

## Romania - Exit strategies: registering a share transfer when target shares are encumbered by third parties

**The stock market's flexibility is its greatest selling point for publicly traded companies, as it allows a fast flow of capital while still enabling majority shareholders to implement fundamental corporate changes should they wish to exit the market.**

However, even with all of this flexibility, shares may not always be free of other encumbrances, defences or liens, and the sale of such shares may be opposed by the interested parties or even refused to be recognised as a genuine sale by the Trade Registry. This is especially troublesome when shareholders aim to regain full ownership of the company.

So how can a majority shareholder exit the stock market when dealing with encumbered minority stock? Would a squeeze-out procedure succeed, or will it be deemed to defraud secured creditors? Most importantly, how may a majority shareholder regain full ownership over its company once again?

### **Facts**

In January 2018 the majority shareholder of a foreign-owned joint-stock company, which was headquartered in Romania and listed on the Bucharest Stock Exchange, initiated a tender offer to purchase all minority shares in accordance with capital markets laws. The shareholder aimed to:

- regain full ownership of its company;
- exit the stock market; and
- eventually convert the company into a limited liability company (LLC) to be more appealing for an upstream merger.

However, following the tender offer, the shareholder failed to acquire the remaining stock and had to initiate a squeeze-out procedure so that it could become the sole shareholder of the company.

Despite the shareholder exercising its rights under the Romanian Companies Law (31/1990), the Trade Registry refused to recognise the squeeze-out procedure and register the shareholder as the sole owner of the company. It argued that if it was to recognise the squeeze-out and record the stock transfer it would affect the creditors' rights, as all the minority shares were encumbered in favour of various creditors.

The shareholder immediately filed a complaint against the Trade Registry with the Bucharest Court. Besides the shareholder's will to regain ownership of its company, there was also the fear that as long as the Trade Registry refused to recognise the share transfer, the company would risk the severe penalty of winding up at the request of an interested party within the next nine months as, after the squeeze-out, it became a joint-stock company with only one shareholder – a clear violation of the Companies Law.

### **Grounds for dismissal and defence**

Following two hearings and supportive documentation being filed, the Trade Registry dismissed the request for registration of the share transfer, arguing that the existence of previously registered garnishments over the target shares prevented a valid transfer of the shares, despite the unfolding of a delisting process clearly regulated by the

capital markets laws. In its response to the majority shareholder, the Trade Registry argued that if it were to recognise the squeeze-out and record the stock transfer, it would affect the creditors' indemnities as such minority shares were encumbered in favour of creditors and the transaction was seen as putting such assets out of their reach.

The reasoning behind the dismissal resolution highlights the Trade Registry's unfamiliarity with and confusion regarding the squeeze-out procedure and its effects on the transfer of ownership, as well as the legislative void that exists relating to recognising such capital markets mechanisms.

As part of the legal defence against the Trade Registry's dismissal, the majority shareholder argued that:

- such refusal contravened the rights of the company to submit and register all such relevant acts for publicity purposes and violated the fundamental legal principle of having corporate acts recorded by the Trade Registry for opposability purposes, as stipulated under the Registry Law (26/1990) and the Civil Code;
- according to the Companies Law, the ownership right to shares issued in a dematerialised form and traded on a regulated market or in an alternative trading system is transferred according to the provisions of the stock market legislation;
- according to the Companies Law, any garnishment on shares is only of a protective nature, being an indemnity over the benefits that would be due to the shareholder during the business activity of the company;
- as a rule, in case of a share transfer, creditors may still pursue the 'benefits' (ie, have monetary claims against the net proceeds resulting from a share sale); and
- transactions with listed securities are complex operations conducted under the close and strict supervision of the Financial Supervisory Authority (ASF) and involve several stages which take place without the buyer's or seller's involvement; thus, the rules regulating stock market transactions do not only ensure the fairness of a share transfer but also give creditors the guarantee that their interests will not be defrauded, as they can collect their debt from the collector account opened and managed by an independent intermediary authorised by ASF.

Thus, the Trade Registry, being mainly a publicity instrument, has no power to review the legality of a squeeze-out procedure. Rather, it has only the obligation to record the transfer of ownership and make the related registration, regardless of the existence of any garnishments.

### **Decision**

The Bucharest Court ruled in favour of the majority shareholder. The court emphasised the Trade Registry's duty to recognise the squeeze-out as a genuine sale and register the share transfer regardless of garnishments, since the transfer was made in accordance with the capital markets legislation.

The Trade Registry did not appeal the decision.

### **Comment**

As this case shows, it appears that the Trade Registry's internal registration procedures are not fully aligned with the laws and regulations governing the stock market. The stock market legislation sometimes derogates from the general rules on the transfer of ownership rights and the establishment of garnishments over shares, and has specific mechanisms available to ensure fast-paced market transactions.

Garnishments on publicly traded stocks are subject to different publicity requirements that do not require registration with the Trade Registry and have no effect on the ownership transfer. Any pledge on financial instruments must be constituted according to the rules of the market on which they are traded. Thus, the general laws governing the stock market and the Capital Market Law (297/2004) in particular must be followed when establishing a pledge over publicly traded stock.

To conclude, when aiming to either regain full ownership of a publicly traded company, exit the stock market, convert the company into an LLC or envision an upstream merger where the legal regime for the minority shares is not entirely clear, it is best to consider allocating sufficient time and resources for the potential court proceedings against the Trade Registry.