

The background of the page features a dark, semi-transparent overlay of various financial charts, including a bar chart on the left and several line graphs in different colors (green, red, blue) across the bottom and middle sections.

ANTI-DILUTION RULES

Authors:

INDEX:

1

Concept of dilution of equity interest.

2

Definition of anti-dilution clause

3

Types of anti-dilution clause:

3.1 Full Ratched.

3.2 Broad Based Weighted Average.

4

Additional clauses to anti-dilution.

4.1 Right of preference.

4.2 Goodwill issue.

5

Conclusion.

1

Concept of dilution of equity interest

agreement of the current partners. There is, thereby, a personal relationship between the parties (company vs. current partners).

In the stock companies, the shareholder who owns the share and this part of the company may sell, transfer, donate – at any time, regardless of the wishes of the other.

The company can also opt for its expansion, adding more partners through the sale of new shares or quotas, and these decisions are signed at shareholder meetings. In such cases, as each partner has a percentage referring to his part of the company, when new members are admitted, there will be a dilution in proportional terms. That is, the dilution of corporate interest is the process by which, proportionally, the fraction (%) that the shareholder has and its weight within the company is proportionally reduced.

2

Definition of anti-dilution clause

The anti-dilution clause is a clause whose main objective is to prevent dilution of the participation of existing shareholders, if new shares are issued in a subsequent round at a price lower than that paid by previous investors (also called down round).

Antidilution can be operationalized in two ways through the Mechanisms of Full Ratchet or Weighted Average.

3

Types of anti-dilution clause

3.1. Full Ratched.

This provision protects investors from dilution caused by new stock issues below that of the investor's original investment.

In this modality, it is guaranteed that the dilution is 0, where the investor can maintain his percentage and original participation without any type of change. In addition, it determines the down round company to hand over a portion of the shares to the shareholder that would have its stake diluted, so that this does not occur.



Thus, it is the most aggressive modality of anti-dilution found in investment contracts, generating a series of disincentives, either for entrepreneurs or for investors themselves. For, when an investor negotiates a full ratched clause, future investors will also try to obtain this protection, thus limiting the company's borrowing capacity, as the sum of all holdings may never exceed 100%.

Because of this, this clause is seen as a strong factor that hinders the growth of startups in the current market. Due to this, other versions of the anti-dilution clause have been developed and among them the broad based weighted average is:

3.2. Broad Based Weighted Average

In this provision, it is prevented the cheapie of the shares of a company in future rounds of investment. In general, it provides that in a down round, the company must recalculate the valuation of the diluted shareholder's shares, issuing, therefore, the shares that the shareholder is entitled to based on its contribution and the new updated issue value.

That is, a broad based weighted average clause does not ensure that the dilution will be zero, but it safeguards the shareholder from reducing the shares.

This clause, when compared to full ratched, manages to support and protect the investor's participation without implying large losses for others involved in the investment. And because of this, she has been seen in a good way by the private equity and venture capital ecosystem.

4

Additional anti-dilution clauses

4.1. Right of preference

The preemptive right guarantees the other partners the preference to be acquired the shares in the case of the credit or subscription of the company's share capital, or in the case of the sale of the shares/shares by one of the partners.

That clause shall determine that the partner, who intends to sell his shares, should notify the others, who have the right to acquire them, so that they can express their interest.

It should be observed the concrete case, the advantages and disadvantages of and its applicability, since the triggering of this right can make the acquirer a majority partner, and may even change the power of control of the company.

It is generally used in a way that ensures corporate stability, not allowing a terminated partner to gain full control of the company. Nessthe clause is free for the parties to establish hypotheses in which the preference will not be admissible, such as in cases of transfer between companies of the same economic group resulting from a corporate restructuring.

4.2. Goodwill issue.



When a company increases its capital (issuing new shares), it can sell them at its nominal value (or fixed on the issue), or with a profit, that is, with a surplus. This surplus/profit is called goodwill.

In limited companies with nominal value quotas, it is necessary that the premium of the subscription is placed in the capital reserve. And, according to the value of the quotas, a new partner may be directed to control the company. However, in the vast majority of cases, when there is an excessive increase in capital, the limited company is changed to anonymous, in order to avoid tax and other taxes.

Goodwill, therefore, is an additional amount charged by companies in the issuance of shares.

5

Conclusion

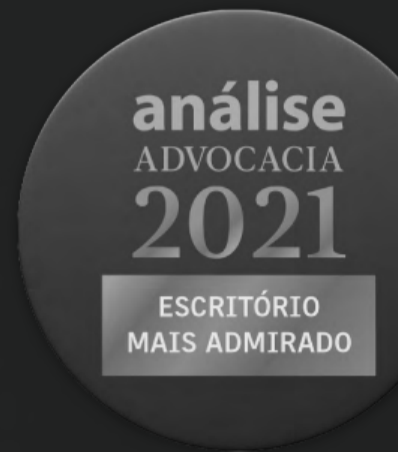
As provided, it was demonstrated the extreme importance in the stipulation of clauses that protect the enterprise, either against the dilution of actions or other cases not foreseen at the beginning of the operation, but that can happen during any phase of the project and in its corporate relations.

Thus, it is essential to evaluate its legal and financial aspects, through the assistance of a specialized professional, thus avoiding the devaluation of investments. And while expansion is an extremely important factor for business growth, there are numerous legal alternatives that can help and protect those involved from further losses.

We at Campos Thomaz & Meirelles have as main objective to give all the necessary support to companies in all practices related to business law. We offer complete advice to Brazilian clients and multinational groups in all aspects of corporate life.



Our recognitions



Análise
Advocacia (2021)



Chambers & Partners
Brazil (2021 & 2022)



Leaders League
(2021 & 2022)



Transactional
Track Record
(2021 & 2022)



The Legal
500 (2022)

Meet our Partners



Alan Campos Thomaz

Partner

Technology & Digital Business, Privacy and Data
Protection, Fintechs and Intellectual Property

at@camposthomaz.com

+55 11 9 8375.2627 +1 (650) 6436652



Sérgio Meirelles

Partner

Corporate, M&A, Venture Capital
and Wealth

sergio@camposthomaz.com

+55 11 9 7551.9865



Filipe Starzynski

Partner

Litigation & Law Enforcement, Civil,
Real State, Labor and Family

filipe@camposthomaz.com

+55 11 9 7151.9639



Juliana Sene Ikeda

Partner

Intellectual Property, Technology,
Agreement and Life Sciences

juliana@camposthomaz.com

+55 11 9 8644.1613



Follow us



Subscribe to our newsletter