



COVID-19: TOUGH ISSUES FOR VENTURE CAPITAL FUND INVESTMENTS

In the survey conducted by 500 Startups, a global venture capital firm, on the members of the startup investor community, majority of investors suggested that COVID-19 will have a negative or somewhat negative impact on early-stage investment activity in 2020. Most of the investors also believe that the impact could last between one and two years.

Sequoia Capital, Silicon Valley's top venture capital firm, has also described the pandemic as "the black swan of 2020" and urged its founders and CEOs to brace themselves for turbulence. Even if some investors see the pandemic as a curse, some will view it as an opportunity. TNB Aura, for example, a Singapore-based venture capital firm focused on Southeast Asian investment, has recently launched a new fund to invest US\$2million in each startup affected by the COVID-19 pandemic.

Regardless of whether venture capital players will change their investment strategies moving forward, the current executed and binding venture capital fund commitments and investments need to be honoured. The following are some of the common concerns raised by venture capital fund managers facing with the Movement Control Order ("MCO") and our general advice on how the concerns may be addressed:

At Venture Capital Fund Level

- **Failure to achieve first closing date** - If the definition of the First Closing Date is not wide enough to cover the situations where the minimum fund size cannot be achieved before the specified date or within the specific duration, fund manager should look for other provision in the document governing the fund (e.g. Limited Partnership Agreement or Constitution) that allows for the First Closing Date to be extended. More often than not, the fund manager needs to obtain the approval of either the investors or the governing bodies of the fund in order to extend the First Closing Date.
- **Restriction on capital call** - Hard copy delivery of the capital call notice may not be possible or will be delayed during the MCO period. As such, if it is allowed by the document governing the fund, capital call notice should, during the MCO period, be given through email.

- **Failure to fulfil capital call** - The MCO and the pandemic may also cause delay or default on the investors' part to make payment in respect of capital call. This is especially true for investors with high level of bureaucracy. To avoid penalty or other consequences of default on calls, the investors may amicably discuss with the fund manager of the cause of delay and seek the fund manager's agreement to extend the notice period, if the same is allowed by the fund document.
- **Commitment and divestment period extension** – More time may be required by the fund manager to find new deals and to divest its current investments. Some deals in the pipeline may also need to be reconsidered due to the change in projections. Typically, the approval of either the investors or the governing bodies of the fund is required for the commitment period or the divestment period to be extended.
- **Restriction for meetings** - Provisions allowing meetings to be conducted by way of telephone and video conference are common in the documents governing fund nowadays. Although some may prefer a physical face to face meeting, the MCO will render such meeting impossible. For the fund to continue with its transactions, all parties must consider holding their meetings, including the meetings of the investment committee, by way of telephone or video conference, if the same is allowed by the document governing the fund.

At Venture Capital Investment Level

- **Failure to fulfil conditions precedent** - Some of the conditions precedent to the investment agreement that, among others, relate to the consents of the authorities and financial institutions may not be able to be fulfilled due to the MCO. If the investment agreement does not contain force majeure clause, depending on the terms of the investment agreement, the parties may request or mutually agree for extension of the conditions precedent period.
- **Restriction for closing** - Closing may, to a certain extent, be affected due to MCO in which shares may not be allotted and the investment amount may not be disbursed. Again, if the investment agreement does not contain force majeure clause, the parties may, depending on the terms of the investment agreement, request or mutually agree for extension of the relevant period.

If the above flexibilities are not built into the existing fund document or investment agreement, depending on the terms of the document, the parties may agree to vary or amend any of the terms of the document in order for the parties to address their issues. Otherwise, the fund, the investor and/or the investee company may seek to exercise other rights and remedies available to them under the fund document or the investment agreement.

In the aftermath of the MCO and the pandemic, startups are expected to suffer from urgent cash flow issues. The assistance from the venture capital players are foreseen to be much needed. Some industries may no longer be lucrative and some others may become more attractive. In this situation, venture capital players may need to reconsider its investment strategies and review the investment objectives and restrictions contained in its fund documents and determine whether the funds are allowed to make the intended new investments.

Important Information

Azmi & Associates has set up Azmilaw Task Force to look into all issues arising from COVID-19 and MCO. Clients are welcomed to contact their usual Partner who will bring their issues to Azmilaw Task Force for our further action.

Prepared by:



Norhisham Abd Bahrin
Partner
Mergers & Acquisitions, Corporate
DL: 603 2118 5016
E: norhisham@azmilaw.com



Hanizah Mohd Huzin
Senior Associate 2
Mergers & Acquisitions, Corporate
DL: 603 2118 5042
E: hanizah@azmilaw.com

We hope that the above discussion is of assistance to you and your company. If your operations or contractual obligations are affected by the COVID-19 outbreak, we are ready to assist you on any queries you have.

Corporate Communication

Azmi & Associates

21 April 2020