

A FAIR PRICE PRINCIPLE IN SQUEEZE-OUT ACQUISITIONS

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Abstract

Fair price is the important criterion in squeeze-out acquisitions. Entrepreneur's law of Georgia unites mandatory tender offer and mandatory acquisition of shares under this hood. Both institutions are examples of compulsory contracting and with their essence are interruptions into shareholders property rights. In those cases, redemption is almost only measure offered to minority shareholders, which is exactly why it is vital to ensure, that shareholders receive adequate compensation for the unwilling disposal of their property.

Keywords: Squeeze-out, fair price, shareholders rights

Introduction

Fair price is the important criterion in squeeze-out acquisitions. For the purposes of this article, the term 'squeeze-out' is considered as a situation, where a controlling shareholder exercises his legal right to oblige the minority shareholders of a targeted listed company to sell their shares of the target to him. Entrepreneur's law of Georgia unites mandatory tender offer and mandatory acquisition of shares under this hood. Both institutions are examples of compulsory contracting and with their essence are interruptions into shareholders property rights. In those cases, redemption is almost only measure offered to minority shareholders, which is exactly why it is vital to ensure, that shareholders receive adequate compensation for the unwilling disposal of their property.

The article overviews lapses in the process of assessment of fair price under Georgian legislation and is based on international experience. It offers some modified approaches in order to protect minority shareholders interests.

The research is based on general scientific methodology. Abstractive-logical methodology is broadly used which includes analysis and synthesis, induction and deduction. Comparative legal methodology of research is also applied.

The article consists of the introduction, one main part and three paragraphs and the conclusion. The main text discusses all the problems connected with evaluation of fair price in Georgian legislation and judicial practice.

Problems of establishment of fair price in Georgian legislation and practice

General overview

Fair price principle applies in many corporate law relationships, but it is especially important in the process of squeeze-out, since, in some cases, it is the only remedy to protect minority shareholders interests. Unlike the mandatory tender offer, in case of mandatory acquisition of shares, minority shareholders have no opportunity to avoid selling shares. The only benefit that they might get from the transaction would be fair price, but the question is how faire that price will be.

The squeeze-out acquisitions are relatively new institutions in Georgian legislation. Emerging from common law into European law and through EU regulations into Georgian

law, squeeze-out is highly disputed in legal doctrine or practice. As much as it is possible to say on advantages or disadvantages, it is highly important to ensure that minority shareholders receive due compensations so that they would not have to give away their property for nothing. “Striking the right balance between the interests of minority/majority shareholders or, in other categories, interests of minority shareholders and facilitation of the efficient takeover market is one of the most troublesome tasks for the legislature and the judiciary dealing with the squeeze-out cases. This seems especially true with regard to compensation paid to the expelled shareholders in squeeze-out transactions” (Miliutis, 2013).

Mandatory tender offer

The approach is different with mandatory tender offer and mandatory acquisition of shares. As already mentioned above, mandatory tender offer still leaves the chance to minority shareholders to reject tender offer if the redemption price is inappropriate. This conclusion is made on the basis of the Article 15.3 of the Law on Security Market (LSM) according to which “all proposals or recommendations [...] on acceptance or repudiation of tender offer, as well as tender offer, must be conducted in accordance with regulations established by National Bank of Georgia.” Since Entrepreneurs Law of Georgia (EL) refers to LSM, the Article 15.3 must be applied in case of mandatory tender offer (Burduli, 2007, 24).

The Article 53² of EL regulates mandatory tender offers. One of the aspects of takeover is that a buyer must offer fair price for the shares to minority shareholders.

According to the Article 53^{2.2} of EL “An auditor or a brokerage firm shall establish the offered redemption price. The offered redemption price must be no less than the maximum price that the redeeming shareholder has paid within the last six months for the company’s share of this class. The auditor or the brokerage firm shall draw up a report indicating the documented facts establishing the basis for the offered redemption price. The buyer shall reimburse the expenses of the auditor or the brokerage firm. The buyer shall also be obliged to provide the auditor or the brokerage firm with all information available to him/her/it on the purchase of shares. The auditor or the brokerage firm shall be held responsible with all his/her/its assets for damages he/she/it caused to the shareholder as a result of negligence or deliberately misestimating of the offered redemption price.”

Based on this article the main principles of the redemption of shares could be highlighted:

1. The price must be fair;
2. The definition of fair price is not established by legislation;
3. Price is evaluated by auditor or brokerage;
4. The minimal price is established by EL which equals to the maximum price of the share for past six months.

The problem with this regulation is that minority shareholders have no option to bargain and argue the established price. It is not comforting that EL establishes minimal price of redeeming shares, since this price equals to maximum price of the share for past six months. Squeeze-outs are usually associated with a preceding low market flee-float, which affects the price of shares. Even though EL refers to “minimal price”, in reality this is the only approach of calculation of fair price that is offered by Georgian legislation or doctrine in contrast with the experience of European countries (Germany and Austria, for example) where several methodologies of evaluation are set in place and often applied simultaneously (Dollinger, 2008).

Next problem is that assessment is delegated to audits or brokerage firms, while brokerage is completely underdeveloped in Georgia. I am inclined to agree with the position offered in Georgian legal doctrine, which considers the possibility for the minority shareholders to address the court if they do not consent with offered tender price. The Article

53¹.6 of EL must be applied in that case (legal analogy) (Burduli, 2007). Also, it is still unclear what part the court system will play in the process of establishment of fair price. Price of the share, itself, is not a legal category and evaluation requires special knowledge, which brings the necessity of expert conclusion. Some legal precision on the methods of evaluation must be welcome.

Mandatory acquisition of shares

The approach is much stricter in case of mandatory acquisition of shares. The Article 53⁴.2 of EL states that the court shall decide on a mandatory acquisition of shares as determined in the Civil Procedure Code of Georgia. The fair value and the date of share redemption shall be fixed by court decision on a mandatory acquisition of shares as determined in the Civil Procedure Code of Georgia (CPC).

It is important to keep in mind that the first redaction of mandatory selling out of shares was declared void by the Constitutional Court of Georgia. Basic argument was that the law did not ensure offering fair price to minority shareholders. Constitutional court supported the idea of evaluation shares by independent brokerage companies or experts. Nonetheless, it is still doubtful whether the procedure adopted after the decision of the Constitutional Court guarantees necessary protection to minority shareholders and ensures them with due compensation for their the restriction of their property.

Though EL declares boldly that court fixes fair price, the appropriate articles of CPC and practice have different impression.

The Article 309¹² (1-2) of CPC declares that to determine the fair redemption price of the shares, the court shall appoint an independent expert or a broker company within seven days after an application has been filed. An independent expert or a broker company shall prepare a redemption report that shall include documented circumstances of redemption as well as the method to be used for determining a fair redemption price of the shares and the price of the shares determined on that basis. The costs of an independent expert or a broker company shall be borne by the offeror.

The participation of parties is ensured only on the level of appointment of expert or brokerage.

The Article 309¹² (3) states that when selecting an independent expert or a broker company, the court may take into account the opinions of the parties. The parties may recommend to the court candidates to be appointed [as experts]. The final decision as to who is to prepare a redemption report shall be made by the court. The parties may challenge an independent expert or a broker company on the grounds provided in the Article 35 of this Code.

CPC does not grant the possibility of disputing the offered price or representation of alternative evaluation to minority shareholders. In fact, court makes decision based on the evaluation provided under the Article 309¹². Though, CPC states that when establishing a fair price for redemption of shares, a court shall take into account:

- a) the value of these shares on the stock market;
- b) estimated revenues that the joint stock company may expect to gain in the future;
- c) assets (including reserves, goodwill, experience, prospects and business relationships of the enterprise) and liabilities of the joint stock company.

CPC does not state based on which data the court should enquire these measures. As already mentioned, those criteria are not legal and require special knowledge and basically, court completely relies on the assessment of expert or broker. Generally, under CPC, all parties enjoy the possibility to challenge any proof provided by concurring party and represent alternative expert conclusion or evaluation. They are entitled to request additional or repeated expertise, while in the process of hearing cases on compulsory acquisition of

shares, parties lack those options. Of course, the fact that those procedures are monitored by court is much better regulation but the interests of parties are not sufficiently protected and by “parties” both - the offeror and minority shareholders are meant, since broker might suggest risen or diminished redemption for shares.

Since the legislation is so imprecise, court practice must suggest at least some instructions on calculation of fair price. Today, this kind of case law is missing. There are really few cases on compulsory acquisition of shares and courts just make copy-pastes of the Article 309¹⁴ of CPC and do not even mention whether the offered price is fair indeed. It is probable that situation would be different if these particular cases were brought in front of the Supreme Court of Georgia, but, unfortunately, the decision of the Appeal Court on mandatory acquisition of shares is final.

Conclusion

After the summarization of all the above mentioned, it is clear that Georgian legislation does not properly protect minority shareholders rights by guarantying them fair redemption in the process of squeeze-out acquisitions. The only approach of calculation of fair price offered in EL is based on the price of share for past six months. The approach is insufficient and too vague leading to unfair results in most cases. In case of mandatory tender offer, minority shareholders have no opportunity to discuss the offered price. It would be more appropriate if they at least had possibility to address the court. Although, nowadays, without further clarifications from legislation, court only plays part of some kind legalization institution and, roughly to speak, only puts seal on the offered price by expertise or broker not taking into account that under the Article 309¹⁴ of CPC, courts not only have right to say final word on fairness of price and, unless they find it due, turn down squeeze-out, but it is their obligation as well.

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