

Tag along and drag along clauses in shareholders' agreements

In our two previous "MNKS booklets" dedicated to shareholders' agreements¹, we briefly described the main contractual clauses intended respectively to (a) restrict the transferability of the shares of a company, namely inalienability clauses, approval clauses and pre-emption clauses and (b) ensure the maintenance of a company's share capital structure, namely stand-still clauses, anti-dilution clauses and ratchet clauses, as well as the main legal rules governing them under Luxembourg law.

Restricting the transferability of shares and ensuring the maintenance of the capital of a company are of course two important elements for the latter and its shareholders. However, there is a third element that is equally important in this context, which consists in organising a right and/or obligation to withdraw in whole or in part for all or some of the company's shareholders in certain circumstances.

Several contractual clauses, the validity of which is generally accepted by both Luxembourg doctrine and case law, pursue such an objective. Examples include option clauses², exclusion clauses, withdrawal clauses, initial public offering clauses or joint selling clauses of the company³.

The most common clauses - or at least the most frequently encountered and applied in practice - intended to organise a right or obligation (total or partial) for shareholders to leave a company are (a) the so-called tag along clauses and (b) the drag along clauses.

We will deal below with these two types of clauses, whose legal subtleties are not always fully understood in practice, in order to give parties who wish to use them a better knowledge of their purpose and functioning.

The purpose of tag along clauses⁴ is to allow one or more shareholder(s) of a company⁵ (the "**Beneficiary(ies)**") to transfer, if it/they wish(es) so, all or part of the shares it/they hold(s) in a company at the same time as one or more other shareholder(s) (the "**Transferring Shareholder(s)**") who have decided to transfer all or part of its/their shares to a purchaser (the "**Purchaser**")⁶. In more general terms, it is therefore a right (and not an obligation) of the Beneficiary(ies) to transfer all or part of its/their shares in a company at the same time - and most frequently on the same financial terms - as the Transferring Shareholder(s) transfer(s) its/their own shares to the Purchaser. This explains in particular why tag along clauses are so frequently referred to, particularly in Belgian law, as a "*droit de suite*" (translating literally as a right to follow)⁷, which seems to be their best denomination in French.

Where they may appear misleadingly easy to draft, tag along clauses present multiple variants and complexities. The drafting of these clauses requires the determination of several conditions related, on the one hand, to the triggering of such clauses, and on the other hand, to their implementation.

Without this list being exhaustive, the author, beneficiary or debtor of a tag along clause, must therefore, at the very least, take a position on the following main elements during its drafting and negotiation:

¹ This terminology refers to any partnership agreements or shareholders' agreement of a company.

² Whether call options, put options, crossed options or options organised to as to form a « buy or sell » clause.

³ Which will not be dealt with in this « MNKS booklet », but will be ultimately considered in one of our forthcoming booklet dedicated to contractual clauses in shareholders' agreements preventing or remedying to long-term conflict between shareholders.

⁴ Also qualified in French as "*clause de remorquage*".

⁵ Who usually are minority shareholders.

⁶ Who usually are majority shareholders.

⁷ It must be noted that in France, the notion of « *droit de suite* » however generally refers to the possibility for a seller to be paid an additional price in the event of a transfer by the initial transferee of shares acquired from the seller to a third party at a higher price in a certain period of time following the initial transfer.



- triggering threshold: the tag along clause must specify whether it may be triggered by its Beneficiary in the event of a transfer by the Transferring Shareholder of any of its shares or only of a certain percentage of its shares⁸;
- proportional nature: the tag along clause must specify whether, at the time of its implementation, its Beneficiary may simultaneously transfer to the Transferring Shareholder all its shares in the company⁹ or only a number of shares proportionally identical to those transferred by the Transferring Shareholder¹⁰;
- allocation of the shares transferred: the tag along clause must also organise what will happen if, in the event of the exercise of the tag along right, the Purchaser refuses to increase the number of shares it initially planned to acquire¹¹;
- nature of the Transferring Shareholder's obligation: the tag along clause should clarify the precise obligation devolved to the Transferring Shareholder in the event the Beneficiary exercises its tag along right; several degrees of obligation are conceivable:
 - o obligation of the Transferring Shareholder to directly purchase the Beneficiary's relevant shares, provided that it subsequently retransfers them (or not) from the Purchaser¹²;
 - o obligation of best efforts ("*obligation de moyen*") or procurement ("*porte-fort*") of the Transferring Shareholder to ensure that the Purchaser will simultaneously also acquire the relevant shares of the Beneficiary, with (or without), in case of default by the Purchaser, a prohibition for the Transferring Shareholder to transfer its own shares (unless it acquires itself the relevant shares)¹³;
 - o obligation of result ("*obligation de résultat*") of the Transferring Shareholder to ensure that the Purchaser will acquire the relevant shares of the Beneficiary at the same time as its own shares with, in case of default by the Purchaser, an obligation for the Transferring Shareholder to purchase itself the relevant shares of the Beneficiary or to pay it a fixed allowance....
- financial conditions of the transfer: the tag along clause must specify at which price its Beneficiary may transfer its shares concurrently with those of the Transferring Shareholder; this will generally be the same price as that offered by the Purchaser to the Transferring Shareholder ; however, it could be agreed otherwise, for example in case that the price offered does not seem to be in good faith;
- other conditions of the transfer: the tag along clause must specify which representations and warranties shall or shall not be given by the Beneficiary to the Purchaser in relation to the transfer of its shares; it must also specify, in case of such representations and warranties, how these will be granted to the Transferring Shareholder (e.g. individually, severally and jointly ...) and their possible limitations.

Tag along clauses are most frequently found in shareholders' agreements concerning joint ventures or management buy-outs. They confer on shareholders' relations an increased *intuitu personae* character, the Beneficiary indicating that its presence in the company is directly linked to the presence of the Transferring Shareholder. By their nature, tag along rights are generally granted to minority shareholders. However, they often have as indirect effect to complicate (depending on their wording and Beneficiary(ies)) the transfer of the shares of the company by the Transferring Shareholder(s) having agreed to grant them¹⁴.

⁸ Being cautious in specifying whether the clause will only play for example in the event of the transfer of an interest amounting to X% or more of the shares or more generally in the event of a transfer in one or several occasions to the same Purchaser of X% or more shares over a determined period of time.

⁹ Therefore called a total tag along right.

¹⁰ Therefore called a proportional tag along right.

¹¹ In this case, parties could effectively provide that, for example, the Transferring Shareholder shall waive the transfer of its shares to the Purchaser or that the number of shares contemplated to be sold initially to the Purchaser shall be reduced so that the Beneficiary could proportionally sell the same numbers of shares as theirs.

¹² Which could be legally secure by a put option granted by the Transferring Shareholder to the Beneficiary regarding the shares concerned.

¹³ Analysed by some authors of doctrine as « *a promise whereby the seller guarantees to the beneficiary of such clause the purchase of its shares by the third party. If the latter agrees to ratify, it takes on the promisor's commitments who therefore is released. If it disagrees, only the promisor will be held liable and the beneficiary of the clause will only obtain damages, to the exclusion of any forced execution.* ».

¹⁴ Because they will commit the Purchaser to purchase more shares than initially agreed if it wants to complete a transfer with the Transferring Shareholder, or because the Beneficiary could be a key person of the Company that the Purchaser would like to maintain in the share capital upon entrance, whereas this entrance will permit to the Beneficiary to withdraw as the case may be.



Drag along clauses or "*obligation de suite*" clauses impose - contrary to tag along clauses - on one or more shareholder(s) (generally minority shareholder(s)) of a company (the "**Compelled Shareholder(s)**") to transfer all or part of its/their shares of a company to a buyer (the "**Buyer**") at the same time as one or more other majority shareholder(s) (the "**Beneficiary(ies)**"), if it/they require(s) so. In more general terms, these clauses give its/their Beneficiary(ies) a right (but no obligation) to oblige the Compelled Shareholder(s) to transfer its/their own shares at the same time and generally on the same terms as its/theirs. They impose, in other words, an "obligation to follow" on the Compelled Shareholders.

The purpose of these clauses is thus mainly to enable its/their Beneficiary(ies), if it/they find(s) a Buyer interested in acquiring all the shares of the concerned company, to facilitate the sale of its/their shares by avoiding having to deal with the expectations of one or several minority shareholder(s) and by excluding the risk of suffering a discount on the price offered by the potential Buyer who could not buy the entire share capital of the company. These clauses are common in private equity transactions where the (majority) financial shareholder(s) ultimately want(s) to ensure an exit from the capital.

The important points during the negotiation and drafting of drag along clauses are identical to those described above with regard to tag along clauses, with the following particularities:

- triggering threshold: the drag along clause can generally only be implemented in case of an offer received by a Buyer to acquire 100% of the company's shares¹⁵; in certain specific cases and circumstances, the drag along clause may not be applied before the expiration of a certain period of time;
- proportional nature: the drag along clause will generally not be proportional; it will quasi-systematically and indivisibly cover all the shares of the Compelled Shareholder(s)¹⁶;
- nature of the Compelled Shareholder's obligation: the drag along clause must specify the precise obligation devolved to the Compelled Shareholder in case of the triggering of the drag along clause; for example, the obligation to transfer its shares to the Beneficiaries or directly to the Buyer, whether or not guaranteed by a (transferable) call option mechanism in favour of the Beneficiary...
- financial conditions of the transfer: the drag along clause must specify at which price the Compelled Shareholders will be forced to transfer their shares at the same time as those of the Beneficiaries (*i.e.* the market price, obtained according to a procedure for placing the company on the market described in the shareholders' agreement and usually involving the intervention of financial intermediaries); this will generally be the same price as the one offered by the Buyer for the Beneficiaries' shares; however, depending on the circumstances, it is quite regularly agreed on a determinable price to be decided by an expert in case of a dispute of the good faith nature of the price proposed by the Buyer or even a floor price ;
- other conditions of the transfer: the drag along clause must specify which representations and warranties shall be given or not by the Compelled Shareholder(s) to the Buyer in connection with the transfer of its/their shares; it must also specify, in case of such representations and warranties, how these will be granted by the Compelled Shareholders (e. g. individually, jointly and severally between them, jointly and severally with the Beneficiaries...) and their possible limitations. The drag along clause will also generally specify that the Buyer may not be an affiliate of the Beneficiary in order to compensate for a bad faith triggering of this mechanism and to avoid a squeeze-out of the Compelled Shareholder (in principle a minority shareholder).

¹⁵ This being said, a drag along clause could (very) theoretically be practicable as soon a Buyer would make an offer to purchase a number of shares higher than those owned by the Beneficiaries.

¹⁶ This being said, a proportional drag along clause could also be theoretically practicable.



It should be pointed out in conclusion that both in the case of tag along clauses and drag along clauses, the practice in Luxembourg consists largely in "duplicating" such clauses in the company's articles of association, with the obvious aim of making them enforceable against third parties and thus protecting their Beneficiaries against any attempts to circumvent their object. Finally, these clauses are naturally subject to the general principles of Luxembourg company law, such as approval in case of a transfer of shares to a non-shareholder third party, or the principle that the non-execution of an obligation to perform is in principle resolved in damages, so there will be no guarantee for example that a judge will order the forced execution of a drag along clause.

CONTACT



Jean-Philippe Smeets
Head of M&A
smeets@mnks.com
T: +352 26 48 42 1



Melissandre Demarcq
Associate
demarcq@mnks.com
T: +352 26 48 42 1

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