SHAREHOLDER DISPUTES REGARDING THE EXIT OF A SHAREHOLDER:

THE GOOD-, THE BAD-(LEAVER) & HAVILTEX

Amsterdam District Court 18 January 2023, ECLI:NL:RBAMS:2023:867

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1. INTRODUCTION

Disputes regarding leaver provisions in shareholders' agreements occur on a regular basis. A shareholder who leaves the company may consider himself a good leaver under the shareholder agreement, while the remaining shareholders consider him to be a bad leaver. The qualification good leaver or bad leaver is especially relevant for the price that the departing shareholder receives for his shares, which he is often obliged to offer to the remaining shareholders.

Published case law on this type of disputes is scarce, but confirms that an unambiguously worded leaver provision in a shareholders' agreement contributes to an effective exit of a shareholder.[2] An important factor in this respect is that shareholders' agreements are commercial agreements that judges tend to interpret more objectively and linguistically than other types of agreements.[3]

This article highlights the judgment of the Amsterdam District Court on 18 January 2023, which confirms that a leaver provision can facilitate an effective exit of a shareholder through regular civil proceedings even if the leaver provision is not directly invoked and results in the shareholder having to accept a price for his shares that is lower than the amount he invested in the company, even when he qualifies as a good leaver.

In this specific case, the remaining shareholder of a start-up first invokes the leaver provision in writing in February 2019 and then again in December 2021 after the departing shareholder's employment agreement is terminated as of December 2018. After initiating proceedings in late June 2022, the exit of the departing shareholder is effected within seven months at a share price of EUR 1. The court hereby sets a high bar for honouring a claim of forfeiture of rights, in line with established case law, and determines the moment of termination of the employment agreement as the reference date for the valuation of the shares. What's more, the court declares that the judgment shall have the same effect of a notarial deed of transfer if the departing shareholder refuses to cooperate in the transfer (pursuant to Article 3:300(2) of the Dutch Civil Code).

Of interest for legal practice is to know how the court arrives at its judgment - by answering some of the questions that arise in many leaver disputes:

(i) Does the termination of the departing shareholder's employment agreement qualify as a good leaver or a bad leaver situation under the shareholders' agreement?

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[2] See, for example: Gerechtshof Den Haag, 6 April 2021, ECLI:NL:GHDHA:2021:915, Rechtbank Amsterdam, 11 January 2023, ECLI:NL:RBAMS:2023:76, Rechtbank Rotterdam, 1 September 2021, ECLI:NL:RBROT:2021:9338, Gerechtshof 's Hertogenbosch, 23 February 2021, ECLI:HR:GHSHE:2021:534 and A.M.M. Huijg, H.M.C. van der Linden, 'The bad leaver rule: it better be good', *Bb* 2022/18.

[3] HR 5 April 2013, ECLI:NL:HR:2013:BY8101 (Lundiform/Mexx).

(ii) Does a mandatory offer provision under the shareholders' agreement apply even if a considerable period of time elapsed before the leaver provision was invoked?

(iii) If so, at what price should the departing shareholder's shares be offered?

(iv) What reference date for the valuation of the shares should be used?

In answering the first two questions, the court qualifies the adduced evidence on the basis of an objective linguistic interpretation of the relevant provisions.

Questions iii and iv, according to the court, should be interpreted using the Haviltex standard, as it is of the opinion that a purely linguistic interpretation does not suffice. In answering these last two questions, the court pays more attention to subjective circumstances to interpret the parties' intentions, but concludes that the objective linguistic interpretation of the provisions of the shareholders' agreement should prevail.

2. THE DISPUTE

On 20 December 2016, two investors entered into a shareholders' agreement (the "**Shareholders' Agreement**") in relation to their participation in a limited liability company (B.V.) incorporated in 2015 (the "**Company**"). The Company is a start-up belonging to an international group with another Dutch company and a US company, among others.

The Shareholders' Agreement contains a provision which prescribes that in case of termination of cooperation between the Company's group and a shareholder, that shareholder is required to offer his shares to the remaining shareholder(s) (Articles 4 and 5). The Shareholders' Agreement distinguishes between the situation where the departing shareholder leaves as a bad leaver (Article 2) or as a good leaver (Article 3).

In this case, the departing shareholder initially performed services for the Company's group under a management agreement. As of 1 January 2017, the departing shareholder worked for the US group company on the basis of an employment agreement. On 30 November 2018, the departing shareholder's employment agreement was terminated by the US group company by means of a termination letter dated 7 September 2018 stating that the departing shareholder was considered a good leaver.

By letter dated 22 February 2019, the remaining shareholder requested the departing shareholder to offer his shares to him for an amount of EUR 1. After this communication, there is no contact between the parties for some time. On 8 December 2021, the remaining shareholder again summoned the departing shareholder to cooperate and offer this shares to the remaining shareholder. As the departing shareholder did not respond to this summons, the remaining shareholder initiated legal proceedings by a writ of summons dated 30 June 2022. In short, the remaining shareholder claimed that the departing shareholder was required to cooperate in effectuating the transfer of his shares for an aggregate price of EUR 1.

The remaining shareholder's claim is based on the contention that the termination of the departing shareholder's employment relationship with the US group company constitutes a situation as described in Article 2 (bad leaver) or Article 3 (good leaver) of the Shareholders' Agreement, as a result of which the mandatory offer obligation ex Article 4 of the Shareholders' Agreement is applicable. The remaining shareholder further argues that the departing shareholder must offer his shares for a price of EUR 1, as the shares did not represent any value at the time the obligation to offer a share arose. This is argued to be the case because the Company's EBIT, on which the share price should be based, was negative in the 12 months prior to the departing shareholder's termination.

According to the departing shareholder, the mandatory offer obligation derived from Article 4 is not applicable because there was no situation as described in Article 2 or Article 3. The departing shareholder contests that he is a (good- or bad-) leaver. He contests that he had any employment relationship with the Company's group at all. The departing shareholder argues that he only worked for the group as an independent contractor. The departing shareholder further challenges the valuation of the shares and the determination of the share price. The departing shareholder is of the opinion that the share price should be determined based on the EBIT of the other Dutch group company or the entire group of the Company over the past 12 months.

3. COURT JUDGEMENT AND ANALYSIS

3.1 (i) Bad leaver or good leaver?

In shareholders' agreements it is customary for managers who are also shareholders to agree that they are required to offer their shares to the other shareholder(s) when they leave as managers. The price they receive for the offered shares is determined dependent on the qualification as a good- or bad leaver. A bad leaver can generally expect a lower price per share. Usually, managers qualify as bad leavers if their employment ended due to an urgent reason as mentioned in Section 7:678 of the Civil Code. We observe that the bad leaver provision in the Shareholders' Agreement (Article 2) was also aligned with this standard.

Thus, to answer the first question, the court must determine whether there is a situation as defined in Article 2 (bad leaver) or Article 3 (good leaver*)*. The court concludes fairly quickly that there is no bad leaver situation because the remaining shareholder did not argue that the employment agreement with the departing shareholder had been terminated due to an urgent reason attributable to the departing shareholder. In addition, the termination letter expressly stated that the departing shareholder was considered a good leaver. Thus the departing shareholder is considered to be a good leaver.

3.2 (ii) Mandatory offer

In assessing whether the obligation to offer shares applies even if there has been a considerable period of inactivity, the court first established that the mere lapse of time before the leaver provision was invoked is not sufficient for a successful reliance on forfeiture of rights on the side of the remaining shareholder. The fact that the departing shareholder was first asked to comply with the offer obligation two months after the end of the employment agreement and the fact that the remaining shareholder subsequently sat idle until December 2021, does not mean that the departing shareholder could legitimately expect that the offer obligation could no longer be enforced against him. The court could not find any additional special circumstances present on the basis of which the departing shareholder could assume that the remaining shareholder would no longer rely on the Shareholders' Agreement. This means that, according to the court, there is no forfeiture of rights, as argued by the departing shareholder. It is relevant here that Article 18 of the Shareholders' Agreement shows that the failure by a contracting party to act to a certain extent does not allow that party to waive his or her rights. Contrary to what the departing shareholder argues, the content of that article (also) applies to all parties. It is established that the parties agreed to the Shareholders' Agreement, thus the entire Shareholders' Agreement applies.

With regard to the first two questions, we conclude that an objective linguistic interpretation of the provisions of the Shareholders' Agreement is sufficient. The provisions leave no ambiguity or room for interpretation and the court does not consider it necessary to expressly give additional consideration to factors other than linguistic interpretation.

3.3 (iii) Price for the shares

Article 5(1)(b) of the Shareholders' Agreement reads as follows: "*(...) A Good Leaver is required to offer the shares held by him in [the Company (ed.)] at 100% of the value based on 5 x the EBIT for the last 12 months*". The parties interpret this article differently. The remaining shareholder finds that the share price should be determined based on the Company's EBIT for the 12 months preceding the termination of the cooperation with the departing shareholder. The departing shareholder argues that the share price should be determined on the basis of the EBIT of the other Dutch group company or the entire group of the Company over the past 12 months from today, by which he seems to mean the time of the offer.

The court ruled that a purely linguistic interpretation of Article 5 (1)(b) is not sufficient and that the Haviltex standard should be applied. This means that when answering the question of what the parties have agreed to, it comes down to the meaning the parties could reasonably attribute to each other's statements and behaviour in the given circumstances, and to what they could reasonably expect from each other in this respect.

It follows from established case law that the Haviltex standard has both a subjective and objective component.[4] An interpretation of an agreement on the basis of the subjective Haviltex standard aims to ascertain the parties' intentions by giving weight to more subjective connecting factors. Interpretation on the basis of this standard is reasonable in situations where legal relationships are more unequal or parties have less legal knowledge, for example with consumer contracts. When interpreting an agreement on the basis of the objective Haviltex standard, (a) the text of the clause is read in (b) the context of the entire contract, where (c) consideration is also given to the knowable scope of the relevant clause and (d) the plausibility of the interpretation.[5] When interpreting commercial agreements such as shareholder agreements, the nature of such agreements justifies the application of the objective Haviltex standard taking into account all the circumstances of the case.[6] It is assumed that parties to this type of agreements are professionals and have deliberately entered into a written agreement with assistance from (legal) professionals.[7]

The court rules that the remaining shareholder's interpretation (that the Company's EBIT is meant) is consistent with the linguistic interpretation of Article 5(1)(b). It also considers the content of the other provisions of the Shareholders' Agreement and substantiates its opinion by pointing out that the Shareholders' Agreement explicitly refers to the Company and not to another entity or the Company's group. There are also no clues in the rest of the Shareholders' Agreement to suggest that the value of an entity other than the Company should be taken.

In this case the court does not consider the departing shareholder's contention that the price he paid for the shares at the time of his investment was based on the value of the Dutch group company of which the Company is a part. The apparent purport and most plausible interpretation of the leaver provision

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[4] HR 20 February 2004, ECLI:NL:HR:2004:AO1427, NJ 2005/473, para 4.4 (*DSM/Fox*), A-G Timmerman in his opinion (at 4.31) for HR 23 October 2009, ECLI:NL:HR:2009:BJ7331.

[5] B-A. de Ruijter and D. Glazener, Chronicle of takeover disputes in coronagraph 2021, *MoM* No 5 & 6/2022, pp 125 - 135.

[6] HR 19 January 2007, ECLI:NL:HR:2007:AZ3178 (*Meyer/Pontmeyer*), HR 5 April 2013, ECLI:NL:HR:2013:BY8101 (*Lundiform/Mexx*), see also A-G Timmerman in his opinion (under 4.32 and 4.36) for HR 23 October 2009, ECLI:NL:HR:2009:BJ7331. Earlier, the Court of Appeal of 's Hertogenbosch also applied this standard when interpreting a good leaver/bad leaver provision: Court of Appeal of 's Hertogenbosch, 23 February 2021, ECLI:HR:GHSHE:2021:534, r.o. 3.7.4.

[7] HR 19 January 2007, ECLI:NL:HR:2007:AZ3178 (*Meyer/Pontmeyer*), see also A-G Timmerman in his opinion (at 4.32 and 4.36) for HR 23 October 2009, ECLI:NL:HR:2009:BJ7331.

leads to the conclusion that the share price the departing shareholder receives for his shares should be determined on the basis of the value of the Company.

It follows from the above considerations of the court that it matters what parties agree on paper. Had the shareholders of the Company clearly described what EBIT should be used by, for example, including a definition of EBIT in the contract, there would have been no discussion.

3.4 (iv) Reference date

In order to determine the reference date and the share price as well as to ascertain the parties' intentions, the court first considers what was agreed in writing in the Shareholders' Agreement. With respect to the reference date, the court held that the stipulations of Article 4 (1) of the Shareholders' Agreement should be adhered to. Pursuant to this article, the departing shareholder was obliged to immediately offer the shares to the remaining shareholder. In conjunction with Article 4 of the Shareholders' Agreement, the court explains Article 5(1)(b) of the Shareholders' Agreement in the sense that the 12-month period is started from the moment the cooperation with the departing shareholder ended: 1 December 2018. Referring to the Company's financial statements, the court finds that the remaining shareholder has sufficiently substantiated that the Company did not make a profit in the 12-month period prior to 1 December 2018 and the Company's EBIT was negative during that period. Therefore, at the time of the shareholder's departure, the shares had no value under the valuation measure in Article 5(1)(b) of the Shareholders' Agreement and the symbolic purchase price could be set at EUR 1.

Finally, the court devotes a further paragraph to the departing shareholder's contention that at the time of investment, the remaining shareholder had led him to believe that investing in the Company's group was a no-brainer, that the group was going to make a large profit and that the chances of losing money were slim. The court first notes that no counter argument was connected to this claim and that given the nature of the investment (being an investment in a start-up) and the formulation of the provisions of the Shareholders' Agreement the departing shareholder could not draw the conclusion that the investment was without any risk. According to the court, the departing shareholder's expectation that he would at least have his deposit be reimbursed in the event of a buyout must therefore remain for his own account.

In this last paragraph, we read the court's application of the subjective Haviltex standard. The court seems to pay attention to the question whether, based on communications made by the remaining shareholder at the time the investment took place, expectations were reasonably raised with the departing shareholder on the basis of which the departing shareholder could have interpreted the arrangements between the parties and the provisions of the Shareholders' Agreement in such a manner that he would never be able to receive a lower price for his shares than his initial investment (EUR 28,000).

The court concludes that this is not the case and in this respect pays attention to the capacity of the parties which is also a relevant circumstance in the interpretation of contracts according to the Supreme Court[8] and concludes that as investors in a start-up, they should have considered that such an investment is not without risks.

We find this line of argument by the court to be sound. An investment in a start-up or scale-up company is inherently risky and it is not uncommon for companies in the start-up or scale-up phase to fail to realise the growth of value initially envisaged by investors.

[8] HR 20 September 2013, ECLI:NL:HR:2013:CA0727 (*Rotterdam/Eneco*).

Based on the above, the court concluded that the claims of the remaining shareholder should be allowed and that the departing shareholder should transfer his shares to the remaining shareholder for a price of EUR 1.

In the last paragraph of its conclusion, the court makes the remarkable observation that it realises the outcome of these proceedings is unsatisfactory for the departing shareholder, especially since at the hearing it appeared that the remaining shareholder offered a share price that was equal to the amount of their investment to other former shareholders of the Company in the past, and that the remaining shareholder was not (anymore) willing to make this offer to the departing shareholder. However, the court continued that the expectation for the same treatment from the departing shareholder is not legally enforceable, pointing to the written agreements between the parties in the Shareholders' Agreement. The fact that those agreements are detrimental to the departing shareholder is no ground to set aside those agreements, the court concluded.[9]

4. CONCLUSION

In this case, the route of going to court resulted in a stalemate between shareholders that persisted for a number of years being settled within a period of months. The court's judgement in this case can even substitute a deed of transfer which means the remaining shareholder can directly effect the transfer of the shares if the departing shareholder does not cooperate in accordance with this ruling.

In our view, the court's application of the objective Haviltex standard is justified given the nature of the agreement and the relations between the parties as co-shareholders in a start-up. The predominantly linguistic interpretation of the leaver provision leads to the most plausible interpretation of the agreements between the parties. This leads to a disadvantageous situation for the departing shareholder due to the share price of EUR 1 he shall receive in contrast to the amount of EUR 28,000 that he paid for the shares and the fact that other shareholders did receive the amount of their investment. This seems unfair. In this context, the court indicates that it realises that this outcome is unsatisfactory for the departing shareholder. However, this is what the parties agreed to (*pacta sunt servanda*). Thus, the departing shareholder should have been more careful when drafting the Shareholders' Agreement.

The lesson for practitioners is that application of the Haviltex standard can turn out to be '*ugly'*, even for a good leaver, when it comes to explaining agreements made between shareholders. The motto should be: think before you begin. Parties investing in companies, especially in start-ups or scale-ups, should think carefully about the wording of the agreements they make with their fellow shareholders in the customary leaver provisions with regard to the share price in the event of an exit. If no agreements are made regarding the (minimum) share price to be received and the reference date for valuation in that regard, the investor has no guarantee that he will get back at least the amount of his investment in case of a (mandatory) sale. Especially in the case of a good leaver/ bad leaver provision, the pricing mechanism and certainly the reference date will require attention. For the investor, it is advisable to set this reference date at a time when the value or profitability of the company is as advantageous as possible.

[9] In this context, we also refer to the recent opinion of P-G Drijber in the Supreme Court concerning a judgment of the Court of Appeal of 's-Hertogenbosch that was appealed in cassation. In this case, the Court of Appeal ruled that a purchase price for depositary receipts ultimately amounting to EUR 1 does not make application of a bad *leaver* provision of a depositary receipts holders' agreement unacceptable in the given circumstances according to standards of reasonableness and fairness. According to Drijber, this judgment of the Court of Appeal is not incomprehensible. The Supreme Court subsequently disposed of the case by invoking 81 RO(HR 14 April 2023, ECLI:NL:HR:558).