



301-302, 3rd Floor, Delhi Blue Apartments, Main Ring Road, Near Safdarjung Hospital, New Delhi-29
Tel: +91-11-40755716/17 Fax +91-11-41628863 Web: www.indiavca.org

December 18, 2009

The Securities and Exchange Board of India
Bandra Kurla Complex
Mumbai.

Dear Sirs,

Re: Our discussions qua investment by a DVCF into an LLP

We thank you for sparing time to meet us to discuss the subject of permitting Domestic Venture Capital Funds ('DVCFs') to invest in Limited Liability Partnerships ('LLPs'). During the course of the meeting, you had sought certain clarifications, which have been provided herein below -

1. Should DVCF be only a "limited partner" in an LLP? Should it be permitted to become a "designated partner" in an LLP?

An issue that was discussed was the need for a DVCF, as an investor, to take control of the LLP in the event of default by the promoter. In such a situation, the DVCF may be required to be registered as a "designated partner" of the LLP. You had sought a clarification on whether DVCF's involvement needs to be restricted to being a "limited partner" or can it be extended to DVCF being registered as "designated partner"?

LLP Act provisions

Section 28(1) of the Limited Liability Partnership Act, 2008 ('LLP Act') provides that a partner is not personally liable for an obligation of the LLP. The liability of the partner is thus, restricted to his capital contribution.

Further, section 7(1) of the LLP Act provides that every LLP shall have at least two "designated partners" and at least one of them shall be a resident of India. The term "designated partner" has been defined by section 2(1)(j) of the LLP Act to mean any partner designated as such pursuant to section 7.

The term “resident in India” has been clarified vide Explanation to section 7(1) to mean a person who has stayed in India for a period of not less than 182 days during the immediately preceding one year. However, in case of a LLP in which all partners are bodies corporate or in which one or more partners are individuals and bodies corporate, then, the proviso to section 7(1) provides that at least two individuals who are partners of the LLP or nominees of such bodies corporate shall act as designated partners.

The liability of a designated partner is also limited except that a designated partner is additionally liable to all penalties imposed on the LLP for contravention of any provisions of the LLP Act.

Thus, assuming a DVCF can be registered as a partner with an LLP, then, it should be, if a situation may so require, nominate any person to act as a “designated partner”. If there is perceived risk of unlimited liability being imposed on a DVCF, then, either, there could be a requirement for a DVCF to appoint a Chartered Accountant or another professional to assist in compliance of provisions of the LLP Act or the DVCF be required to incorporate an SPV to be appointed as a “designated partner”.

2. Manner of contributions made by partners to an LLP

During the course of our discussions, you desired to comprehend the manner in which contributions will be made by a DVCF to an LLP i.e. whether as equity or as debt.

LLP Act provisions

As per Section 32(1) of the LLP Act, a contribution by a partner may consist of tangible, moveable, immovable or intangible property or other benefit to the LLP, including money, promissory notes, other agreements to contribute cash or property and contracts for services performed or to be performed. Further, Section 66 mentions that a partner may also lend monies to the LLP and would have the same rights and obligations with respect to the loan as a person who is not a partner i.e. as a creditor.

Thus, under the LLP regime, partners could contribute monies either by way of capital or as a loan to the LLP.

SEBI DVCF Regulations envisage situations wherein the DVCF could invest in a VCU either by way of equity or as debt. Whereas equity funding to a VCU is counted towards 66.67% criteria, debt funding is included as a part of the 33.33% limit. Further, debt funding is permitted provided DVCF has invested into the equity of the VCU.

Considering that capital contribution by partners in an LLP is akin to investment in equity, investment by DVCF as capital contribution or for acquisition of capital contribution / partnership

interest in an LLP should be covered within the 66.67% category. Further, any loans advanced by the DVCF to the LLP should be covered within the 33.33% limit.

3. How will DVCF exit from the LLP i.e. what are the available avenues for disposing the stake in the LLP?

During the course of our discussions, you desired to comprehend the manner in which the DVCF will exit from LLP and related exit options such as listing of the LLP in future, etc.

LLP Act provisions

Section 3(2) confers perpetual succession to an LLP. Further, section 42(1) of the LLP Act recognizes the right of a partner to transfer either wholly or in part the right to share profits and losses of the LLP and the right to receive any distributions in accordance with the LLP agreement. Thus, the partnership interest in an LLP is transferable, in a manner akin to transfer of equity shares of a company.

There are no provisions under the LLP Act prohibiting listing of partnership interest. However, the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 envisage listing only of equity shares and convertible securities [refer sub-section (zj) of section 2(1)]. Thus, DVCF could exit from an LLP by way of sale of partnership interest to another investor.

Alternatively, where the LLP has sufficient cash, the DVCF could withdraw the Capital or apply for cessation of its partnership interest and withdraw the sum standing to its Capital Account.

4. Manner of accounting for capital contribution/loan in the books of the LLP

During the course of our discussions, you wanted to know the manner in which the LLP will account for capital contributions/loan received from the DVCF.

LLP Act provisions

Section 32(2) of the LLP Act mentions that the monetary value of contributions of each partner shall be accounted for and disclosed in the accounts of the LLP in the manner as may be prescribed. Rule 23(1) of the Limited Liability Partnership Rules mentions that the contribution of each partner shall be accounted for and disclosed in the accounts of the LLP along with nature of contribution and amount. Rule 23(2) further mentions that where the contribution of a partner consists of tangible, movable or immovable or intangible property or other benefits brought or contributed by way of agreement or contract for services, it shall be valued by a practicing Chartered Accountant or by an approved valuer from the panel maintained by the Central Government.

Rule 24(1) casts an obligation on every LLP to maintain appropriate books of accounts. Further, Rule 24(4) mentions that every LLP shall file a Statement of Account and Solvency in the prescribed form (Form 8) with the Registrar within a prescribed period. A perusal of the 'Statement of Account' section of the Form suggests that the contribution of partners is accounted under the sub-head "Partners Funds" under "Contribution and Liabilities".

As regards loan from partner, section 66 of the LLP Act discussed above envisages a loan and regards the partner as an ordinary creditor. Such loans could be accounted as secured/unsecured loan in the financials of the LLP.

Our request

We trust the above clarifies all the issues/queries raised in the course of our meeting. Considering the enormous advantage that the permissibility of DVCF investment into an LLP would confer on the venture capital industry, we would like to humbly request you to consider the representation in favourable light.

Thanking you,
Yours sincerely,



Mahendra Swarup
President – IVCA

