to retain control of the business; and
- its own need to (1) protect its investment throughout the lifecycle and (2) control (to a degree) the exit process.

The legal terms will also be influenced by the structural and economic terms of the transaction, such as the level of rollover, size of any sweet equity pot, amount of debt to be raised, and ranking of securities as between shareholders. As a result, there are fewer "rules of thumb" as to what constitutes standard market practice and a carefully considered approach to the legal terms will be essential.

An extremely committed and technically well-rounded practice with an excellent approach to doing business. The team is great to work with and highly client-centric; they balance tenacity with pragmatism.

**Legal 500, 2020**

## Key controls over investment

### 1. Board control

Typically, on a minority investment, a private equity investor will have less control over the composition of the board and (absent specific agreement to the contrary) will not be able to change the management team. However, a sponsor is often able to exert influence over the board through its right to appoint one or more investor directors and any rights to appoint an independent chairperson or non-executive director. This should be balanced with the rights of majority shareholders to control the board, and consideration should be given to the circumstances in which that balance should be tipped.

### 2. Step in rights

Additionally, in certain circumstances (e.g. following a "default event"), a private equity investor will want enhanced rights which enable it to "step in" and protect its investment. These enhanced rights will typically include:

- **Voting rights:** increased voting rights by disenfranchising shares held by other investors or giving voting rights to the investor's non-voting shares (e.g. preference shares);
- **Board control:** additional rights to appoint directors and/or remove existing directors;
- **Emergency funding:** the ability to provide emergency funding on a non-preemptive basis (typically subject to a catch-up right for the other shareholders);
- **Operation of the drag:** the ability to operate the drag-along provisions without regard to any conditions which would otherwise apply (e.g. delay, value floor, etc.); and
- **Appointing third party advisers:** the ability to appoint third party advisers to advise on strategic options, which the board must consider and/or implement in good faith.

### 3. Veto rights

Finally, whether a minority or majority investor, there are certain fundamental operational decisions and matters that a private equity investor should ensure it has veto rights over. This list is often extensive, though typical examples include:

- borrowings outside of the existing debt finance arrangements;
- material acquisitions and disposals of assets;
- amendments to constitutional documents;
- returns of capital;
- share issues or reorganisations; and
- changes in the nature of the business.

On minority investments, a private equity investor may be asked to concede veto rights to other shareholders, such as a founder shareholder no longer actively involved in the operation of the business. Any concessions should be carefully considered, particularly in respect of rights that apply following a default event, as the investor should not fetter its ability to protect its investment.

The whole team worked tirelessly to execute the transaction on an ambitious timetable and the TS culture of supporting one another did not go unnoticed.

**Richard Booth, Inflexion Private Equity Partners LLP on Inflexion's minority investment in Huws Gray.**

# Key mechanisms to influence an Exit

### 1. Drag provisions

As a minority investor, a sponsor may be unable to negotiate a traditional "drag-along" provision. To bridge the gap and provide the private equity investor with enough flexibility to achieve an exit, the other shareholders may be more willing to accept a drag-along mechanism where:

- **Delay:** the drag-along only becomes operable after a specified date following completion;
- **Shareholder acceptance:** a set threshold of other shareholders must approve the transaction;
- **Value floor:** a minimum return must be achieved by dragged shareholders as a condition precedent to the operation of the drag-along mechanism; and/or
- **ROFO:** the other shareholders have a right of first offer ("ROFO") before the drag-along mechanism can be triggered.

Conversely, majority shareholders may seek the ability to drag the private equity investor into a sale. Careful consideration should be given as to whether such a right can be accepted, and what limitations are required (e.g. value floor, delay, etc.) in order to ensure any sale occurs on terms financially acceptable to the private equity investor.

### 2. Other mechanisms

If the private equity investor is not able to negotiate drag-along rights, it may be able to negotiate alternative means to influence an exit, including:

- "exploding" or "stepped" coupons on the investor's preference shares or loan notes which take effect after a specified date following completion;
- rights to receive a guaranteed dividend or to require some or all of its loan notes or preferences shares to be redeemed on a specified date following completion; and/or
- provisions requiring all parties to work together to achieve an exit by a certain date, and rights for the investor to appoint third party advisers to advise on an exit if it has not been achieved by the pre-set date.

# Key contacts

**Paul Dolman**
Partner, Co-Head of Corporate, Head of Private Equity & Financial Sponsors
paul.dolman@traverssmith.com
+44 (0)20 7295 3274

**Lucie Cawood**
Partner, Private Equity & Financial Sponsors
lucie.cawood@traverssmith.com
+44 (0)20 7295 3468

**Emma Havas**
Partner, Private Equity & Financial Sponsors
emma.havas@traverssmith.com
+44 (0)20 7295 3294

**Ian Keefe**
Partner, Private Equity & Financial Sponsors
ian.keefe@traverssmith.com
+44 (0)20 7295 3303

**Genevieve Marten**
Partner, Private Equity & Financial Sponsors
genevieve.marten@traverssmith.com
+44 (0)20 7295 3387

**Adam Orr**
Partner, Private Equity & Financial Sponsors
adam.orr@traverssmith.com
+44 (0)20 7295 3267

**Edmund Reed**
Partner, Private Equity & Financial Sponsors
edmund.reed@traverssmith.com
+44 (0)20 7295 3286

**James Renahan**
Partner, Private Equity & Financial Sponsors
james.renahan@traverssmith.com
+44 (0)20 7295 3466

**Ian Shawyer**
Partner, Private Equity & Financial Sponsors
ian.shawyer@traverssmith.com
+44 (0)20 7295 3269

**George Weavil**
Partner, Private Equity & Financial Sponsors
george.weavil@traverssmith.com
+44 (0)20 7295 3392

**Will Yates**
Partner, Private Equity & Financial Sponsors
will.yates@traverssmith.com
+44 (0)20 7295 3460



The information in this document is intended to be of a general nature and is not a substitute for detailed legal advice.

Travers Smith LLP is a limited liability partnership registered in England and Wales under number OC 336962 and is regulated by the Solicitors Regulation Authority. The word "partner" is used to refer to a member of Travers Smith LLP. A list of the members of Travers Smith LLP is open to inspection at our registered office and principal place of business: 10 Snow Hill, London EC1A 2AL.



Travers Smith LLP 10 Snow Hill, London EC1A 2AL +44 (0)20 7295 3000 | traverssmith.com