Venture capital investment in Ireland: market and regulatory overview

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Market overview

1. What are the main characteristics of the venture capital market in your jurisdiction?

Venture capital and private equity

In Ireland, venture capital (VC) is a subset of private equity and typically refers to the provision of capital for early stage companies with a high growth potential. The term is also used to capture the provision of development capital to mature companies at a later stage in their corporate life cycle. VC investments are most often characterised by an unsecured equity investment for a minority stake. Typically, investee companies are unquoted, small to medium sized enterprises and investment occurs before the investee company has certain or predictable cashflows. It is not common for a VC investment to be financed by third party debt.

By contrast, private equity investors generally invest for a controlling stake in a business, with a more defined exit strategy (typically within a range of between five to seven years). Private equity investment usually occurs in more mature, cash generative companies with established business models, to finance expansion, consolidation, turnaround and ultimately a disposal. Generally speaking, a private equity investment will be leveraged via debt funding.

Market trends
According to research carried out by the Irish Venture Capital Association (IVCA), VC investment in Irish companies grew 11% in 2019 to EUR820 million in aggregate (increasing from EUR740 million in 2018).

The general trend for 2019 was that there was a decrease in larger transactions, but a corresponding increase in lower value deals below EUR10 million.

There was a significant rise in the number of deals valued between EUR5 and 10 million, from EUR37 million in 2018 to EUR102 million in 2019 (an increase of 175%).

There has also been a significant increase in lower value deals:

- In the EUR1 million to EUR5 million category, the value of deals is up 50% and the volume of such deals up by 59% on last year, increasing from EUR154 million in 2018 to EUR230 million in 2019. The volume of companies raising in this category increased from 71 in 2018 to 113 in 2019.
- There has also been a strong increase in seed funding, up 55% year on year from EUR49 million in 2018 to EUR76 million in 2019.

The IVCA research indicates that the main benefactors of VC investment in 2019 were software and ICT (accounting for 39% of all VC funding); life sciences (20%), cybersecurity (13%) and Fintech (9%).

Notable transactions for the year include:

- A EUR66 million round completed by the Irish Fintech company, Fenergo.
- The successful USD30 million round by home diagnostics start-up LetsGetChecked.
- A EUR23 million raise by Future Finance; and the USD15 million raised by Cybersecurity firm, Tines.

Sources of funding

A common path for early stage companies in Ireland is to obtain funding from Enterprise Ireland (EI). EI is a public government initiative responsible for the development and growth of Irish enterprises in global markets. EI has committed up to EUR175 million as a cornerstone investor to VC funds under the Seed & Venture Capital Scheme 2019 to 2024. EI directly invested EUR24 million in Irish entities in 2019 and supported a total of 127 companies. Investment is provided through EI’s High Potential Start-Up (HPSU) and Competitive Start Fund (CSF) programmes. In 2019, PitchBook's 2019 global ranking (which is based on annual deal count) placed EI second in terms of top VC investors in global seed funding, and first in Europe.

Typical sources from which early-stage companies obtain funding include:

- Enterprise Ireland (notably the CSF and HPSU funding programmes).
- Venture capital firms (Irish and international).
- Private investors (business angels or families).
• Early stage incubation centres and accelerator programmes hosted by Irish universities and institutes of technology.
• Family offices.
• Crowdfunding.

Types of company

VC investment is typically provided to companies with strong prospects for scale and growth, often with underdeveloped or developing products and revenues at an early stage in their corporate lifecycle. Attractive sectors for VC investment in Ireland currently include software and ICT, life sciences, Fintech, cybersecurity, health and biotech, envirotech and manufacturing.

There is also a growing interest in VC investment in Ireland for companies exploring increasingly technical issues such as startup companies who aim to provide technology based on substantial scientific advances and high tech engineering innovations. This sector has attracted investors with companies tackling challenging and complex fields like artificial intelligence, blockchain and autonomous systems.

Standardised investment terms

There is no standardised set of investment documents used in Irish VC transactions. Occasional reference is made to provisions in the UK-based BVCA standardised documents for early stage VC investment, but they would not be commonly adopted or used as the base terms for a VC transaction in Ireland.

Tax incentive schemes

2. What tax incentive or other schemes exist to encourage investment in portfolio companies? At whom are the schemes directed? What conditions must be met?

Employment investment and incentive scheme

The EII is a tax incentive, which provides for tax relief of up to 40% in respect of investments made in certain corporate traders. The EII allows individual investors to obtain income tax relief investments made in each tax year into EII certified qualifying companies. Changes introduced in Finance Act 2019 increased the annual investment limit from EUR150,000 to EUR250,000 and to EUR500,000 for investments of a minimum of ten years. The Finance Act 2019 also provided a substantial change by which full relief will be available in the year in which the investment is made. Currently relief is given in two tranches, 30% in the year of investment and 10% in year three, subject to where the company concerned has increased its number of employees or its expenditure on qualifying research and development.
An investor cannot be connected with the company. Connected, in this context, includes situations where the individual or a relative of the individual (a spouse, civil partner, ancestor, lineal descendant or sibling):

- Is in partnership with company, or any company in the investee group.
- Is an employee or director of the company, or any company in the investee group, and receiving (or being entitled to receive) any payment other than those that a third party would receive in the same position.
- Has an interest in the capital of the company. A person has an interest in the capital of the company if they do, or can, hold any of the issued share capital, loan capital, voting rights or rights to assets on a winding up, subject to two exceptions:
  - if the only "interest in the capital of a company" that a person has is shares that were raised as part of an EII supported fundraising and that person is not under the control of the company. This means that third party EII shareholders, and their family, can continue to make EII investments in a company which they do not control;
  - if the only shares the person holds are founder shares (for example, the EUR100 subscribed on foundation of the company), the company has not issued any other shares and the company has not yet commenced any business activity.

**Carried interest and venture capital funds**

Section 541C of the Taxes Consolidation Act 1997 (as amended) provides an attractive tax regime for Irish VC fund managers. The legislation treats the carried interest received by VC fund managers from investment in relevant companies as chargeable gains and charges those gains at a special 12.5% rate for companies and a 15% rate for individuals or partnerships.

"Carried interest" is the share of profits, excluding those profits attributable to investors by reference to an initial rate of return, received by an individual, company or partnership for managing the relevant investment (the share ratio having been agreed at the outset). The regime applies in respect of carried interest received from a qualifying VC fund, which requires the fund to be structured in the form of a limited partnership, where all of the following apply:

- The main purpose of the partnership is to make investments in unquoted shares or securities of a private trading company that the partnership will hold for at least three years.
- The investee company carries on a business of research and development activities or the development of new technological, telecommunication, scientific or business processes.
- The individuals, companies or partnerships that invest in the fund are either limited or general partners and they are legally obliged to provide capital sums for investment purposes over a period of time.

**Funding sources**
3. How do venture capital funds typically obtain their funding?

VC funds obtain their funding from a number of public and private sources.

A significant amount of VC derives from other Irish and European-backed institutions including the:

- Ireland Strategic Investment Fund (ISIF), an Irish State-supported fund mandated to invest to support economic activity and employment in Ireland.
- European Investment Bank (EIB).
- European Investment Fund (EIF).

As noted in Question 1, Sources of funding, EI has also committed up to EUR175 million as a cornerstone investor to VC funds under the Seed & Venture Capital Scheme 2019 to 2024.

Private investment is also obtained from a number of sources including:

- High net-worth individuals.
- Family offices.
- Corporate investors.
- Sovereign wealth funds.
- Pension funds and insurance companies.

It is common for Irish VC funds to contain a combination of public and private funding from the sources listed above.

**Fund structuring**

4. What legal structure(s) are most commonly used as vehicles for venture capital funds?

The most common legal vehicle used for VC funds is a limited partnership (LP). In Ireland, LPs are typically governed by the Limited Partnerships Act, 1907 (The LP Act), although Ireland also has a regulated LP vehicle, regulated by
the Central Bank of Ireland (CBI), known as an ‘investment limited partnership’ (ILP), which is governed by the Investment Limited Partnerships Act, 1994.

An LP is constituted pursuant to a limited partnership agreement (LPA) entered into by one or more general partner(s) (GPs) on the one hand, and any number of limited partners (the investors) on the other hand. An LP is not incorporated and does not have separate legal personality. All of the LP’s assets and liabilities belong jointly to the partners in the proportions agreed in the LPA.

The GP is responsible for managing the business of the LP and, as the LP does not have the power to enter contracts in its own name, the GP usually enters into contracts on its behalf. The GP has unlimited liability for the LP’s debts and obligations (although the GP will typically be a newly incorporated, limited liability company).

A limited partner’s liability is generally limited to the value of the capital it contributed or which it has undertaken to contribute, to the LP, save where the LP takes part in the management of the business of the LP (in which case, it is possible for the limited partner to lose its limited liability status). In this regard, while limited partners do not typically play a role in the management of the LP, it is usual for limited partners to participate on advisory committees which advise the GP on specific issues during the lifetime of the LP.

An LP is transparent from an accounting and taxation perspective and is not subject to Irish company law. There are also fewer public filing requirements for an LP than a company.

5. Do venture capital funds typically invest with other funds?

Co-investment between VC funds is common in Ireland. This form of syndication can occur both with indigenous VC funds investing together and those investing with an international VC partner.

Investment objectives

6. What are the most common investment objectives of venture capital funds?

The duration of an Irish VC fund is typically between eight and ten years, comprising of a period of investment (about four to five years from establishment of the fund) and a realisation period of similar duration in which the VC fund seeks to dispose of its investments for a significant profit.

Typically, an Irish VC fund seeks to make at least a threefold return on its investment, and to return the net proceeds to its own investors.
The timeframe within which a fund would seek to exit its investment depends on a number of factors, including the type of investment, the valuation of the portfolio company, the industry in which the fund is investing and the state of the market during the investment and exit periods. A typical holding period is about five or six years.

7. Can the structure of the venture capital fund affect how investments are made?

Investments in Irish portfolio companies are typically made directly by the VC fund (as a limited partnership, see Question 4) or through a special purpose vehicle held by the fund. The structure does typically impact how an Irish VC investment is made in an investee company. The investment is generally made by way of share subscription (often contained preferential rights to ordinary shareholders) or via convertible loan notes.

**Fund regulation and licensing**

8. Do a private equity fund’s promoter, principals and manager require authorisation or other licences?

Although an LP and its GP are not typically subject to regulatory authorisations or registrations, most VC funds will meet the broad definition of an "alternative investment fund" or "AIF" under the European Union (Alternative Investment Fund Managers) Regulations 2013 (the Irish legislation that transposed Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) into Irish law).

Where this is the case, the VC fund, or AIF, will be required to appoint an "alternative investment fund manager" or "AIFM" (as defined under AIFMD) and it is the AIFM that will be subject to regulatory authorisation or registration. The AIFM can perform the portfolio management function in respect of the VC fund itself or it can delegate this function to another entity (including the GP) and in most instances, depending on the assets under management of the AIFM, any such delegate will be required to be authorised or registered for the purpose of asset management in its home jurisdiction.

9. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?
Most VC funds are structured as LPs pursuant to the LP Act. While the vehicle (or LP) itself is unregulated, where the LP meets the definition of an AIF under AIFMD (which is typically the case), the LP is required to appoint an AIFM and the AIFM will typically be the regulated entity in the structure. Where the AIFM is authorised (as opposed to registered) under AIFMD, the authorised AIFM will be subject to AIFMD in full and the LP can be marketed on a pan-European basis under the AIFM’s AIFMD marketing passport.

Under the AIFMD marketing passport regime, the CBI typically has 20 working days within which to transmit a complete passport application to the regulator of the EU member state in which it is proposed that the AIF be marketed and on transmission of the passport application, the AIF can be marketed in that member state to investors who are considered to be "professional clients" or can, on request, be treated as such within the meaning of Annex II to Directive 2014/65/EU (MiFID II).

Where a registered AIFM ("sub-threshold AIFM") is appointed in respect of the LP or AIF, the registered AIFM will generally be unable to use the AIFMD marketing passport. A registered AIFM is an AIFM whose assets under management in respect of its AIFs:

- Do not exceed EUR100 million (including assets acquired through the use of leverage) or
- Do not exceed EUR500 million where its AIFs are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

However, where the LP or AIF meets the criteria of a "qualifying venture capital fund" and has a registered AIFM managing less than EUR500 million in unleveraged AIFs with five year lock-in periods, the European Venture Capital Fund Regulation (Regulation (EU) No 345/2013) may permit the registered AIFM to benefit from an EU-wide marketing passport for its qualifying fund, without the registered AIFM needing to opt-in and comply with AIFMD in full.

Where the above referenced marketing passports are unavailable (such as where the VC fund is not an AIF), the VC fund would need to be marketed through the national private placement regimes of each relevant jurisdiction.

10. How is the relationship between investor and fund governed? What protections do investors in the fund typically seek?

In addition to the LP being subject to The LP Act, the relationship between the investors (or limited partners) and the fund (or LP) will be governed by the LPA constituting the LP. The LPA will contain provisions in relation to the general governance of the LP and detailed provisions relating to the relationship between the investor and the fund, including:

- Information in relation to the investment policy and investment restrictions of the LP and the circumstances in which these may be amended.
- Details of the information that is to be provided to the investors and the circumstances in which the GP must engage with the investors before making a decision in respect of the LP.
• Provisions relating to dealing mechanics, such as the rules relating to the drawdown of the investors' commitments and the investors' redemption rights.

• Provisions to deal with defaulting investors who, for example, do not adhere to a drawdown request and/or do not provide funds to the LP within stated time limits.

• Provisions relating to the role, powers and duties of the fund manager and/or the GP, the fees payable to these entities and the way in which their respective appointments may be terminated.

• Provisions in relation to the division of the assets and/or profits of the LP amongst the investors, the GP and/or the fund manager.

**Interests in portfolio companies and securities regulation**

11. What form of interest do venture capital funds take in an investee company? Are there any restrictions on direct investment in a company's equity securities by foreign venture capital funds? What regulations govern the offer and sale of securities in venture capital transactions?

**Forms of interest**

VC funds will typically invest by way of preferred equity. In the case of seed stage companies where financial viability is uncertain, or where a valuation decision is deferred to a later stage, an alternative form of investment is by way of convertible loan notes. Convertible loan notes operate by converting shares into the same class as other investors on a funding round but are offered at a discounted price. If no subsequent funding round takes place, the loan notes convert into ordinary shares. Convertible loan notes can be either unsecured or secured on the assets of the company and can enjoy a coupon rate on the principal amount of the loan which ensures a current return for the VC fund.

Warrant instruments can be issued by the investee company as a form of interest. This grants a right to the holder to subscribe to a specific class of share(s), on a specific date or prior to an exit. The advantages of warrants are that it allows the investor to assess the investee company's success of the business before committing funds.

Debt investments or a mix of preferred equity and debt are common.

**Restrictions on direct investment**

No restriction exists in Ireland on direct investment in a company's equity securities by foreign VC funds and there are no restrictions on the foreign ownership of shares in Irish companies. Government policy encourages foreign investment, and the tax regime can be attractive depending on the structure used.

**Securities regulation**
Securities regulations are not triggered by the offer and sale of shares in a private company as it does not usually constitute an offer of securities to the public. Therefore no filings are required other than in the registers of the investee company.

**Valuing and investigating investee companies**

12. How do venture capital funds value an investee company?

As VC funds typically invest in early-stage companies without a strong history of revenue and profitability, the methodology for valuations of investee companies is generally not an exact science. Much focus is put on the prospect of growth of the relevant company by reference to tangible categories including the company’s products, the market (including any entry barriers to market) and the strength of the management team. The valuation is often the source of negotiation between the founders/shareholders and VC funds with plenty of focus placed on the level of dilution post-completion. The VC firm will typically seek to strike a balance between obtaining an attractive valuation and retaining a reasonable shareholding for the founders to ensure they are suitably incentivised to scale and grow the company’s business in line with the VC firm’s expectations.

As a rule of thumb, the valuations are generally set in euros irrespective of the origin of the investor, but it is not wholly uncommon to be set in US dollars (USD) where the investor is from the US.

13. What investigations do venture capital funds carry out on potential investee companies?

In carrying out due diligence, VC funds will generally look at the financial statements and projections, IP rights, employment arrangements with key employees and contracts with key customers and suppliers.

The level of diligence is often dictated by the size of the investment. If it is on the larger end of the scale, the venture capital fund will often conduct a broader due diligence exercise engaging legal, tax and other professional advisers. Extensive warranties will generally be sought from the founders and the investee company. The aim of these warranties is to extract further information in respect of the risks associated with the investee company.

**Legal documentation**
14. What are the principal legal documents used in a venture capital transaction?

If the investment occurs by way of a share subscription, the primary legal document is a subscription and shareholders’ agreement (SSA) which oversees the relationship between the shareholders. Occasionally, these are split into two separate documents:

- A subscription agreement dealing with the mechanics of the subscription and any warranty protection to be given.
- A shareholders’ agreement regulating the ongoing business of the company and the relationship between it and its shareholders.

The main protections required by VC investors in Ireland typically include board appointment rights, veto rights, information rights, protection of goodwill/restrictive covenants from the founders and covenants regarding the business and operation of the company.

Warranties given by the company and the founders in favour of the incoming investor also form part of the SSA. It would be typical for the warrantors to be permitted to provide a disclosure letter setting out the exceptions to these warranties (and thus, if disclosed to a suitable threshold, will insulate the warrantors from liability for such exceptions).

The relationship between the company and the shareholders is governed by the constitution of the company which sets out the rights attaching to the different classes of shares in the capital of the company, the rights in respect of share issues and transfers, and board and shareholder meetings. This is the only document that will be available to the public and requires filing with the Irish Companies Registration Office.

If the investment is made by way of a convertible loan note, an investment agreement will be put in place between the shareholders and loan note holders. The investment agreement will have similar terms to an SSA as set out above. A disclosure letter and loan note instruments providing for the rights attaching to the loan notes will also be required.

An investor will generally also require the management team to enter into robust contracts of employment, if not already in place.

**Protection of the fund as investor**

**Contractual protections**

15. What form of contractual protection does an investor receive on its investment in a company?
The SSA typically contains a number of contractual protections for a VC investor, including:

- Consent/veto rights under which certain specified matters cannot take place without the prior written consent of the investor. The scope of the veto rights is often heavily negotiated, but typically a minimum level of protection from the investor will be required to capture will include the following:
  - the issue by the company of any new shares or securities convertible into shares;
  - the amendment of the constitution of the company or any of the rights attaching to any of the shares;
  - any material change to the nature of the business of the company;
  - the disposal of any material assets (including intellectual property) of the company, or the making of a material acquisition;
  - the making of any loans or borrowings, and the creation of any security or other encumbrance over the assets of the company;
  - amendment or adoption of the business plan; and
  - entering into any litigation (other than routine debt collection).

- Protective covenants regarding the running of the business at arm’s length and in the ordinary course.

- Information and access rights, including access to annual audited financial statements and monthly or quarterly management accounts.

- Warranties in connection with the company’s share capital and the key aspects of its business (although warranty claims are rarely made as the claim will affect the investment’s value and damage the relationship between the investor and the founders).

- Anti-dilution protections against any future down-rounds, often involving the issue of further shares to the VC fund paid-up from profits (for example, share premium accounts or subscription at par (low nominal value)).

**Forms of equity interest**

16. What form of equity interest does a fund commonly take (for example, preferred or ordinary shares)?

The most common instrument issued for VC investments in Ireland is a share with certain preferential rights (for example, preferential returns, anti-dilution protection, conversion and redemption rights). VC funds may also invest by way of convertible loan notes or warrant instruments.
Preferred shares

17. What rights does a fund have in its capacity as a holder of preferred or preference shares?

These can vary depending on the VC fund involved in the transaction. The most typical rights attaching to a preference share that a VC fund would seek include:

- Fixed preferential dividend (generally a percentage of the subscription price per annum on a cumulative basis).
- Priority on distribution of proceeds of any liquidation or deemed liquidation. The holder receives a return on its original investment, in priority to all other shareholders and a pro-rata balance of any exit proceeds.
- Redemption rights.
- Conversion rights.
- Voting rights equivalent to ordinary shares.
- Anti-dilution protections against any future down-rounds.

Management control

18. What rights are commonly used to give a fund a level of management control over the activities of an investee company?

Most VC investors will require a contractual right to appoint at least one individual to the board of directors of the investee company (and each subsidiary of it), with an option to appoint an observer to attend (but not vote) at board meetings. The number of board appointees will often be determined based on the level of shareholding of each investor.

It would also be typical for a VC investor to have a suite of veto rights (see Question 14 and Question 15), which generally cover fundamental or material management decisions and any non-ordinary course matters.

Share transfer restrictions
19. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation or the company’s organisational documents?

It is common for there to be restrictions on transfers of shares by the founders. Occasionally, these restrictions will include a "sunset provision", so that they cease to apply after a certain period of time.

Any transfer to which the investor consents will usually remain subject to extensive pre-emption rights in favour of the investor. Even if the pre-emption rights are not exercised, and the sale is permitted, the investor may still trigger the tag along right.

Investment documentation often contains good leaver/bad leaver, tag along, drag along and pre-emption on transfer provisions. The percentage threshold at which the tag becomes exercisable can be set at an appropriate level so that small transfers do not trigger the tag.

20. What protections do the investors, as minority shareholders, have in relation to an exit by way of sale of the company?

Often investors will totally preclude founders/key individuals in the business from selling any shares, unless the investor consents otherwise. The rationale is to ensure that the key drivers of the business remain fully focussed on the job of running the company, but also to ensure that an exit for the investor can be linked to a founder's exit. There would often be carve-outs from these restrictions for transfers between permitted transferees such as such as family members, trusts or to related corporate entities.

In addition, the VC investor will typically benefit from tag along and drag along rights.

Further protection is also provided through pre-emption or veto rights on founder transfers, which seek to ensure an exit for investors is linked to a founder's exit.

**Pre-emption rights**
21. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

Yes, VC funds typically require both standard “offer-round” pre-emption rights and also generally require a veto right over the allotment of shares (other than certain permitted categories of share issues prescribed in the investment documentation).

Consents

22. What consents are required to approve the investment documentation?

The board of directors of an investee are required to approve the entry into the documentation required to complete the investment and, if applicable, the allotment of shares to the investor.

Typically, it is also necessary to amend the company’s constitution to include the various preferential rights required by the investor (including the those set out in Question 17). Any such amendment to the constitution will require approval of at least 75% of votes cast in person or by proxy by shareholders entitled to vote.

In most cases, the existing shareholders will have standard pre-emption on allotment rights which will need to be waived in respect of the investment.

• It is important to review any pre-existing shareholders’ agreements, the constitution and any banking or other agreements of the company to determine if any other consents, approvals or amendments are required pre-completion.

Costs

23. Who covers the costs of the venture capital funds?

Costs made by the VC investor, including legal expenses and due diligence costs, will normally be paid by the investee company. An agreed cap on such costs is usually contained in the initial term sheet signed by the parties.
Portfolio company management

24. In what ways are founders and employees incentivised? What are the resulting tax considerations?

Incentives

Employee share option plans (ESOP) are often used to incentivise existing employees and attract new talent. Management can be incentivised through cash bonus arrangements.

Tax

**Cash bonuses.** Tax is paid on cash bonuses through the PAYE system at an approximate cumulative rate of up to 52% (40% income tax top marginal rate, 8% Universal Social Charge (USC) for PAYE income over EUR70,044 and employee social insurance (PRSI) at 4%). Employer PRSI would also be applicable at the rate of 10.75%.

**Subscription of shares.** If a founder or an employee subscribes for shares at a price below the market value, income tax, employee PRSI and USC are payable on the difference between the market value of the shares and the subscription price paid. Capital gains tax (CGT) at 33% will be payable on any profit gained on disposal of the shares.

**Exercise of options.** If options are exercised, income tax, USC and PRSI are chargeable on the difference between the exercise price plus the paid for the grant of the option, and the market value of the shares at the date of exercise of the option.

**Assignment/release of options.** In the case of assignment or release of options, income tax, USC and PRSI are chargeable on the difference between the consideration received for assignment or release less the price paid for grant of the option. There are no employer withholding obligations, but employers must give notice of the following events to Revenue Commissioners by 31 March in the year following the income tax year in which the relevant event occurs:

- Grant of an option or other right, which may become subject to tax.
- Allotment of any shares or transfer of any asset under the option or right.
- Provision of any consideration for the assignment or release of the option or right.
- Receipt of written notice of the assignment of any option or right.

Income tax, USC and PRSI are payable by the employee, at the same rates as cash remuneration, within 30 days of the exercise of the right to acquire shares. This is outside the PAYE collection system. No employers’ PRSI arises on exercise, assignment or cancellation.
Income tax, PRSI and USC are also payable, at the same rate as cash remuneration, by an employee on the grant of any option, which is capable of being exercised more than seven years after it is obtained. Credit is given for this tax against the tax charge arising when the option is exercised, assigned or released.

25. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture?

As noted in Question 20, VC investors typically seek to ensure founders remain fully focussed on the business through a "share lock-up", precluding founders/key individuals in the business from selling any shares, unless the investor consents otherwise.

It is also common to introduce good/bad leaver provisions, under which a leaving party must offer their shares in the company for sale to the remaining shareholders or the company. The sale price for the leaver's shares depends on the nature of that person's departure. The categorisation of what constitutes a bad leaver can be the source of much negotiation, as can the effect of provisions on "earned" or equity paid for by the founders at market value. Generally, some form of vesting schedule is agreed between the parties to mitigate the punitive nature of the leaver concept.

It would be common for the founder(s) to provide protection of goodwill covenants, including non-compete and non-solicitation clauses. Such restrictive covenants will only be enforceable by the Irish courts if they are limited in time, geographical scope and to the business of the investee company.

Often the existing ordinary share capital of a founder is considered to be sufficient equity incentive in most venture-backed companies. Generally, the founder(s) will retain majority ownership and if their equity has been diluted due to further funding rounds, they can be granted further options as part of an employee option pool.

Cash and other bonus structures can be used in venture-backed companies but they may not always be tax efficient and are less common than equity incentives.

Exit strategies

26. What forms of exit are typically used to realise a venture capital fund's investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

A VC fund's exit options are very limited if the company is unsuccessful. The most common option is a sale to an investor who specialises in buying distressed assets, which will likely result in a low purchase price.
Redemption by the company of any preference shares held by the fund is often not possible as the company must have sufficient profits available for distribution (or distributable reserves) to do so.

If the company is solvent, a members' voluntary liquidation can be availed of. This process involves the appointment of a liquidator to the company who is charged with realising the assets and discharging the liabilities of the company and distributing the balance (if any) to the company's shareholders. If the company becomes insolvent, an insolvent liquidation will be required and any return for the VC fund on its investment is unlikely.

Investors will be concerned to maximise the recovery of their investment, their market reputation and, if they have a director on the board of the investee company, those directors' duties. The main relevant duties are to act in the best interests of the investee company and its creditors and prevent the investee company from trading while insolvent, which can expose the directors to personal liability.

27. What forms of exit are typically used to realise a venture capital fund's investment in a successful company? What are the relative advantages and disadvantages of each?

**Trade Sale (share sale or asset sale)**

If a trade sale is conducted as an auction or competitive process it can often increase the price payable for the company at a reduced risk when compared with an IPO. Greater control over the process can be retained by the fund than in other exit options. Often extensive warranties and indemnities will be sought by the purchaser and warranty and indemnity insurance is becoming more popular. If the sale does not complete or if there are job losses as a result of the sale it can cause reputational damage.

**Management buyout**

A successful buyout generally depends on the management team securing funding by way of a private equity fund who will take a controlling stake in the company. An advantage of a management buyout is that it incentivises management involved to ensure completion of a successful exit for the VC fund, and they may be less likely to facilitate a sale to a competing bidder.

**IPO**

An IPO can maximise the price payable for shares in the company, however the costs, time and risk are also considerable and may not allow for a full and timely exit for the VC fund. The majority of investment agreements will include a lock-in period in which VC funds are restricted from disposing of their shares for a set period so this will affect the fund's ability to achieve an exit via an IPO.

The creation of a new fund to take over old investments while keeping the same investor base can also be an option.
28. How can this exit strategy be built into the investment?

VC firms will generally signal their exit strategy in the investment documents. This can range from a softer expression of intent with a prospective timeline, to a more robust right to achieve that exit (for example, a right to appoint corporate finance or investment bankers to achieve such an exit).

Reform

29. What recent reforms or proposals for reform affect venture capital in your jurisdiction?

There are currently no relevant reforms or proposals for reform affecting venture capital in Ireland.

Contributor profiles

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**Professional qualifications.** Ireland, Solicitor, 1995

**Areas of practice.** Corporate; mergers and acquisitions, private equity and venture capital; joint ventures; financial services and energy.

**Recent transactions**

- Acting for Irish Life Group Limited on a range of acquisitions and disposals including the disposal of IPSi to FNZ and the acquisitions of Acumen & Trust, APT, Conexim and Clearview.
- Acting for An Post (and the minority shareholders) in respect of the sale of TSC Ventures Limited (operator of One4All gift cards) to Blackhawk Inc.
- Acting for Broadlake Capital on the disposal of its interest in Merlyn Industries.
• Acting for Gore Street Energy Storage Fund plc on its acquisition of energy storage assets in Ireland.

• Acting for ESB in relation to all legal aspects of its establishment of a SIRO joint venture with Vodafone to deploy fibre to the building.

• Acting for ISIF on its subscription for a preferred equity interest of c. 30% of the fully diluted issued share capital of Finance Ireland Limited.

• Financial Risk Solutions Limited on its sale to Aquila Software.

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Professional qualifications. Ireland, Solicitor, 2012

Areas of practice. Corporate; private equity and venture capital; mergers and acquisitions; joint ventures; FDI; life sciences and renewable energy.

Recent transactions

• Acting for the shareholders of Adapt Pharma in relation to its USD635 million sale to Emergent BioSolutions.

• Acting for Arc Devices in relation to the equity investment by US manufacturing group, Avnet.

• Acting for Avenue Capital on its acquisition of the interests held by Pollen Street Capital in Castlehaven Finance.

• Acting for the shareholders of Barracuda FX in relation to its sale to Broadway Technology.

• Acting for management of Boru Energy in relation to the USD1 billion investment commitment by The Carlyle Group.

• Acting for Bronfman Family Office on its investment in Shorecal Limited, Ireland's largest Domino's pizza franchisee.

• Acting for Gaelectric Holdings plc in relation to all aspects of the wind down of its operations, including the sale of Ballagh windfarm to BlackRock.

• Acting for Greencoat Renewables plc on numerous acquisitions of operating wind assets from a range of sellers, including the US funds, Impax and Blackrock Real Assets.

• Acting for the Innovu Group in relation to its acquisition of Wexford Insurances.
• Acting for management in relation to the acquisition of Nua Healthcare by the Icon Infrastructure investment group.