



Department of
Primary Industries and
Regional Development

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Legal considerations for raising capital





The Investor Readiness Program is an initiative of the Department of Primary Industries and Regional Development delivered in collaboration with BDO Australia.

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Legal issues with raising capital

As part of becoming investor ready, it is necessary to be familiar with the regulations around raising capital in order to ensure that the information you provide is correct and complies with various guidelines and regulations.

The information provided below does not include Initial Public Offerings (IPOs) and Public Offer Documents. The methods of raising capital described are exempt from the requirement to produce such documents, however, these methods require an Information Memorandum (IM) to be provided to potential investors.

Methods of raising capital

There are many rules and regulations governing businesses and their operations. This guide will outline the relevant provisions and information in relation to capital raising.

Capital raising is governed by the *Corporations Act 2001* (the Act) and regulated by the Australian Securities and Investment Commission (ASIC). The Act provides exemptions from producing IPOs under s708. The investor is responsible for ensuring they meet the requirements for exemption under s708 of the Act.

Your business structure is relevant to determine if you can raise capital through an investor, and the regulations that will apply in the process. The most common way for private companies to raise capital are through:

- small-scale offerings
- direct offers to professional or sophisticated investors
- making an offer through a financial service licensee.

Small scale offerings

This is a popular method for small businesses seeking to raise capital. This method can be used, when:

- raising \$2 million or less
- the amount raised is from no more than 20 investors in a 12-month rolling period
- the offer made is personal, where there is a connection between you and the investor.

The connection between you and the investor can be satisfied provided you have:

- had contact with the person previously
- have a professional or other connection with the investor
- the investor states or indicates they are interested in similar offers.

Sophisticated investors

Offers made to a person deemed to be a sophisticated investor do not need to be disclosed. For an investor to be deemed as sophisticated, they must meet criteria and have been issued with a qualified accountant certificate within two years of the offer being made. In addition, the minimum amount to be invested must be greater than \$500,000.

Professional investors

Offers can be made to people who are deemed to be a professional investor with an IM as they are excluded from the disclosure requirements. These people include financial service licensees, superannuation funds (or trustees of such fund), listed entities, a body corporate who is in the business of investing, or if they are a foreign company, would be under one of the above if they were Australian.

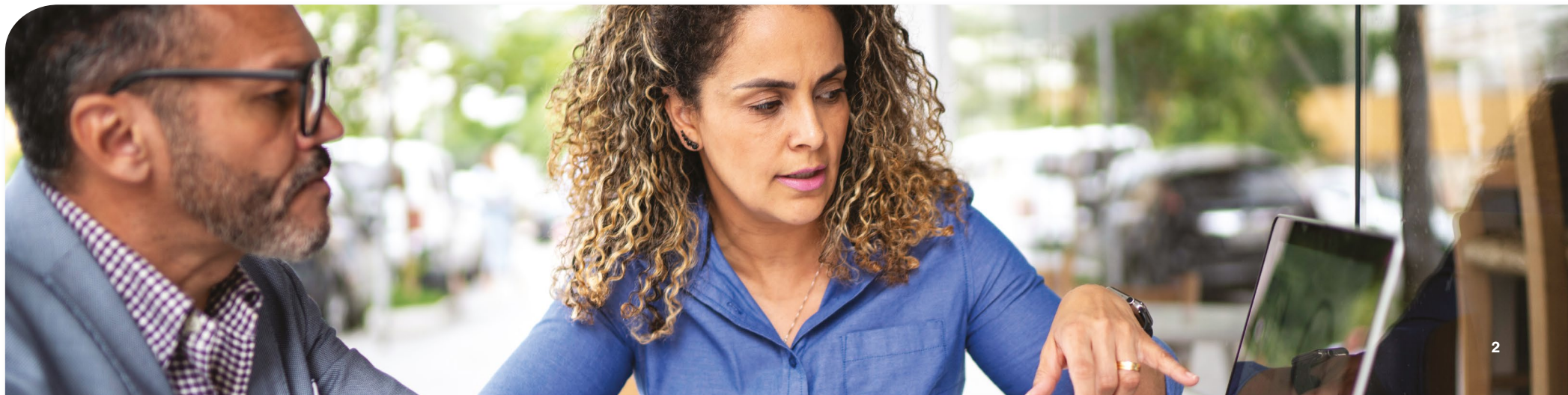
Australian financial service licensee

Offers for investment can be made through financial service licensees, using an IM. The licensee must be satisfied that the person to whom the offer is made has satisfactory experience in investing, which allows for an informed decision regarding the value, risk, and information provided regarding the investment.

Documentation

The documentation provided to potential investors, whether formally or informally, can carry certain legal obligations. It is important that all documentation provided (including financial statements) is an accurate reflection of the business' position at that point in time, as these documents are relied upon by the investor.

Any inaccuracies in these documents could be discovered during a due diligence process, whereby an audit of the business is conducted by the investor. The areas which are investigated include: accounts, pending or potential legal action, contracts, compensation liabilities, intellectual property and business operations.



Legal issues surrounding the negotiation with an investor

The negotiation process with investors can seem overwhelming to business owners when you are preparing to raise capital.

Obligations

During the negotiation process, you have obligations you must be aware of as a business owner. Your obligations during this process are:

- to negotiate in good faith
- transparency and to provide accurate information
- to determine what terms are necessary before commencing negotiation to avoid ambiguity.

The investor, alongside you, has obligations they must meet. Their obligations include:

- to negotiate in good faith
- transparency and to provide accurate information
- to ensure information remains confidential.

Rights

Although most regulations exist to protect the investor during this process, you as a business owner also have rights. Some of your rights include to:

- protect the assets of your business
- have a fair contract which is in the best interest of the business
- ensure information remains confidential.

The investor's rights during this process include:

- right to investigate (due diligence).

During a due diligence process, the buyer is likely to investigate the following:

- financial reports (including balance sheet and profit and loss statements)
- lease arrangements
- stock take
- any relevant licenses applicable to trade
- employment agreements.

Creating the contract

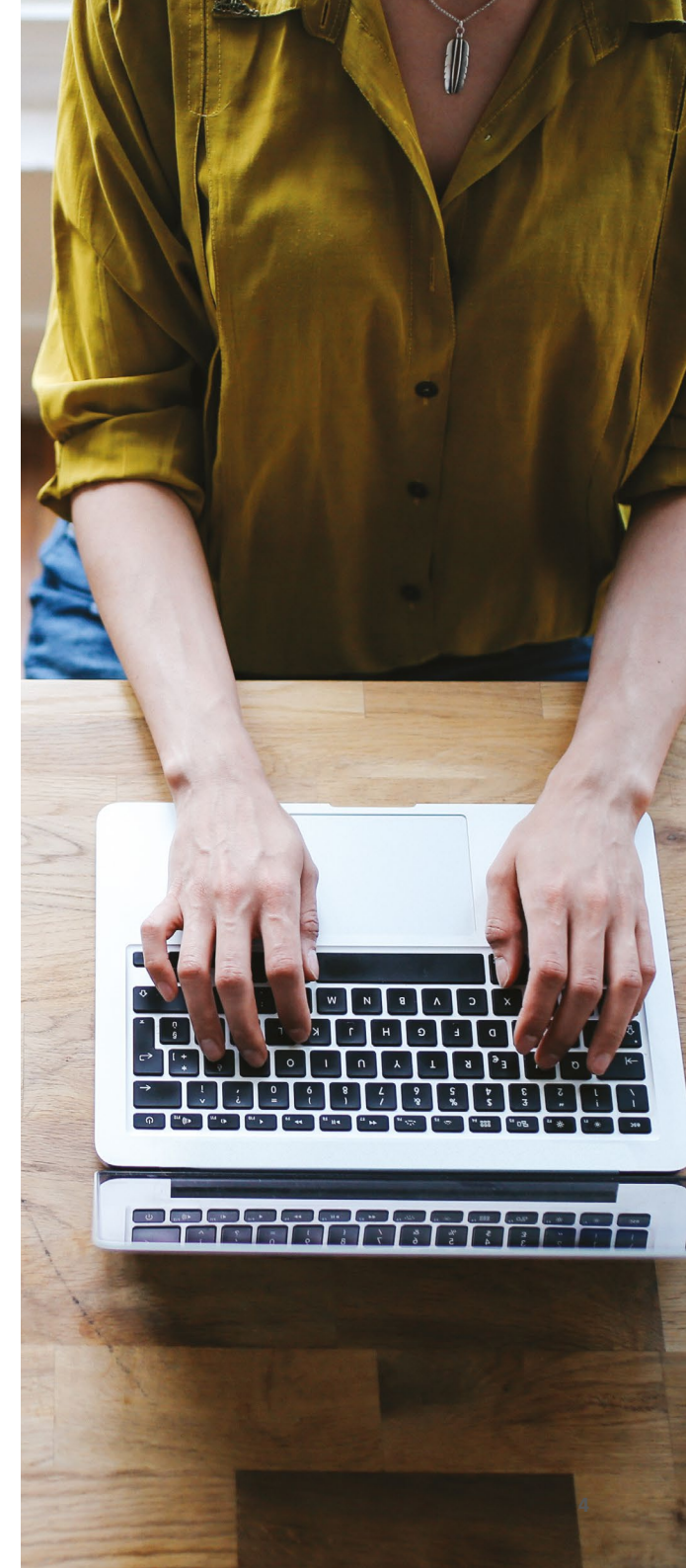
When creating contracts, it is imperative that you have compiled terms which you deem necessary in order to maximise your business' value. You may want to consider the following be included in your term sheet:

- asset protection
- who will pay expenses for the sale
- operational control
- warranties for both you and the investor (which provide protection for potential breach of contract)
- the power, function, and roles of board members
- insurance policies, what they will include and who will pay them
- the governing law in the event of legal action between you and the investor
- confidentiality and data centre agreements
- lease agreements
- ownership of intellectual property
- loan repayment schedules if loans are present
- existing business contracts and whether these will be transferred into the new structure, or the maximum amount of contracts which will be transferred.

The investor will also be prepared with terms they see necessary to maximise the value and protect their investments. While investors will want to include the above terms, they may seek to include the below terms as well:

- golden handcuffs (employment restraints), where key employees are prevented from leaving the business without consequences, such as voiding shares in the company
- for giving loans which have been issued personally
- transferring existing and all new contracts to the new structure
- removing private use of assets.

It is important to engage an experienced legal professional when creating your term sheet to assist you in this negotiation process to ensure you are able to maximise your business' value.



Critical legal documentation for capital raising

Shareholder agreement

When looking to raise capital in a company structure, you will need to ensure you have a shareholder agreement. This contract is made between the shareholders, relating to the operation of the company. Such an agreement will typically include the following subjects:

- issuing new shares
- sale of existing shares
- director's duties, including that of the managing director or partner
- conduct of board and shareholder meetings
- delegation authority of directors
- dispute resolution.

The shareholders agreement can be drafted before looking for external investment or when you begin engaging with investors, based upon your term sheet.

Term sheet

A term sheet is a pre-contractual document. It sets out the key terms of a transaction agreement between parties. A term sheet can also be referred to as a 'heads of agreement' or 'memorandum of understanding'. When an investor decides to invest in your company, they will generally provide you with a term sheet.

This document is generally an informal document, outlining the basic terms under which an investment will be made.

Typically, the term sheet includes the following topics:

- investment valuation
- vesting
- board and control
- employee stock ownership plan
- liquidity preferences
- anti-dilution
- dividends
- legal documents.

Subscription agreement

A subscription agreement is an investor's application to join a company as a shareholder. It is always a two-way guarantee between a company and a shareholder.

A subscription agreement formalises the terms of the investment and specifies:

- number of shares to be issued
- subscription price for those shares
- when the company will issue the shares
- warranties and representations.

The Department of Primary Industries and Regional Development is ready to assist you

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