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Shoot-out right

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Summary: The article provides a basic analysis of the shoot-out right, in particular as regards the mechanism of its functioning. The shoot-out right is an instrument for handling of conflict situations in a company, where the exercise of this right is usually connected with exit of one of the shareholders and domination of the company by the remaining shareholder. At first sight, the shoot-out right is an elegant and fair solution for overcoming a shareholder conflict, which could threaten the very existence of the company. However, this right, and in particular its exercise, brings some risks.

Keywords: conflict of shareholders, deadlock, Russian roulette, determination of purchase price per unit, financial asymmetry.

1 Shoot-out right in general

Shareholder conflicts in closed corporations also arise for other reasons than the opportunist conduct of a majority or minority shareholder.[1] In fact, it is a closed corporation with two shareholders[2], each of whom holds 50% of voting rights, that is most threatened by the risk of deadlock.[3,4] This egalitarian structure means that each shareholder *de facto* has the veto right. The application practice only confirms this theory and shows that a deadlock most frequently arises in corporations with two shareholders.[5] Corporations where a minority

1 BACHMANN, Gregor, Eidenmüller, Horst, Fleischer, Holger ENGERT, Andreas. *Regulating the closed corporation.* Berlin/Boston: Walter de Gruyter GmbH, 2014, pp. 75.

2 Ownership structure and voting rights, split in the proportion 50:50, is fairly common in closed corporations; for example, in case of small family businesses, whose shareholders are siblings or a married couple, but also in the typical case of joint ventures, whose shareholders are two capital companies.

3 *Deadlock* means a situation where a disagreement (conflict) on certain matter exists among shareholders, who in view of the split of the voting rights and majority, that must be achieved in the vote according to the Statute, are unable to adopt a decision resolving the conflict. None of the shareholders is able to adopt the decision alone, i.e. without votes of the other shareholder.

4 BRAUN, Arthur, SALLFELLNER, Lukas. Vrchní zemský soud Norimberk: K shoot-out (u) ve společenské smlouvě. *In* Právní rozhledy, 2014, č. 20, pp. 723, [online] Available: http://www.beck-online.cz Accessed: 7. 2. 2019.

5 BACHMANN, Gregor, Eidenmüller, Horst, Fleischer, Holger ENGERT, Andreas. *Regulating the closed corporation.* Berlin/Boston: Walter de Gruyter GmbH, 2014, pp. 76.

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shareholder holds a blocking minority or where the Statute requires unanimity for approval of certain decisions by general meeting, are also inclined to deadlocks.

Resolution of conflicts triggered by deadlock situations is usually time and cost intensive, because third persons (lawyers, financial advisors, arbiters and others) often enter this process.[6] Irrespective of whether one of the shareholders is directly responsible for the deadlock, such situations can temporarily paralyze or even hinder the proper functioning of the corporation, thwart investment made by the corporation, or damage its good reputation on the market.[7]

The shoot-out right is an instrument that was developed in the conditions of Anglo-American law as a response for fast and cost-effective resolution of deadlock situations. As suggested above, its primary purpose is elimination of persistent deadlock, where using a formalized procedure of determination of the purchase price of shares the participation of several shareholders is factually transformed to an exclusive (majority) participation of one of them. This procedure leads to elimination of the ineffective "*status quo*", which decreases the total value of the corporation or endangers its very existence. In the Anglo-American environment the right in question is known as "*shoot-out right*" or "*shot-gun*".[8]

In the foreign application practice this right is not used only as an instrument for overcoming of deadlock situations or resolving shareholder conflicts in general. The shoot-out right is often agreed as a mechanism which allows voluntary exit of a shareholder not wishing to stay in the company.[9] It can also be agreed as a specific option to buy or sell shares of the company.[10] In these cases this right is more frequently designated by the term "*buy-sell clause*".

6 LANDEO, M. Claudia, SPIER, E. Kathryn. *Shotguns and Deadlocks.* Yale Journal on Regulation, 2014, Vol. 34, pp. 1. [online] Available at: http://digitalcommons.law.yale.edu/yjreg/vol31/iss1/4 Accessed: 7. 2. 2019.

7 Available at: http://www.achourpartners.com/upload/publikace/59bf81f51f683.pdf Accessed: 30. 10. 2018.

8 Shoot-out is the most fitting term that best reflects the substance of this right. It can be likened to classic Western scenes where two men face each other and in 10 seconds only one of them remains to stand.

9 *"If for any reason any Member ('the Electing Member') is unwilling to continue to be a member of [the partnership] if another Member ('the Notified Member') is also a member of [the partnership], then the Electing Member may give the Notified Member written notice stating in such notice the value of a 1% Membership Interest ('Interest Value') whereupon the Notified Member shall, by written notice given to the Electing Member within 30 days from the date of receipt of the Electing Member's notice, elect either to purchase the Electing Member's interest in [the LLC] or to sell to the Electing Member the Notified Member's interest in [the LLC]."*

10 This will apply in situations where an initiating offer to buy or sell shares is sent on the basis of manifested will of the shareholder, whereby the agreement on the shoot-out right does not require previous unsuccessful resolution of deadlock as a condition of the exercise of this right.

The shoot-out right is an instrument which basically permits fair and equal reallocation of sources of the company between shareholders (the shareholder who stays in the company and the exiting shareholder) thanks to a mechanism, using which the shareholders should determine the unit price of shares. But this statement is not true in absolute terms. The shoot-out right can only be used as an instrument permitting fair reallocation of sources in the absence of asymmetry between the shareholders – including information, financial and managerial asymmetries. On the other hand, in the presence of any form of asymmetry the exercise of the shoot-out right will lead to undesirable effects and unequal reallocation of sources.[11]

Depending on the particular circumstances of the case and the intensity, with which the asymmetry had affected the unit price of shares at the exercise of the right, which lead to unfair and unequal reallocation of sources of the company, such approach may be considered as abuse of the right by a court (the issue of asymmetry is discussed in greater detail in Chapter "Drawbacks of the shoot-out right").

2 Characteristics and purpose of the shoot-out right

The shoot-out right can be described as a specific contracting procedure that leads to the purchase or sale of shares of a company, and which is applied in case of a deadlock or in other cases agreed upon by the parties. A peculiarity of this right is the specific mechanism by which the participating shareholders come to the offered amount of the purchase price for their shares.

At the exercise of this right one of the shareholders submits to the other shareholder an offer to buy or sell shares of the company and determines the purchase price per unit ("initiating shareholder"). The other shareholder has the right to decide whether it will buy or sell shares from/to the initiating shareholder for the offered purchase price per unit. This decision is left to absolute discretion of the other shareholder. The initiating shareholder has the subjective pre-emption right to buy or sell shares from/to other shareholder, but the content of this right is determined by the other shareholder, who then has the subjective obligation to buy or sell shares of the initiating shareholder under the conditions specified in the initiation offer. It is the tricky part of the whole contracting mechanism: a shareholder can start the shoot-out process but it cannot be certain whether the other shareholder will have to exit the company, or whether it will be forced to leave itself.[12]

11 For further details see LANDEO, M. Claudia, SPIER, E. Kathryn. *Shotguns and Deadlocks.* Yale Journal on Regulation, 2014, Vol. 34, [online] Available at: http://digitalcommons.law.yale.edu/yjreg/vol31/iss1/4 Accessed: 18. 2. 2019.

12 BRAUN, Arthur, SALLFELLNER, Lukas. *Vrchní zemský soud Norimberk: K shoot-out (u) ve společenské smlouvě. In* Právní rozhledy, 2014, č. 20, pp. 723, [online] Available at: www.beck-online.cz Accessed: 7. 2. 2019.

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This contracting procedure corresponds to so-called "*cake-cutting procedure*"[13], where one person cuts the cake in two pieces (which figuratively corresponds to the initiating offer to buy or sell shares with indication of the purchase price per unit), while the other person has the right to decide which of the pieces it will choose (again figuratively speaking, the other shareholder as the addressee of offer will determine the type of transaction to be performed, i.e. purchase or sale).

The main (traditional) purpose of the shoot-out right is to react to arising deadlock situations and to resolve them by the fast and cost-effective termination of participation of one of the shareholders in the company, if other solutions (in particular mutual agreement) failed in given case.[14]

The rise of these situations and the impossibility to resolve them by different means will then trigger the process of the exercise of this right. The triggering of this process is usually connected with formal notification of this fact to the other party. In the application practice there is often an intermediate phase between the formal notification of the initiation of the exercise of the right and the exercise of the right itself. It is a defined period (time-limit), which starts by the notification, and its vain expiration is the condition for the exercise of the shoot-out right itself. This period should provide to shareholders the required space for resolution of the conflict by mutual agreement or through a mediator or arbiter. It should also motivate the shareholders not to approach the exercise of the right with "excessive" ease.[15] The rise of deadlock and the running of the period can be likened to a hanging sword of Damocles,[16] because at given moment each shareholder is (or should be) aware that if they fail to resolve the deadlock any of them will face the threat of undesired exit.

The phase of the exercise of the shoot-out right usually carries a degree of uncertainty for the initiating shareholder, who loses control of further development of situation by sending of the initiating offer. The initiating shareholder can manifest its will to act as buyer at the beginning of the exercise of the right, but this position may be reversed following a manifestation of will by the other shareholder. The other shareholder will namely have absolute discretion to

13 From the English term *"cake-cutting procedure"*.

14 For this reason, in the practice we encounter its further equivalent designation "*dead-lock resolution clause*".

15 In Anglo-American terminology this time-limit is designated by the term "*cooling-off period*".

16 *Sword of Damocles* is an idiomatic expression that was included in the dictionary as a proverb or comparison. It is used for description of a situation where an individual should not be calm or indifferent when waiting for something that matters to him – and which may not end well. It also describes a situation where happiness is in danger. Available https://sk.wikipedia.org/wiki/Damoklov_me%C4%8D Accessed: 24. 1. 2019.

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decide which of the shareholders will remain in the position of seller and which will act as buyer.[17]

Nonetheless, it has to be said that the shoot-out right is not the single, exclusive mechanism for resolution of a deadlock situation. Mutual agreement of shareholders (e.g. reached with help of an independent third party, mediator) can never be excluded from the resolution process. But if agreement fails other resolution mechanisms are available. For example, shareholders can agree that *(i)* one of the shareholders will be granted a casting vote on a regular rotational basis (more suitable for ownership structures with at least three shareholders), or that *(ii)* decision will be delegated to other body of the company, e.g. supervisory board or ad-hoc body of the company set up for this purpose, or that *(iii)* the dispute will be referred to an arbiter for decision.[18] However, not all of these solutions will be permissible from the perspective of corporation law in domestic conditions. The weight of votes, which is often connected with participation, is usually fixed and cannot be changed *ad hoc* for the purpose of resolution of a deadlock situation. Delegation of powers defined by law between individual collective bodies of the company will be impermissible, too.[19] The right of casting vote can be imagined as a solution for overcoming a deadlock that has arisen during the managerial vote, if the Statute of the company contains e.g. a provision that in case of a tie the vote of the chairman of the board of directors will be decisive.[20] Moreover, in view of the ownership structure consisting of two shareholders and the arrangement of their internal relations as regards administration and management (based on the balance of power) the deadlock would thus only be transferred to another body of the company. Another suitable solution would be special regulation of the conditions of transferability of shares by the Statute, i.e. if the shareholders do not resolve a deadlock within the determined period the Statute shall be changed automatically, by the passage of time. The existing rules limiting transferability of shares would cease to be applied, which would *de facto* lead to transformation of a closed corporation to an open corporation. But neither this solution would probably bring the desirable outcome to shareholders in the application practice, due to the factors such as insufficient liquidity of

17 It also depends on the particular content of the right to request the acquisition of a share, because during the exercise of the right the parties can go through several rounds of offers and counter-offers (phase of the exercise of the right is adjusted as an auction) and thus repeatedly find themselves in a position of purchaser and seller.

18 BACHMANN, Gregor, Eidenmüller, Horst, Fleischer, Holger ENGERT, Andreas. *Regulating the closed corporation.* Berlin/Boston: Walter de Gruyter GmbH, 2014, pp. 77.

19 According to Section 125 paragraph 3 of the Commercial Code (limited liability company) it is permissible for a general meeting to reserve decisions about issues which fall within the competence of another body. However, due to the balance of power, the deadlock would only be transferred again from the statutory body to general meeting.

20 However, at the same force of shareholders it seems again improbable that one of the shareholders would be willing "to sacrifice" *ex-ante* its position in the company.

shares, the search for a potential transferee, negotiation of the purchase price of shares, transaction costs etc.

However, for the sake of completeness, we must say that all suggested solutions (irrespective of the degree of their effectiveness) are complicated or even inadmissible from the perspective of corporation law. On the other hand, shareholders as the parties may agree such solutions at the level of law of obligations and incorporate them in the shareholders´ agreement. For example, they can conclude a specific agreement on the exercise of voting rights, which would represent a modality of the case of a shareholder with casting vote. The shareholders would draw lots to choose among them a shareholder, who will be empowered to vote on the matter, while the other shareholders will be obliged to refrain from exercising their voting right.

The use of the shoot-out right in the application practice can be even wider; all depends on the content of the shareholders´ agreement at given moment. As we have already mentioned, the shoot-out right is not only an instrument for resolution of deadlock situations. The definition of a trigger event for the exercise of the right will be a matter of agreement. Or the shareholders will intentionally not define such event at all. [21]

However, the structure of the content of the shoot-out right is, in principle, the same. The first part of the right will define (or intentionally not define) an event, which is the reason for initiation of the exercise of the shoot-out right by one of the shareholders. The second part will regulate the contracting procedure (including the mechanism of determination of the unit price and the pre-emption right of the other shareholder to buy or sell shares) to be followed after the initiation of the exercise.

3 Event triggering the exercise of the shoot-out right

3.1 Deadlock

Deadlock is the Achilles heel of closed corporations.[22] In foreign literature the authors defining a deadlock usually refer to the court decision in case Palmieri *v.* A.C Paving Co[23], which in the part Grounds of Judgment defines a deadlock

21 For further details see Chapter "Event triggering the exercise of the shoot-out right".

22 FLEISCHER, Holger, SCHNEIDER, Stephan. *Shoot-out Clauses in Partnership and Close Corporations – An Approach from Comparative Law and Economic Theory*. Max Planck Private Law Research Paper No. 11/13 [online] Available at: https://www.peacepalacelibrary.nl/ebooks/files/339410493.pdf. Accessed: 7. 2. 2019.

23 Palmieri *v.* AC Paving Co Ltd 1999 48 BLR (2d) 130 (BCSC): *"There is an equal split or nearly equal split of shares and control; there is a serious and persistent disagreement as to some important questions respecting the management or functioning of the [organization]; there is a resulting deadlock; and the deadlock paralyzes and seriously interferes with the normal operations of the [organization]."*

as follows: "*In case of equal split or nearly equal split of shares and control among shareholders, and serious and persistent disagreement as to some important questions respecting the management or functioning of the corporation, there is a resulting deadlock, which paralyzes and seriously interferes with the normal operations of the corporation.*"

The deadlock can be described as a situation where a dispute has arisen between (or among) shareholders on certain matter and because of the split of voting rights and majority, which according to the Statute should be achieved in the vote, they are unable to adopt a decision resolving the dispute. None of the shareholders is able to adopt a decision at general meeting alone, i.e. without votes of the other shareholder. Typically, a deadlock arises when a company is owned by two shareholders, each of them holding 50% of the share capital and voting rights of the company. Under these circumstances also decisions requiring a simple majority to be valid suddenly become an agenda that must be approved by mutual consensus of shareholders to be adopted. In closed corporations (moreover often small family businesses) a deadlock may not only cause legal problems but it can also significantly affect the family or social level of interpersonal relations.[24]

A deadlock among shareholders can simply arise also in connection with the decision-making on matters, for which general meeting is competent and for which the law prescribes at least a two-third majority of votes of shareholders required for approval of such decision.[25] Or the Statute can require a higher majority of votes, or even unanimity of the vote. A deadlock may arise at general meeting also in connection with activation of so-called "blocking minority", as well as on the sole ground that general meeting does not have the quorum.[26]

However, a deadlock need not necessarily arise in connection with decision-making of general meeting. It may also arise at the managerial level, when deciding on matters of management of company. In the practice it is usually designated as *"managerial deadlock"*. Of course, it will apply in situations where the statutory body is collective; has an even number of members and the Statute does not contain other special regulation relating to resolution of a deadlock.[27]

24 In the envisaged case it is a model example. Of course, a deadlock can also arise at a different split of ownership structure of a company with several shareholders.

25 Section 127 paragraph 4 of the Commercial Code and Section 187 paragraph 2 of the Commercial Code.

26 This option depends on the particular form of a company. While the quorum of general meeting in limited-liability companies is prescribed directly by the Commercial Code, in joint-stock companies and simple joint-stock companies a special legal regulation of the quorum of general meeting is absent, so its regulation in this case must result from the Statute of the company.

27 For example, by granting of so-called *casting vote* to the chairman of the board of directors, or by revocation and election of new members of the statutory body, etc.

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But the environment, in which a deadlock arises, is irrelevant; only the extent to which a deadlock affects the overall functioning of the company, is relevant.

In connection with the exercise of the voting right of a shareholder, which leads to a deadlock, the question arises whether in this case an abuse of the right can be stated. The answer is simple: yes, it can. Of course, all will depend on the specific circumstances of the case. In English shareholders´ agreements these cases are called "*artificial deadlock*", i.e. deadlocks intentionally and artificially (without a reasonable ground) caused by shareholders. Shareholders´ agreements prohibit such conduct.[28] In France these situations are fittingly named "*abus d´égalité*", i.e. abuse of equality. In domestic sources a similar expression does not occur. But we say in the same breath that the Commercial Code prohibits any abuse of the shareholder´s rights. The Commercial Code in Section 56a paragraph 1 only sets out, by the way of example, cases of the abuse of a majority or minority as forms of the abuse of the shareholder right. In any case, Section 56a paragraph 1 of the Commercial Code can also be applied to situations where an abuse of equality occurs.

The French doctrine classifies cases of abuse of equality to the category of cases of abuse of minority in a company, because in the case of abuse of equality has the same consequences. Opportunism of the abusing shareholder hinders the approval of required decisions by the company. This conclusion is logic and correct. If a minority shareholder holds a blocking minority the size of its shareholding and the number of votes falling to it are irrelevant. The only relevant fact is that their quantity/number is sufficient for blocking of adoption of a decision at general meeting. The issue of abuse of equality can be seen through the same prism. This knowledge is also relevant for domestic law, because it allows the conclusions of decision-making of courts in matters of abuse of position of a minority shareholder to also be applied to deadlocks induced by abuse of equal position of a shareholder.

3.2 Other events triggering the exercise of shoot-out right

A deadlock is not necessarily the only reason for the exercise of the shoot-out right. On the contrary, these events can be quite diverse in the application practice. The definition of a group of these events will be a matter of agreement of shareholders. For example, the mere change of the ownership structure at one of the shareholders of the company may mean such event. In joint ventures these

28 *"In no circumstances shall a Shareholder create an 'artificial deadlock' and then exercise its rights under this Clause 16. For the purposes of this Clause 16.1.6, an 'artificial deadlock' shall be a deadlock caused by a Shareholder, or its appointees on the Board (a) voting against an issue or proposal in any case where the passage or approval of the same is required pursuant to this Agreement to enable the Company to carry on the Business properly and efficiently, or (b) by being absent from any Board Meeting or General Meeting without any reasonable cause."* [online] Available at: https://www.sec.gov/Archives/edgar/data/1296774/000119312504204040/dex1013.htm Accessed: 7. 2. 2019.

events are often associated for example with violation of obligations by a shareholder in the performance of his tasks during the implementation of the business plan or the failure to achieve an agreed milestone during its implementation (i.e. the shoot-out right is used as a penalty mechanism toward shareholders in these cases).

4 Advantages and drawbacks of the shoot-out right

4.1 Advantages of the shoot-out right

4.1˙1 Fairness of the procedure of determination of the purchase price per unit

The main advantage of the shoot-out right is traditionally its high fairness, reflected in the mechanism of determination of the amount of offered unit price of shares. Participating shareholders are motivated to a "correct" adjustment of the amount of offered unit price by the ever-present threat that shares of company could be purchased for a "too high" price or sold for a "too low" price during the exercise of the right.

In this context foreign authors often refer to a case from American case-law, specifically to a selected part of grounds of judgment delivered by the judge Easterbrook of the United States Court of Appeals for the Seventh Circuit, who in the case Valinote *v.* Ballis[29] literally says: "*As the party making the offer (to buy or sell shares) can end up on the opposite side of this transaction, it eliminates the risk of undervalued offer... The possibility that the person naming the price can be forced either to buy or to sell keeps the first mover honest.*"[30]

Similarly, Carey to the doctrinal approach says: "*Without offer from a third party tested by the market the determination of the amount of offered purchase price is always unsure. Moreover, the risk from adjustment of a too low or too high purchase price of shares lurks in the background and a shareholder, who first initiates the exercise of the right, may end up as buyer with an exorbitant price or as seller for a too reduced price.*"[31]

The shareholders are motivated to submission of fair offers by their own fear and the threat of closing a "bad" deal.

4.1.2 Efficiency of the shoot-out right mechanism

The shoot-out right and its mechanism are usually efficient, unlike standard processes of mutual negotiations which may involve several rounds of mutually

29 Valinote *v.* Ballis; 295, F3d. 666 (Ill. 2002).

30 Judge Easterbook states that *"The possibility that the person naming the price can be forced either to buy or to sell keeps the first mover honest."*

31 CAREY, A. Stevens. *Buy/Sell Provisions in Joint Venture Agreements.* pp. 659. [online] Available at: https://www.pircher.com/media/site_files/47_BuySellProvSAC.pdf, Accessed: 7. 2. 2019

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addressed offers and counter-offers of shareholders (one time the offer indicates the purchase price x, the next time y; or after revision of the initial plan the offer to buy is replaced by a new offer to sell etc.). Moreover, in case of a persistent deadlock the shareholders may behave irrationally and are unwilling to sit down at the negotiating table.

To resolve a deadlock by agreement, manifestations of will of shareholders must meet on both sides – in the matter of the amount of purchase price and in the question whether shares of a shareholder will be bought or sold. On the contrary, in case of the shoot-out right a single shareholder is able to unilaterally initiate its mechanism, using which it submits its offer, where the shareholder only determines the amount of unit price of shares. At the moment of delivery of the offer to the other shareholder (addressee) the contracting obligation arises, whereby the other shareholder cannot reverse the contracting process by making a counter-offer (it cannot refuse the offer on the ground of the offered amount of price); the other shareholder can only choose whether its manifestation of will shall confirm that the subject of the contract will be the purchase or sale of shares. Moreover, the whole process is squeezed in the agreed time-frame, which allows relatively fast termination of the contracting process. The contracting process, which is the result of the initiated exercise of the shoot-out right, differs from a traditional contracting process that is accompanied by mutual negotiations. The fact that shareholders agreed upon the shoot-out right does not automatically mean that its exercise must be initiated (although all agreed conditions for the exercise were fulfilled). Shoot-out remains in substance the right of the entitled shareholder, *ergo* it does not mean the obligation to initiate the shoot-out mechanism. In the application practice it is even common for shareholders to primarily try to resolve a deadlock situation by agreement, whereby both parties are fully aware of the existing threat, and any shareholder may initiate the exercise of the shoot-out right (negotiations and failure to reach an agreement on the deadlock is a separate condition for initiation of the exercise of the shoot-out right) at any moment.

Shareholders are thus put under pressure to conduct negotiations in an effective manner, otherwise there is the ever-present threat of initiation of the exercise of the shoot-out right (a figurative sword of Damocles handing over the shareholders during such negotiations). The application of this procedure is also documented by empiric experiences from the Anglo-American environment. They confirm that there is in fact a limited number of events, in which a deadlock situation would be terminated only on the basis of the exercised shoot-out right (for further details see Chapter "Unpredictability of outcome").

4.1.3 Time and cost savings

The exercise of the shoot-out right can bring to shareholders a time saving (length of the process, starting from the beginning of the exercise of the shoot-out right until the conclusion of the contract on purchase or sale of shares)[32], as well as saving of related transaction costs (for example costs of legal services, appraisal of shares by independent expert etc.).

4.2 Drawbacks of the shoot-out right

4.2.1 Unpredictability of outcome

However, the shoot-out right has also a number of fundamental drawbacks, in particular overall unpredictability of outcome after the initiation of the exercise of this right. It is related to the risk for the participating shareholders, when a shareholder who manifested its will to exit the company in the submitted offer, is forced to become its sole shareholder instead.[33]

It is the unpredictability of outcome after the initiation of the exercise of the shoot-out right that significantly decreases its attractiveness as an instrument of shareholder conflict resolution. It is also documented by empiric experiences from abroad (Anglo-American environment), where tested subjects in case of a conflict preferred the submission of individual offers to buy or sell shares over the initiation of the exercise of the agreed shoot-out right. These findings were confirmed by researches implemented in England and the United States of America, where shareholders´ agreements often contained shoot-out clauses, but these clauses were only rarely executed.[34]

It may be concluded that the shoot-out right is applicable as a preventive (rather than a real) instrument for shareholder conflict resolution, in particular due to the mentioned risks, i.e. the loss of control and the overall unpredictability of outcome after the initiation of the exercise of this right.

4.2.2 Cases of asymmetry between shareholders

The shoot-out right can serve as a fair instrument for shareholder conflict resolution. This argument is valid if the following conditions are fulfilled: *(i)* shareholders have enough information from inside of the company, and which allows them to correctly estimate the value of its holding in the company, *(ii)* shareholders have enough available resources for the purchase of shares of the other shareholder, or they are able to obtain them (thanks to their creditworthiness) from creditors, and finally *(iii)* each of the shareholders has more or less the same skills, experience and qualification to be able to manage the company alone (without the other shareholder).

32 However, it will fully apply only to the most stringent variants of the exercise of the shoot-out right (i.e. Russian roulette or Mexican shoot-out).

33 FLEISCHER, Holger, SCHNEIDER, Stephan. *Shoot-out Clauses in Partnership and Close Corporations – An Approach from Comparative Law and Economic Theory*. Max Planck Private Law Research Paper No. 11/13. pp. 6. [online] Available at: https://www.peacepalacelibrary.nl/ebooks/files/339410493.pdf. Accessed: 7. 2. 2019.

34 Ibidem, pp. 16.

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If this balance is disturbed, we talk about imbalance or asymmetry. As we have already indicated, there are different forms of asymmetry among shareholders:

Information asymmetry – a shareholder due to the lack of required information is unable to correctly estimate the value of its holding in the company, which may cause the amount of the unit price offered by the shareholder to be too low or too high. In this case the lack of the shareholder´s access to such information is not the main problem. Such scenario is very improbable in case of a closed corporation, because the shareholder directly performs the function of executive of the company at the same time, or has its nominee in the statutory body, or has the right to information directly from corporation law (the right of shareholder to information). The problem is a situation where a shareholder has this type of information, but is unable to correctly interpret it. The shareholder can then "benefit" from resulting consequences of the incorrectly determined price during the exercise of the shoot-out right.

Financial asymmetry – while one shareholder has enough financial resources, the other shareholder "has got deep pockets" (is short of cash). The exercise of the shoot-out right under these circumstances places the other shareholder into a vulnerable position. Such shareholder lacks the required funds to pay out the other shareholder in the process of the exercise of the shoot-out right. Moreover, such shareholder may not have a real opportunity for acquisition of such funds (in the form of loan or credit), because of its low creditworthiness or due to the short period of time, which is usually agreed within the process of exercise of the shoot-out right. This situation occurs frequently also in the domestic application practice, especially in start-ups incorporating a group of shareholders, who are the bearers of the idea or business know-how, and another group of shareholders (investors), who bring the required capital and managerial experiences in the company.

Managerial asymmetry – The division of managerial tasks in a company may be an important source of asymmetry, especially in a situation where management of the company is entrusted to a single shareholder. The same applies in situations where both shareholders formally participate in management of the company in equal measure, but in fact only one of them has genuine experiences and skills required for professional management of the company. The other shareholder simply will not be able to manage the company without active participation of the other shareholder in its management.

In the presence of one of these asymmetries higher demands are put on shareholders during negotiation of the content of the rights, obligations and conditions of the exercise of the shoot-out right with the aim to minimise the risk that such right is declared invalid by the court or that the court does not provide judicial protection on the ground of abuse of the right.

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For example, in the presence of asymmetry the shareholders should agree *ex ante* on the protection against opportunist conduct of the "more competent" shareholder. The right to initiate the shoot-out mechanism under these circumstances should be granted to the "less competent" shareholder. Asymmetry between shareholders leads to opportunism, which causes uneven reallocation of resources of the company during the exercise of the shoot-out right. Another solution is to refuse an agreement on the shoot-out right as a mechanism for resolution of deadlock situations and to concentrate on other methods of conflict resolution.

4.2.3 Other disadvantages and drawbacks

In the application practice other situations may occur, where even the exercise of the shoot-out right does not bring the desirable outcome. We are referring to situations where shareholders have the same position and there is no asymmetry between them.

Another example are situations where the potential exercise of this right may cause problems to the shareholders. For instance, the sale of shares may not be an optimal solution from the tax perspective at given moment. The shareholder does not wish to leave the company.

Under certain circumstances the exercise of the shoot-out right may be contrary to the provisions of the law. Specifically, it may constitute a violation of the rules of antimonopoly law. Or, in selected national jurisdictions, it may be subject to the condition that one of the shareholders has the corresponding nationality (in some East Asian countries), or that a hybrid ownership structure with participation of the state is conserved in the company (for example in China). The exercise of the shoot-out right leading to the exit of such shareholder would mean a direct violation of these legal rules.

5 Shoot-out right in law of the Slovak Republic

The shoot-out right in the conditions of the Slovak Republic has become subject of codification due to the new amendment of the Commercial Code, implemented by the Act no. 389/2015 Coll. For the purposes of designation of the shoot-out right the term "*right to request the acquisition of a share*" was introduced into the law.

The right to request the acquisition of a share is one of the subsidiary arrangements to shareholders´ agreements concluded by shareholders of a simple joint-stock company ("SJC"). The same conclusion, that we have already presented in this paper in connection with subsidiary arrangements in SJC, will apply also in this case: The right to request the acquisition of a share in its codified form is reserved exclusively to shareholders of SJC. The right to request the acquisition of a share (as defined by the amendment to the Commercial Code) does not

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envisage the possibility of its negotiation by shareholders as a registered right or its applicability toward legal successors. It is a pure obligatory arrangement.[35,36] The pure obligatory character of this right is also confirmed by the comment literature.[37] In view of the obligatory character, some authors recommend this right to be negotiated by shareholders together with the other rights, in particular with limitations on the disposal of shares according to the Statute of the company, as well as with other subsidiary arrangements to the shareholders´ agreement. They believe that only then the shareholder will have the certainty that its right to request the acquisition of a share will not be frustrated, for example by a speculative transfer to a related party.[38]

The fact that provisions of Sections 289 to 292 of the Commercial Code do not apply to the right to request the acquisition of a share is important in our view, because none of the parties to this agreement can invoke a fundamental change of circumstances, on which the parties probably relied during negotiation of this right (Section 292 paragraph 5 of the Commercial Code).[39]

In terms of the form, the law does not prescribe any special legal form for the right to request the acquisition of a share. It must only fulfil the formal requirements for the shareholders´ agreement, i.e. certification of signatures of the parties.

Regulation of the right to request the acquisition of a share, as drafted in the Commercial Code [40], corresponds to the variant of Russian roulette. The entitled shareholder is a person who first delivers an offer to buy together with determination of the price per share to another shareholder, who thus becomes obliged shareholder. According to legislation, the decisive moment for legal positions of shareholders at the exercise of the right to request the acquisition of a share shall

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35 HOUDEK, Zdeněk. *Zákonná regulace akcionářských smluv na Slovensku*. *In* Dny práva 2015 – část I.. Zákonná regulace v. smluvní úprava? Brno: Masarykova univerzita Brno, 2016, pp. 82.

36 Shareholders of other capital companies can also arrange this right only as a right of obligation, but when drafting it they will rely on the general law of obligations and on the principle of contracting autonomy in private law.

37 For further details see PALA, Radovan et al. *In* OVEČKOVÁ, Oľga a kol. *Obchodný zákonník. Veľký komentár. Zväzok I.* Bratislava: Wolters Kluwer s. r. o., 2017, pp. 1584.

38 Ibidem, pp. 1585.

39 PÁLKA, Radoslav. *In* PATAKYOVÁ, Mária a kol. *Obchodný zákonník. Komentár. 5. vydanie.* Bratislava: C. H. Beck, 2016, pp. 1197.

40 According to Section 220z paragraphs 1 and 2 of the Commercial Code: "*The right to request the acquisition of a share authorises a shareholder (entitled party) to determine the price of one share and to request another shareholder (obliged party) to transfer its shares to it for such determined price. The entitled party means a shareholder who will first deliver its offer with determination of price per share to another shareholder. If the obliged party does not accept the offer submitted by the entitled party within the period and in the manner determined the shareholders´ agreement, it shall be obliged to acquire the shares from the entitled party under the same conditions.*"

be the delivery of the offer, which must contain determination of the unit price per share. The obliged shareholder can accept the offer submitted by the entitled shareholder and after its acceptance it will have to sell its shares to the entitled shareholder. Or the obliged shareholder can remain passive during the period determined to acceptance of the offer, due to which the obliged shareholder will have to buy shares of the entitled shareholder under the conditions resulting from the initial offer of entitled shareholder.

The provisions of the Commercial Code do not require the occurrence of a deadlock situation between shareholders to be a substantive condition of initiation of the exercise of this right. The Commercial Code in this case does not regulate any situations, the occurrence of which should be the condition of the exercise of this right. Conditions of the exercise of the right to request the acquisition of a share as well as their content remain at the discretion of shareholders.[41]

From the perspective of the exercise of the right it may be problematic when the right to request the acquisition of a share is arranged by more than two shareholders. In view of the necessity to determine the purchase price per unit, problems may arise also in a situation where shareholders, who are a party to this subsidiary arrangement, are owners of several types of shares at the moment of initiation of the exercise of the right. Under these circumstances the parties should agree in advance, directly in the shareholders´ agreement, on the "exchange rate" of shares, so that the price determined for one type of share can be used as the basis for determination of price of another type of share.[42]

In view of the wide discretion granted by the law, the right to request the acquisition of a share can be arranged in a manner that its substantive scope will be limited to a specified (required) number of shares, the acquisition of which by the other shareholder will allow overcoming of the deadlock situation. With this solution the draconian dimension of this concept will be undoubtedly supressed; however, the overall readiness and willingness of the shareholders to resolve the deadlock situation by mutual agreement may decrease in proportion.

The Commercial Code also addresses legal consequences of a violation of the right to request the acquisition of a share by the obliged shareholder (i.e. a situation where in case of the exercise of the right the obliged shareholder refuses to sell and buy its shares to/from the entitled shareholder). Under these circumstances the Commercial Code grants to the entitled shareholder the right to sue the obliged shareholder by bringing an action for replacement of manifestation of will. The entitled shareholder will require a replacement for manifestation of will of the obliged shareholder[43], whereby it will indicate in the action the pro-

41 Section 220z paragraph 3 of the Commercial Code.

42 PALA, Radovan et al. *In* OVEČKOVÁ, Oľga a kol. *Obchodný zákonník. Veľký komentár. Zväzok I.* Bratislava: Wolters Kluwer s. r. o., 2017, pp. 1584.

43 Article 229 of the Code of Civil Litigation Procedure or Article 35 second sentence of the Act no. 244/2002 Coll. on arbitration.

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visions of the contract on the purchase of securities in accordance with paragraph 1 of the second sentence, according to which the obliged party should acquire shares of the entitled party. In case of success of the entitled shareholder in this lawsuit the will of the obliged shareholder to conclude the contract set out in the action, on the basis of which the obliged party will acquire the respective shares of the entitled party, will be manifested by the force of res judicata of the judgment.[44]

In comparison with the shoot-out right agreed in other capital companies, the introduction of a one-year preclusive period for the right to request a replacement for manifestation of will of the entitled shareholder seems unnecessarily strict. In case of violation of the shoot-out right agreed within a limited liability company the entitled shareholder may also bring an action to substitute the manifestation of will, but preclusion of the right will not be applied. The right to bring an action for substitution of will of the obliged shareholder is subject to prescription. However, the general prescription period of four years applies in this case.

6 Conclusion[45]

The shoot-out right is an instrument for fast and cost-effective resolution of deadlock situations that decrease the overall value of a closed corporation or jeopardise its proper functioning and existence. Its main purpose is elimination of a persistent deadlock. A formalized procedure of determination of the purchase price of shares is used in this process. This contracting mechanism corresponds to a method called "*cake-cutting*", where one person cuts the cake in two pieces (which figuratively corresponds to the initiating offer to buy or sell with indication of the purchase price per unit), while the other person has the right to decide which piece of the cake it will choose (again figuratively it means the other shareholder as addressee of the offer will determine the type of transaction to be performed, i.e. purchase or sale). Subsequently, the holding will be transferred to a shareholder who was successful in the shoot-out, by which the holding of several shareholders will be transformed to exclusive (majority) holding of the successful shareholder.

However, the shoot-out right also has fundamental disadvantages. Undoubtedly, one of them is overall unpredictability of outcome after the initiation of the exercise of the right. It also brings a risk for the participating shareholders, when the shareholder who manifested its will to exit the company in the submitted offer, is forced to become its sole shareholder instead. The unpredictability of outcome after the initiation of the exercise of the shoot-out right significantly

44 PALA, Radovan et al. *In* OVEČKOVÁ, Oľga a kol. *Obchodný zákonník. Veľký komentár. Zväzok I.* Bratislava: Wolters Kluwer s. r. o., 2017, pp. 1585.

45 This paper was elaborated due to the grant support provided by Research and Development Agency, based on contract No. APVV-15-0456, with the title Long-term and recent development tendencies of positive law in selected branches of the legal system.

decreases its attractiveness as an instrument of shareholder conflict resolution. This is also documented by empiric experiences from abroad (Anglo-American environment), where the tested subjects in case of a conflict preferred the implementation of individual offers to buy or sell shares over the initiation of the exercise of the agreed shoot-out right.

The shoot-out right also has the potential to be abused. Factors that can lead to an abuse of the shoot-out right in the practice are: economic power of a shareholder, access of shareholders to capital and the issue of information asymmetry. The economically weaker shareholder may lack real access to capital (or to sufficient resources), and hence it will not have enough funds for payment of the purchase price to the exiting shareholder. The success in "shoot-out" will not resolve the situation for the economically weaker shareholder. The economically stronger shareholder can then abuse this situation by trying to use so-called "predator potential" of the right to acquisition of shares. This factual abuse of the right consists in the procedure of the economically stronger shareholder, who knows the situation of the other, economically weaker shareholder. For this reason, such shareholder will intentionally make a low-ball offer, because it is fully aware that the economically weaker shareholder will not be able to pay even such decreased price. After the reversal of the situation during the implementation of the exercise the economically weaker shareholder will then be obliged to sell its shares under economically disadvantageous conditions. This imbalance can be reduced by adjustment of conditions of the exercise of the right (and thus decrease the probability that the court will regard the agreed rights as invalid in the respective case), i.e. by providing a sufficient period to obtain required resources for the purchase price from other sources, or by allowing the payment in instalments to the economically weaker shareholder.

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