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SEBI'S LATEST INFORMAL GUIDANCE ON ANGEL FUNDS

AND ITS IMPLICATIONS FOR THE BROADER
ALTERNATIVE FUND INDUSTRY

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Background

On September 17, 2020, the Securities and Exchange Board of India (“SEBI”) issued an informal guidance to Lets Venture Advisors LLP, manager to LV Angel Fund (“**Informal Guidance**”), an angel fund registered with SEBI under the SEBI (Alternative Investment Funds) Regulations, 2012 (“**AIF Regulations**”).

Before delving into what the Informal Guidance states, it would be useful to first refer to some of the relevant provisions of the AIF Regulations.

The AIF Regulations categorizes alternative investment funds (“**AIFs**”) into three categories. The first category of AIFs i.e. Category I AIFs are those which invests in start-ups, early stage ventures, social ventures, SMEs (small and medium enterprises), infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and includes venture capital funds, SME Funds, social venture funds, infrastructure funds and such other AIFs as may be specified.

Angel funds is a sub-category of venture capital fund under Category I AIFs which was subsequently introduced by SEBI in 2013 to boost entrepreneurship for financing small start-ups. Angel funds have been exempted from certain compliance requirements which are otherwise applicable for other categories of AIFs.

The AIF Regulations sets out the conditions which have to be satisfied by an investor who proposes to invest in an angel fund i.e. an angel investor¹. If the angel investor is an individual then one of the conditions prescribed is that the investor must have net tangible assets of at least Rs. 2 crore excluding the value of his principal residence, and if the angel investor is a body corporate then it must have a net worth of at least Rs. 10 crore.

The AIF Regulations also requires the manager of an angel fund to obtain an undertaking from every angel investor proposing to make an investment in a venture capital undertaking, confirming his approval for such an investment, prior to making such an investment (“**Undertaking**”)².

LV Angel Fund’s issues

LV Angel Fund (“**Fund**”) faced certain operational issues in complying with the above conditions. The individual angel investors of the Fund wanted to invest in the Fund through the medium of a limited liability partnership (“**LLP**”) instead of making direct investments taking into consideration succession and estate planning. While each partner of the LLP satisfied the conditions to be qualified as an angel investor, the LLP itself did not meet the criteria of net worth.

¹ Regulation 19A(2) of the AIF Regulations sets out the following definition of an ‘angel investor’:

"angel investor" means any person who proposes to invest in an angel fund and satisfies one of the following conditions, namely,

(a) an individual investor who has net tangible assets of at least two crore rupees excluding value of his principal residence, and who:

(i) has early stage investment experience, or
(ii) has experience as a serial entrepreneur, or
(iii) is a senior management professional with at least ten years of experience;

Explanation: For the purpose of this clause, 'early stage investment experience' shall mean 'prior experience in investing in start-up or emerging or early-stage ventures and 'serial entrepreneur' shall mean a person who has promoted or co-promoted more than one start-up venture.

(b) a body corporate with a net worth of at least ten crore rupees; or

(c) an Alternative Investment Fund registered under these regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

² See regulation 19G(3) of the AIF Regulations.

Also, some of the Fund's investors found it cumbersome and a hassle to provide an Undertaking every time the Fund proposed to make an investment, confirming their approval for such investment. The Investors were happy to waive their rights to approve / disapprove the investment so long as a 'lead investor' gave its consent.

SEBI's Guidance

In its Informal Guidance, SEBI has stated that if the LLP does not meet the minimum net worth criteria of Rs. 10 crore, then it would not be eligible as an angel investor even though each partner of the LLP satisfies the minimum net worth criteria. Though SEBI's guidance on this issue may, at first sight, seem strict, however, it is a fact that an LLP incorporated under the Limited Liability Partnership Act, 2008 is a body corporate and is a legal entity separate from that of its partners. This is similar to a company which is also considered as a separate legal entity from its shareholders. Hence, the minimum net worth criteria stipulated for body corporates cannot be overlooked, unless SEBI provides an exemption. It would not be out of place to mention that LLPs and companies are different from ordinary partnerships under the Indian Partnership Act, 1932 which are not considered as body corporates and do not enjoy perpetual succession³ (though a partnership can be charged as an assessable entity distinct from its partners who can also be assessed individually in light of the provisions of the Income-tax Act, 1961⁴).

On the second issue regarding voluntary waiver of rights by the angel investors, the Informal Guidance responds to the issue by merely stating "*There is no provision in the AIF Regulations which provide for waiver of the said right*".

Implications

It is SEBI's response to the second issue regarding waiver which could have implications for the broader AIF industry. SEBI's guidance on this issue does not seem conclusive. However, going by the response, one may hazard a guess that SEBI does not view such a waiver favourably. This has implications for the broader AIF industry because there may be other provisions in the AIF Regulations or SEBI circulars applicable to other categories of AIFs which gives investors certain rights, which the investors may agree to waive. If a right has been given to an investor presumably for the benefit of the investor, then it seems logical that the investor should also have the ability to waive such a right especially if the investor finds such a right unnecessary or burdensome.

The issue of waiver of statutory rights, however, is not a simple one. Unlike a contractual right which a party can freely waive subject to the terms of the contract, when it comes to the waiver of a statutory right, it has to be seen whether there is an element of public interest involved. As explained by the Supreme Court of India in *Lachoo Mal v. Radhey Shyam*⁵, the general principle is that everyone has a right to waive and to agree to waive the advantage of a law made solely for the benefit and protection of the individual in his private capacity, which may be dispensed with without infringing any public right or public policy. This principle is encapsulated in the legal maxim *cuilibet licet renuntiare juri pro se introducto renunciare*.

If a statute itself prohibits a waiver, then a waiver would not be permitted. Where there is no such express prohibition, it will have to be seen whether a right conferred by a statute is intended to have a more extensive operation as a matter of public policy or public interest. In such a case, waiver would not be allowed.

³ See *Bhagwanji Devraj v. The Union of India*, (1975)16 GLR 357 (Gujarat High Court).

⁴ See *Commissioner of Income Tax, West Bengal vs. A.W. Figgies and Co.*, AIR 1953 SC 455 (Supreme Court).

⁵ *Lachoo Mal v. Radhey Shyam*, AIR 1971 SC 2213 (Supreme Court).

The test to determine whether the nature of interest involved is private or public is to determine whether the right which is renounced is the right of the party alone or of the public also in the sense that the general welfare of the society is involved⁶. If it is a right of the party alone then it is capable of being waived. For instance, in the case of *Lachoo Mal v. Radhey Shyam*⁷, the Supreme Court held that a landlord can waive his/her rights pertaining to eviction of a tenant under a provision of the U.P. (Temporary) Control of Rent and Eviction Act, 1947 as no question of public policy was involved. On the other hand, in the case of *All India Power Engineer Federation v. Sasan Power Limited*⁸, the Supreme Court held that a distribution licensee of electricity cannot waive the pre-conditions for commencing commercial operations which are required to be satisfied by a generating company from whom it procures electricity, as it would affect the tariff which consumers have to pay.

Applying the principles of law discussed above, it has to be ascertained whether a right given to an investor of an AIF under the AIF Regulations is the right of the investor alone or is there an element of public interest and public policy at large involved. In the case of the Undertaking, it can be argued that the right given to an angel investor to approve or disapprove individual investments proposed to be made by an angel fund is really the right of the investor alone and does not affect public interest or public policy at large.

This paper has been written by Adity Chaudhury (Partner).

⁶ See *Indira Bai v. Nand Kishore*, AIR 1991 SC 1055.

⁷ *Lachoo Mal v. Radhey Shyam*, AIR 1971 SC 2213 (Supreme Court).

⁸ *All India Power Engineer Federation v. Sasan Power Limited*, (2017)1 SCC 487 (Supreme Court).

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