PRIVATE EQUITY AND INVESTORS' EXIT RIGHTS: AN ANALYSIS OF 'TAG ALONG' AND 'DRAG ALONG' CLAUSES

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ABSTRACT

This thesis focuses on the role and importance of tag along and drag along clauses-based exit strategies play for private equity firms appearing in the shoes of investors, from the perspective of US law, both federal and the laws of the various States. The main goal of the private equity investors is to make an investment into a promising investee firm, to which institutional banks do not give a loan, with the expectation of future returns. Often, they form a special purpose vehicle (SPV) typically in the form of limited partnership, through which they invest money into the investee firm to limit their liability. The investments are always made for a limited period time. Consequently, it is essential for private equity firms to easily exit the investment, possibly with profits or with minimal losses.

Generally, there are more avenues to exit, simpler and more complex ones, from initial public offerings (IPO) and secondary sales – where the private equity investor decides to sell the business to a different investor[1], to trade sales – where the company is sold to another company, often to bigger corporations seeking "market share".[2] The thesis is, however, devoted to exit through tag along and drag along clauses within the context of the US law, as a jurisdictions possessing mature laws on and ample experiences with these. The analysis aims, on the one hand, to critically asses what dilemmas and other practical issues faced by investors when applying them, and on the other hand, to propose possible solutions for the detected problems.

The result of the research denotes that though there are several ways to exit the investments, tag along and drag along clauses are considered to be the most effective and straightforward routes because they create balance between the interest of the majority stockholders in the company and the interest of the minority. Moreover, they prevent

[1]Douglas J. Cumming Sofia A. Johan, *Venture Capital and Private Equity Contracting an International Perspective*, (Academic Press 2009).
[2] Sanusi Bintang, 'Venture Capital: An American Concept and Its Problems of Implementation in Developing Countries' (2015) 12 Indonesian J. Int'l L. 179.

emergence of deadlocks and abuses of the rights of any party, as well as are tools for achieving the parties' exit goals. Whenever the majority or the minority decides to sell its stake, the majority drags along the minority stockholders to exit, by forcing them to similarly, sell their stocks to a different investor on the same terms, at the same time. Whereas if the majority stockholders decide to sell their stake, the tag along clause grants the right to the minority shareholders to participate in the transaction and sell its stocks at the same terms, at the same price, thus obliging the third party to buy the minority stocks as well. Therefore, the tag along and drag along clauses shall be taken into consideration by the private equity investors.

CHAPTER ONE: INTRODUCTION

§ 1.1 Research Background

The great Private Equity (PE) investors, that put money into an investee firm, do not wait until exiting the venture becomes obvious and complex, thus demanding to commit levels of efforts to exit. Rather, they assure the exit strategies by contracting out the tag along and drag along clauses along the process to remedy the complexity. PE is defined as "funds invested in a new enterprise that has high risk and potential for a high return".[3] The PE funds are mostly related to starting and developing businesses that do not attract debt financing in order to help develop their, often, high-tech businesses.[4] The PE funds are most commonly known as specialized intermediaries.[5] For instance, the PE intermediaries form a special purpose vehicle (SPV) typically in the form of a limited partnership (LP), through which they invest money into the investee firm or into illiquid assets to which banks do not lend money, because there is high uncertainty to make future revenue. Thus, PE serves as financial support for many companies to restructure, grow, expand, and raise additional money.

As a rule, PE funds invest for a limited period time. Normally, as the US literature stipulates, for up to 10 years, which is a time span deemed to be sufficient for the investors to realise their aims and goals.[6] It is for them important, however, also to have the possibility to exit the venture even earlier. Thus, as far as investing into certain company is concerned, the investors need to be able to realise a clear and feasible exit strategy and return of their investment from the firm that they put money into, otherwise it may not worth to invest in.

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[3] Garner, Bryan A, Henry Campbell Black, *Black's Law Dictionary.* St. Paul, MN: West (2009)
[4] Joseph A. McCahery, Erik P.M Vermeulen, *Corporate Governance of Non – Listed Companies* (OUP, 2008).
[5] Douglas Cumming, Uwe Walz, 'Private Equity Returns and Disclosure Around the World' (2010) 41 Journal of Business Studies 727.
[6] Calum Paterson, 'When is the right time to exit a venture capital or private equity backed business*?*' *Real Business* (11 February 2014) < https://realbusiness.co.uk/when-is-the-right-time-to-exit-a-venture-capital-or-private-equity-backed-business/> accessed 20 March 2020.

Determining the value of the firm will depend on several factors, such as stage and sector of business and how it operates.[7] However, when it comes to exit strategies, traditionally, there are three types of exit strategies - initial public offering (IPO), secondary sales and trade sales. While all the exit strategies are practiced in the world of PE investments, tag along and drag along are the rights which make the exit simple, in the event of trade sale.

§ 1.2 Research Hypothesis

This thesis will contribute to the area of private equity investment firms. In particular, it will introduce the exit strategies, tag along and drag along rights, under which investors smoothly exit their investment.

Notwithstanding the fact that practice shows, the most common ways to exit being an IPO[8] when offering the company to the public and selling its shares, trade sale, with the well-drafted tag along and drag along clauses, has become the preferred and straightforward method for PE investors to leave the venture[9], where the company is sold or merged with a considerably larger entity in return for money or stocks in the acquirer.[10]

Yet, the issue that arises as regards the trade sale is that, often time, the company's management may disagree with the trade sale because of the risk of its own replacement. Thus, the author in this paper will demonstrate that the tag along and drag along rights are appropriate tools that address the practical as well as administrative issues, in the sense that, these clauses demand a complete knowledge of the management's aims and interests. Thus, when the interests and goals are established, the tag along and drag along will serve as operative measures to departure from the investment.

[7] Ibid.

[8] Investment Management, 'Exit Strategies for Private Equity Investors' *Finance Train* (2020) <https://financetrain.com/exit-strategies-for-private-equity-investors/ > accessed 20 March 2020.

[9] Guillaume Cazalaa, Wesley Hayes, Paul Morgan, 'Private equity exit excellence: Getting the Story Right' McKinsey & Company (1 August 2019) < https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/private-equity-exit-excellence-getting-the-story-right> accessed 20 March 2020.

[10] Calum Paterson, (n 3).

The reason tag along and drag along clauses are effective is because they create a balance between, the intent of the private equity investor to exit at a time, that is convenient for the majority stockholders and not selling the interest of a business owner in the company against their will. In other words, tag along grants the right to stockholders, usually minority, to exit along with the other stockholders at the same price and time, whereas, drag along grants a right to investing stockholders, to force the other stockholders to exit at the same price and time, when it decides to leave the investment.[11]

§ 1.3 Research Jurisdiction

The jurisdiction under which the present research will focus on is the United States. The United States remains the first-class market for private equity and thus it impacts the depth (with regard to size and liquidity) of its financial market and the inherent tendency for inventions.[12] Moreover, it is a destination of the most prosperous and strong private equity firms, which conventionally have mobilized the highest "'mega' funds".[13] For instance, as stated by Preqin, in 2018, "122 North America – focused funds obtained capital of about the US $36.9 billion as opposed to 42 Europe – focused funds, which mobilized the US $20.9 billion, as well as Asia – focused obtained US$21.9 billion".[14] Hence, the PE sector in the US has greatly evolved throughout the years gained adequate practice of attracting funds, investing, and exiting in a meaningful way.

While the Private Equity (PE) industry has been present in the US and Europe for an extensive period of time, the same cannot be said for Asian countries and specifically Central Asian countries. The notion of PE is largely unknown, and one could hardly speak of the existence of such industry in this niche of Asia. There is a death of laws, cases, empirical

[11] 'Drag Along/Tag Along Rights', *EURO-PHOENIX Financial Advisors Limited*, (2020) <https://europhoenix.com/blog/drag-along-tag-along-rights/> accessed 27 March 2020.
[12] Simpson Thacher and Bartlett LLP, 'Private Equity in the United States' (*Lexology*, 27 March 2019) <https://www.lexology.com/library/detail.aspx?g=91751223-bf37-403e-a014-5cb116636054> accessed 23 May 2020.
[13] Ibid.
[14] Ibid.

studies, and publications. Hence, to research the basis of PE and the exit rights that investors can benefit from, this thesis is resorting to the US as the jurisdiction with one of the most developed and most tested laws in the domain today. However, there will be also successful case laws presented, that are not under the US jurisdiction only, but also European and others. Although the findings will be of general nature, it is hoped that the Central Asian countries will benefit from these lessons as well.

§1.4 Research Methodology

1.4.1 Literature review

The research will define the notion and essence of the thesis based on the literature review. While PE and the exit routes by investors in Central Asian countries not being the focus of the paper, discussion of the current topic is relevant for those jurisdictions. PE industry has a positive impact on the economy and can lead to great developments, hence, the Central Asian regions, where the industry is emerging at this instant, might find it useful to be acquainted with the US literature on PE firms. Different approaches of PE investment and tag along and drag along exit rights, that were adopted in the US, will be discussed and analyzed.

First, the paper tackles the US literature, specifically, the book - *Private Equity at Work (2014),* by Eileen Appelbaum & Rosemary Batt, concerning the emergence, institutional change of PE firms and the investors as managers. It defines how the PE funds emerged, how they operated, and developed and what are the roles of the investors as regards the investment activates. Moreover, the book *Private Equity: Opportunities and Risks* (2015), by H. Kent Baker, Greg Filbeck, and Halil Kiymaz, demonstrates a clear discussion of PE firms, the exit strategies available and which might be more convenient according to the US practice to exit.

Additionally, the book *Venture Capital and Private Equity Contracting an International Perspective* (2009), by Douglas Cumming and Sofia Johan, the book *Corporate Governance of Non – Listed Companies* (2008), of Joseph McCahery and Erik Vermeulen, provide the context of PE firms, the forms of the firms, through which the investors put money into a certain business, as well as the governance of those firms, whether managed by the general partner (GP) of limited partner (LP).

As opposed to that, European literature is also of relevance. The reason is that, after the PE industry had received considerable attention after the dramatic growth and success in the US, it expanded to Europe. Thus, the European literature as well refers to the US literature in order to have a better insight into how the firms operate and what is the right time for the PE investor to exit. The European and other journals on PE fund structure, exit strategies, tag along rights and drag along rights and the advantages of each, by Alexandros Seretakis (2013), Jennifer Payne (2011), Darek Klonowski (2011), George W. Fenn and Nellie Liang, Stephen Prowse (1995), Yaw Brako Osei – Tutu (2014), Douglas Cumming, Uwe Walz (2010), Suren Gomtsian (2013), Jelena Pajic (2012) are other informative literature review in order to enhance the understanding of PE investments and exit rights by investors. Thus, it is vital to discuss other literature, other than the US, in order to determine in what ways other countries learned a lesson form the US literature on PE investment and the exit routes.

1.4.2 Case law

Further, some concrete examples of case laws that define the concept of private equity, fund structure, tag along drag along clauses and what purpose they serve for, will be demonstrated.

Generally, the PE industry in the US has become very famous. Since the emergence, from 1980, it has become one of the "wealthiest sectors of the economy of America".[15] Thus, the case law on the PE industry in the United States is common and easy to have access to.

[15] Bethany Mclean, 'Too Big to Fail, Covid-19 Edition: How Private Equity Is Winning the Coronavirus Crisis', *Wall Street, Vanity Fair* (9 April 2020) < https://www.vanityfair.com/news/2020/04/how-private-equity-is-winning-the-coronavirus-crisis > accessed 25 May 2020

The case laws are not limited only to US legislation but are also traced in Europe. Since in Europe PE is a newly developing industry, the number of the case is considerably less, but they do exist and some of the success cases will be demonstrated in the present research.

As regards the specific, tag along and drag along clauses, regardless of their wide application, the enforceability of the above-mentioned rights, received insufficient attention in legal scholarship and case law.[16]

In common law countries, such as the US and UK, authors usually denote that the tag along drag along clauses are not prohibited and that ideally, they can be enforced. The case laws that are discussed in the present research paper, derive mostly from Delaware jurisdiction because it has the most flexible and complete corporate laws. Moreover, the corporations are in a position to clearly understand their rights and responsibilities.

Whereas civil law countries, Europe is acting cautiously and there are doubts, whether these rights shall be illustrated in the articles of incorporation or stockholders' agreements.[17] Hence, specifically, cases on the tag along and drag along rights can be challenging to find under European jurisdictions.

§1.5 Roadmap

The present thesis consists of four chapters. The introductory chapter outlines the background of the research, hypothesis, jurisdiction, methodology, and roadmap. Chapter two consists of the basis of PE and investors' exit rights. It highlights the brief history and definition of PE, defines the structure of PE fund, the nine stages of the investment process of the PE fund, and a few concrete case examples. The third chapter identifies the exit strategies. It demonstrates the types of exit strategies and defines each, as well as examines, which type is commonly exercised by the investors. Chapter four analyzes specifically tag along drag along clauses, by providing an introduction and overview of each of the clauses. Later it analyses the

[16] Jeffrey N. Gordon and Wolf-Georg Ringe, *Corporate Law and Governance* (OUP 2018) 699.
[17] Ibid. 699.

concept of the above-mentioned clauses and defines how they can be inserted in the stockholder agreement in order for an investor to secure its exit. Moreover, some concrete case studies will be provided to illustrate the practice of tag along and drag along rights. Finally, a conclusion and recommendation will be provided with regards to the easy exit route for the investors of PE firm.

CHAPTER TWO: THE BASIS OF PRIVATE EQUITY AND INVESTORS' EXIT RIGHTS

§ 2.1 Introduction

The key components of PE firms, the definition, structure, process of investment as well as the studies of different routes of exit for PE investors are going to be evaluated in this section. Additionally, to better understand the concept of PE investments, the process and the different ways, which investors use to exit, several cases will be highlighted, that illustrate how PE investment and exit rights are exercised in practice. The cases are not limited to US jurisdiction only, but also derive from various jurisdictions.

§ 2.2 Private Equity Funds

2.2.1 Brief History and Definition

Private equity (PE) as a financial intermediary has had a great influence on the operation of businesses in the economy of the U.S. PE funds emerged back in the 1980s as the main source of unregulated private investment.[18]

The rapid growth of the PE funds by the 2000 was dramatic. "As reported by 'Private Equity Growth Capital Council,' by 2013, the total number of PE firms incorporated offices in the United States amounted to 2,797, while 17,744 PE – backed companies are headquartered in the United States".[19] Some of the well-known PE firms are, KKR[20], Blackstone[21] and Carlyle[22] which were capable of raising an immense unregulated pools of capital, from pension funds, endowments, sovereign wealth funds as well as wealthy people.[23] Since 2000, the

[18] Eileen Appelbaum, Rosemary Batt, 'Institutional Change and the Emergence of Private Equity' in Russell Sage Foundation (eds), *Private Equity at Work* (2014).
[19] Ibid. 34.
[20] Kohlberg Kravis Roberts & Co. L.P., < https://www.kkr.com/?lng=1> accessed 25 May 2020.
[21] The Blackstone Group Inc., < https://www.blackstone.com > accessed 25 May 2020.
[22] The Carlyle Group, < https://www.carlyle.com> accessed 25 May 2020.
[23] Eileen Appelbaum, Rosemary Batt (n 18) 34.

companies that were possessed by the PE funds, have employed about 7.5 million workers.[24] Approximately about 35 percent of the PE investments were derived from the US pension funds, in particular the public pension funds. These pension funds, in the low-interest-rate environment of 2000s, were attracted by the PE firms' promises of possible high return as opposed to investment via bonds or stock.[25] Consequently, access of the pension funds to the money of the workers allowed the PE firms to expand and become globally successful with their investment operations.[26] Therefore, the PE funds and PE investors do not only have a great impact on the employees in the companies that they own, but also on the vendors whom they are engaged in a business with, as well as, the retirement income of millions of working and retired Americans.

The definition of PE is unattainable, in the sense that it has been modified constantly. With the development of PE, since its emergence in the 1980s, the definition has also been changing. PE is a broad term, entailing various kinds of investments.[27] The traditional features of private equity investments are "illiquidity", because private equity involves securities that are not traded on the public market, therefore the securities may confront the risk of losing their value.[28] As an illustration, "in an event of investing into a business that is close to a failure, PE investor will aim to evolve the business by preserving strict management, offering schemes and tactics that will give value to the business".[29] Therefore, PE ensures to create value for the illiquid stocks. The art of PE is to invest in the right companies, and then successfully provide guidance to optimize their chances of being successful. Moreover, it can be denoted that it is private, because the funds are mainly interested in acquiring a private company that has not

[24] Eileen Appelbaum, Rosemary Batt, 'Private Equity: Investors as Managers' in Russell Sage Foundation (eds), *Private Equity at Work* (2014).
[25] Ibid.
[26] Ibid.
[27] Alexandros Seretakis, 'A Comparative Examination of Private Equity in the United States and Europe: Accounting for the Past and Predicting the Future of European Private Equity' (2013) Fordham Journal of Corporate & Financial Law.
[28] Ibid. 619.
[29] Ibiid. 619.

been listed on the stock exchange, and equity is because private equity funds invest in and acquire the equity securities of investee firms.

Black's Law Dictionary defines private equity as "funds invested in a new enterprise that has high risk and the potential for a high return"[30]. It shall be denoted that PE plays a pivotal role in the market exactly because they are willing to provide financing to promising but high-risk ventures that normally would not be in the position to raise capital either from the banking industry nor on the capital markets. Without access to affordable financing, they are doomed to fail, notwithstanding that they possess a promising product, software, or a business model that has great potential. However, if it succeeds, there is a promise of high reward, for instance in the case of technologically innovative ventures, because new technology can produce new marketing concepts and possibilities.

In the Australian case of ***Bruce Parncutt Ltd v Lon Capital LLP***, the definition of "private equity" was examined. It was held that "private equity" makes it clear to refer to "investment services". Additionally, it was determined that "private equity" is "the provision of equity capital by financial investors – over the medium or long term – to non-quoted companies with high growth potential and with the aim to put talent and strategy to raise the value of the company".[31] This case enriched our definition by adding to further components: "medium or long term" investment time span as well as the "talent and strategy" that is necessary for the growth of the company.

What is crucial here, however, is also that PE is a limited time investment. Consequently, after a couple of years, when the goals and aims of the investor are fulfilled, they exit the investment through an initial public offering (IPO), trade sales, secondary sales,

[30] Garner, Bryan A, Henry Campbell Black (n 3).
[31] *Bruce Parncutt formerly Lion Global Investors Ltd v Lion Capital LLP* (2013) ATMO 60.

or through tag along and drag along clauses. Now, we will turn to the question of how PE ventures are structured.

2.2.2 Structuring Private Equity Firm Ventures

The fund may differ extensively in terms of the size and types of investments into which they enter and some might adapt to certain types of companies in which they will invest.[32] The "PE is comprised of venture capital, development capital, mezzanine capital, leveraged buyouts (LBO) and distressed investing".[33] They form a special purpose vehicle (SPV) - "a financial institution responsible for the asset management of a portfolio"[34] (*Angola v. Perfectbit Ltd*) through which they invest money into the investee firm.

Yet, the structure of the fund will normally remain the same, a limited partnership.[35] This form has been exploited not only in the U.S. but globally as well. "Private equity firms are normally formed as a limited partnership (LP) or limited corporations (LLCs)".[36] In LP the requirement is to have one or more partners with, who are called "general partners"(GP).[37] The GP in PE fund will often be a special purpose vehicle (SPV) owned by the PE firm.[38] "The GP will normally invest equity into the fund for the purpose of securing its own interest with those of the fund investors".[39]

The other partners are the "limited partners", who invest in the partnership assets a certain amount of capital and thus possess the limited liability beyond the amount invested.[40] The legal relationship of the GP and the LP is governed by the partnership agreement, which

[32] Jennifer Payne, 'Private Equity and its Regulation in Europe' (2011) University of Oxford 40.
[33] Darek Klonowski 'Private Equity in Emerging Markets: Stacking Up the BRICs' (2011) 14 (3) The Journal of Private Equity 24-37.
[34] *Angola v. Perfectbit Ltd* (2018) WL 01967047.
[35] Jennifer Payne, (n 25).
[36] H. Kent Baker, Greg Filbeck, and Halil Kiymaz, *Private Equity: Opportunities and Risks* (2015), p.316.
[37] Jennifer Payne, (n 25).
[38] Ibid. 3.
[39] Ibid. 3.
[40] Ibid. 4.

stipulates the types of investment which will be made by the fund as well as other administrative costs.[41] Moreover, the GP is obliged to provide comprehensive and periodic updating to the LP about the contribution made by the fund.[42]

The tax authority of the US takes into consideration these limited partnerships and LLCs as "pass-through" stocks that are exempted from corporate income tax.[43] The profit that derives from the investment, is shifted to the members of the partnership and will be taxed only one time at the investor level, or in other words, the investors will be taxed on the normal returns to their investment only. Moreover, these characteristics of the limited liability grant the same advantages to the investors as of to the stockholders in case of a public company. Concerning the limitations, the LPs and LLCs are limited to merely make a capital investment.[44]

As a rule, each partnership invests for a limited period of time, normally, as the US literature stipulates, for up to 10 years, which is a time span deemed to be sufficient for the investors to realize their aims and goals.[45] Within the timeframe of three to five years, the process includes the investment made by the partners. Subsequently, the investments are operated, and then slowly liquidated. Hence, when they are liquidated, the limited partners will distribute the investment among themselves in the form of stocks or cash.[46]

Further, when the period of the investment stage is accomplished, the partnership managers normally elevate a new partnership fund.[47] Thereby, the managers are elevating new partnership funds roughly every three to five years and simultaneously, may manage numerous funds on their various stages.[48] Every partnership is legally distinct and are operated

[41] Ibid. 4.
[42] Ibid. 4.
[43] H. Kent Baker, Greg Filbeck, and Halil Kiymaz (n 36) 316.
[44] Ibid. 316.
[45] Calum Paterson, (n 7).
[46] George W. Fenn and Nellie Liang, Stephen Prowse, 'The Economics of the Private Equity Market' (1995) 168 Board of Governors of the Federal Reserve System.
[47] Ibid. 29.
[48] Ibid. 29.

individually. When the goals are accomplished, the investors will eventually exit the venture. Therefore, next, the investment process will be addressed, and then the exit strategies.

2.2.3 Private Equity Investment Process

Various researches have explored the mechanisms of the private equity investment process.[49] The researches follow contrasting systematic approaches in examining the stages of PE investment processes.

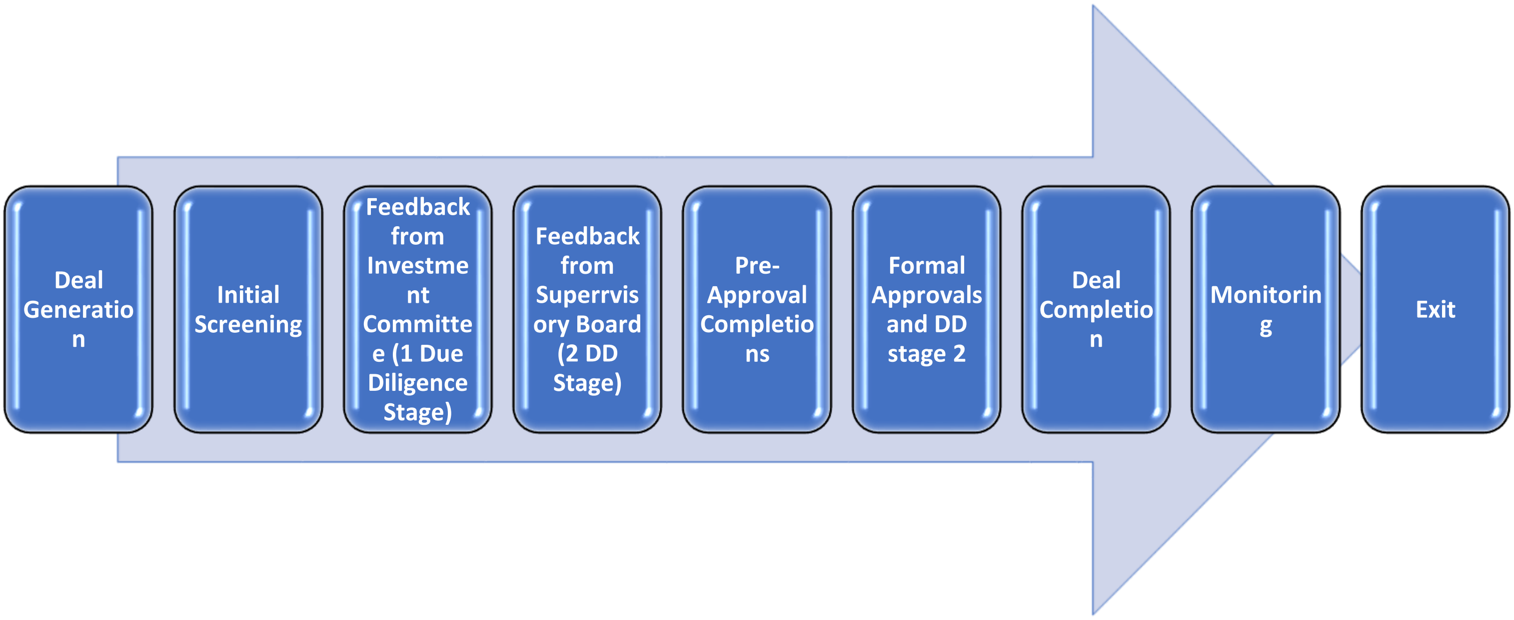
In 1984, one of the early efforts of discovering the PE investment process model was "deal origination, screening, evaluation, structuring, and post-investment activities, according to Tyzoon".[50] Later, by 1994, the practices and perceptions have changed. Hence, Vance and Robert were of the opinion that the investment stages are made of "origination, PE firm-specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing".[51] The issue concerning the latter model was that the stage of post-investment activities was removed. As a rule, all of the models contained screening and required an adequate "due diligence" stage.[52] A successful outcome gave rise to negotiations, the conclusion of the agreement, post-investment assessments, and value-creation and finally exit.[53]

The modern studies in the latter field have emphasized on the complications of the PE investment process in developing markets. According to Kolonowski, in the developing markets, PE investors are confronted with a compound operating environment, especially in Central and Eastern Europe (CEE), because of insufficient information about PE and lack of

[49] *See* Tyzoon T. Tyebjee, Albert V. Bruno (1984), Vance H. Fried, Robert D. Hisrich (1994). Steven N. Kaplan and Per Strömberg, 'Evidence on the Venture Capitalist Investment Process: Contracting, Screening, and Monitoring', University of Chicago (2020).
[50] Tyzoon T. Tyebjee, Albert V. Bruno, 'A model of Venture Capitalist Investment Activity' (1984) 30(9) *INFORMS*.
[51] Vance H. Fried, Robert D. Hisrich, 'A Model of Venture Capital Investment Decision Making' (1994) 23(3) Financial Management Association International.
[52] Yaw Brako Osei – Tutu, 'Private Equity in Ghana: An Analysis of Investments and Exits' 10205383 (University of Ghana Business School 2014).
[53] Ibid. 19.

formal business and records such as "business plans, financial reports, and others".[54] These challenges entail a higher degree of "information asymmetry" and as regards the "weaker legal infrastructure", it might lead to a more complicated process.[55] Klonowski suggests a nine-stage model that was based on the former five-stage model by Tyzoon (1984) and Vance (1994) and strives to address the complications related to PE investments as in CEE as well as other developing markets.[56] Figure 1, that was adopted from the research paper - *"Private Equity in Ghana: An Analysis of Investments and Exits"* illustrates the nine – model stage.

Figure 1. Nine-Stage Model of Private Equity Investment[57]



2.3 Private Equity Success Cases

2.3.1 Express Life Insurance Company Ltd (Ghana)

The case of *Express Life Insurance Company Ltd (Ghana)*, is an illustration of a successful investment process in Africa. In the case, the PE company, Leapfrog invested in the Ghanaian Express Life Insurance Company Ltd in exchange for a majority stake in the company.[58] It invested $5.5 million in the investee firm to meet the enhanced minimum capital

[54] Ibid. 19.
[55] Ibid. 19.
[56] Ibid. 19.
[57] Ibid. 19.
[58] *Express Life Insurance Company Ltd. (Ghana) 2013*

requirements and increase value with the help at the board and operations levels, and thus, support the investee firm to reach more unprivileged Ghanaians.[59] In other words, the Express Life expanded its customer base primarily by introducing new insurance products that provide service to the low-income Ghanaians.[60] It created partnerships, the top management developed and within a year of the investment, the investee firm expanded staff five-fold, while establishing five new branches and few sales offices.[61]

2.3.1 United Enviotech Limited (China)

The case of *United Enviotech Limited (China)*, is another illustration of the investment process, PE firm KKR supporting an investee firm UEL. In this case, the PE firm, KKR invested $113,8 million in convertible bonds and represented 38% of share capital. Thus investing in the investee firm, assisted UEL in securing the long-term debt financing needed in order to help with its expansion.[62] Moreover, it contributed to an acceleration in UEL's by granting growth capital and operational improvements.

Therefore, a lesson from the above cases is that PE investors help and facilitate investee firms to grow. Hence, in order to preserve this growth, the investors shall be assured of an easy exit.

2.3.3 Case Źabka (Poland)

The case of *Źabka (Poland)* is another success story, illustrating how PE investor firm PineBridge supported Źabka, by investing US$24 million into business and acquiring 46% of the stake at Źabka. managed to restructure the investee firm and put it on the path of success.[63] With the help of PineBridge, Źabka developed its stores and increased its revenue.[64] Moreover,

[59] Ibid.
[60] Ibid.
[61] Ibid.
[62] *United Enviotech Limited (China) 2012*
[63] *Źabka (Poland) 2000*
[64] Ibid.

PineBridge assisted to increase sales per store by “spreading the product mix, improving inventory management, and seeking an advertising campaign”.[65] With the engagement of PineBridge in Źabka, it reorganized and eliminated the costs of store owners (“Agents”) and company management (“Partners”), thus reducing the store operating costs. Therefore, Źabaka case could serve as another successful example that allowed investors to invest and easily exit after accomplishing the goals.

[65] Ibid.

CHAPTER THREE: STRATEGIES FOR A PRRIVATE EQUITY INVESTOR TO EXIT

§ 3.1 Exit Rights Studies

As they invest in an investee firm, private equity investors are concentrated on their exit. Exits may also be referred to as divestments. For investors, the exit is an accomplishment of their aims when it is receiving a return in the form of money commensurate to the risks that it accepted and can also gain future opportunities for investment.[66] There are different types of exit routes available, such as initial public offering (IPO), secondary sales, trade sales, etc. Although practice demonstrates that IPO is the most common used avenue to exit the investment, that does not mean that it is effortless, whereas trade sale, ‘tag along’ ‘drag along’ clauses allow the simplest way to exit.

In this chapter first, the types of exit rights will be analyzed in general and then the focus will be on trade sale - the most essential ‘tag along’ ‘drag along’ clauses.

3.1.1 Initial Public Offering (IPO)

Professors H.Kent Baker, Greg Filbeck and Halil Kiymaz, in their book “Private Equity: Opportunities and Risks”, define IPO as “the method in which the stocks of the company get listed on the stock market for the first time”.[67] The exit route proposes to the PE firm to leave the investment by selling the stocks of the company in which it has invested. The authors believe that IPOs are well-known exit routes for the PE firms in the United States and countries where there is a working capital market. The reason is that, when the stock market is “bullish,” and is escalating, the proposed type of exit right can possibly permit the retailor to

[66] Sanusi Bintang, (n 2)
[67] H.Kent Baker, Greg Filbeck and Halil Kiymaz, (n 23) 221.

realize the highest return on the investment made, which makes it convenient for major or high performing investee companies.[68]

As opposed to that, the authors claim that the presented type of exit right can entail enormous transaction costs because of the legal restrictions and the requirements of the supervisors of the market.[69] Those legal restrictions derive from the Securities and Exchange Commission (SEC) in the United States.[70]

The PE firm can exit partially or fully. In case the PE firm decides to exit the investee company fully, potential investors may consider this full exit suspicious and lose confidence in the forthcoming perspective of the business.[71] Hence, the requirements of the IPO may not allow the investors to exit a few or all of their position for a time period referred to as a *lock-up period*.[72] The IPO factors may create a long and costly process for investors to exit.

3.1.2 Secondary sales

A secondary sale is known as an acquisition. In other words, buyers of this type of sale are known as strategic acquirers. An investor or PE firm sells its interest in the company to a different investor. Buyers in a secondary sale are known as strategic acquirers and sometimes venture capitalists.[73] "However, buyers of a secondary block usually do not have the bargaining power of a 100% acquirer to attain full inside information."[74] Obviously, here it can be denoted that it mostly depends on the facts. If the seller sells a majority of controlling block, it normally has a passage to internal information that is to be offered to potential buyers. In case of selling the minority, the PE investor might not be in a position to rely on the help of the board in

[68] Ibid. 221.
[69] Ibid. 221.
[70] Ibid. 221.
[71] Ibid. 221.
[72] Ibid. 221.
[73] Douglas J. Cumming and Jeffrey G. MacIntosh, 'Venture-Capital Exits in Canada and the United States' (2003) 53 (2) The University of Toronto Law Journal 101-199.
[74] Ibid. 118.

receiving and exercising corporate information to sell its interest.[75] However, it is highly possible that the secondary purchaser will not buy an enterprise without the help of the entrepreneur and other owners.[76]

In the case of secondary sales, the "transaction synergies", the overall value and performance of two companies together being greater, are less possible to obtain.[77] While the buyer might have similar capabilities as a strategic acquirer to resolve the information asymmetries, it fails to transfer to the buyer the same unrestricted rights, to integrate and unite the assets of the target company and the assets of its own company.[78] In case the buyer buys the majority of the interest of a certain companies, it may not be able to deal with the control and monitoring because of the threat of accusations by minority stockholders.[79]

Based on these reasons, secondary sales are in a position to acquire a considerably lower purchase price and hence gain lower returns. Secondary sales are not commonly exercised in the private equity market. Therefore, they will not be tackled in deep, as the main concentration of this research is tag along and drag along clauses.

3.1.3 Trade Sales

The PE firm can benefit from the investment made in the investee company by trade sale to a strategic acquirer.[80] Normally, the strategic purchaser is a non – PE firm and the acquisition is beneficial to the purchaser's strategic interest, whether the incentives of its own may involve 'growth of the company', 'innovative products' or expansion.[81] "The acquirer may be the investee company itself, that involves redemption, meaning, repurchasing its own

[75] Ibid. 118.
[76] Ibid. 118.
[77] Ibid. 168.
[78] Ibid. 168.
[79] Ibid. 168.
[80] H.Kent Baker, Greg Filbeck and Halil Kiymaz (n 46) 220.
[81] Didier Fouls, Emmanuel Boutron, 'Exit Strategies in Private Equity' (2015) University Paris Nanterre.

stocks from the PE firm or fund".[82] The purchaser anticipates a greater relative advantage and share of the market with an intention to keep the acquisition for a longer duration.[83] In this regard, the purchaser consents to pay the costs of the strategic choice that is stipulated in the target price and expects greater revenue in the future and hence pays a larger amount for it.[84] Based on this, the trade sale offers the highest price and permits the PE seller instant liquidity.[85]

Further, another benefit deriving from trade sale is that negotiations are conducted with only one purchaser. This enables a speedy and efficient process that does not include the strict regulatory requirements as opposed to IPO, where those restrictions are present.[86] Accordingly, as the most efficient way for a private equity firm, the investor, serves to sell to a strategic buyer, as it grants certain rights to the PE firm, the investor.

[82] Ibid. 220.
[83] Ibid. 220.
[84] Ibid. 220.
[85] Ibid. 220.
[86] Ibid. 220.

CHAPTER FOUR: "TAG ALONG" AND "DRAG ALONG" CLAUSES, ADVANTAGES AND DISADVANTAGES OF EACH

§ 4.1 Introduction

Tag Along and Drag Along rights are the tools that safeguard the investors easy and fast exit from their investment.[87] Often time, the private equity investors and entrepreneurs conflict of interests, when forming their legal relationships and later during the PE investment.[88] In private corporations, the stocks are more often held by the several stockholders, who also might be the directors of the company.[89] This might cause an imbalance between the internal governance of the corporation and oftentimes, might lead to abuses of minority stockholders and further to deadlocks in exiting the investments made.[90]

Although IPO was and is still the most commonly used avenue for the company to become public and sell its stocks, trade sale is the avenue that is being used in the vast majority of cases. In the US, one of the most effective ways for the investors to secure exit from their investment is acquiring contractual rights which will assist to sell their stocks of the business in a trade sale.[91] These rights are known as tag along drag along rights. This chapter of the paper will focus on the analysis of the above-mentioned clauses, what rights are granted to the private equity firm under tag along and drag along clauses, and the practical evidence that denotes the flow of this exit strategy.

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87 "Drag Along/Tag Along Rights", Financial Advisors Limited, EURO-PHOENIX, (2020) <https://europhoenix.com> accessed 24 May 2020.

88 Suren Gomtsian, 'Private Ordering of Exit in Limited Liability Companies: Theory and Evidence from Business Organization Contracts' (2016) 53(4) American Business Law Journal.

89 Jelena Pajic, 'Share Transfer Restrictions and Exit Mechanisms in Shareholders' Agreements' (2012) 7 GSI Articletter 21.

90 Ibid. 21.

91 Keneth J Lebrun, 'Making a Private Equity/Venture Capital Investment in Japan: Implementing Techniques Commonly Used in U.S. Transactions' (2002) 23 U Pa J Int'l Econ L 213'.

§ 4.2 Overview of Tag Along and Drag Along Rights

The tag along and drag along grant the simple way to exit the investment while balance each other out and grant control to private equity firms, the investor. Hence, such rights need to be included in the PE stockholders' agreement executed between the majority and minority investors at the time of the conclusion of the agreement. Stockholders' agreement, can broadly be denoted as "written or unwritten agreements among stockholders, whereby the parties to the include reciprocal rights and obligations in addition to constitutional documents of the corporation".[92] As it has been defined in the case of *Galler v. Galler*, "the stockholder agreement, as a separate, additional, contractual arrangement among the stockholders outside the articles of association, operating as a conventional agreement"[93], allows the parties to agree to any provisions that they desire to stipulate in it. As regards the tag along and drag along rights, it is for the interest of the investor to embed it into the agreement in order to ensure fast and easy exit accordingly.

4.2.1 Analysis of "Tag Along"

Tag along rights or contractual co - sales rights are designed in favor of the minority stockholders against the majority stockholders, in the sale of interest to the third party. It is a right of the stockholder, who is planning to sell its interest to an outside investor, to require the other stockholders to take part in the transaction. The tag along gives the investor the right to sell a pro-rata portion of its stocks to the same purchaser at the same price and at the same terms, or in other words, exit with the other shareholders.[94]

There are two main differences of the tag along right, with various influences on the seller and the third-party buyer.[95] The first difference is that the third-party buyer, after

[92] Jelena Pajic, (n 89)
[93] *Galler v Galler 38475 Supreme Court of Illinois (1964).*
[94] Jelena Pajic (n 89)
[95] Suren Gomtsian (n 69) 700

purchasing the large interest of the company, has to expand the offer to the other stockholders on these same terms and this is known as a full tag along right.[96] The second difference is that it does not require the third-party purchaser to make an offer to all the company units. However, if the tag along right holders intends to take part in a third-party transfer, then the selling stockholder is obliged to diminish its stocks in the transfer and give a chance to holders of tag along right to co-sell their interest, based on a pro rata – a proportional tag along right.[97] As a consequence, the selling majority, as opposed to cashing out its investment fully, it might become a minority investor together with the others.[98]

The stockholder intending to sell its stake must give a notification to the stockholder that is entitled to the tag along right of the proposed sale.[99] Consequently, the latter stockholder will have enough time to consider, whether to exercise the tag along right or not engage in the sale transaction. Thus, if it decides to exercise the right, then the selling stockholder will conduct negotiations between the parties in order to encourage the buyer to purchase both of the stockholdings.[100]

The conceptual models predict that the size of the controlling block impacts the incentives of a controlling group for private benefit extraction.[101] This entails that the smaller the size of the company, which the outside buyer wants to take control of, the higher is the incentive for extracting private benefit of control. The private benefit of control is the economic gain by the influence of the majority stockholders.[102] The low economic benefit permits to share the costs of private benefit extraction with another investor.[103] As opposed to that, investors with high revenue take up the costs because of self-interest and hence they extract

[96] Ibid. 700.
[97] Ibid. 700.
[98] Ibid. 700.
[99] Jelena Pajic. (n 89).
[100] Ibid. 22.
[101] Ibid. 700.
[102] Michael J. Barclay, Clifford G. Holderness, 'Private Benefits from Control of Public Corporations' (1989) 25 Journal of Financial Economics 371.
[103] Suren Gomtsian (n 69) 700.

less private cost-benefit.[104] A tag along right intervenes in this case in order to resolve the issue. The full tag along obliges the outside investor to purchase greater interest than needed for actual control, because the offer has to be provided for the other stockholders at the same terms and conditions.[105] Additionally, often time, investors are ready to pay a higher prices, when they attain control of a company.[106] Consequently, the incentives to extract private benefits are reduced and the increased revenue incentives become much stronger.[107]

A proportional tag along right grants incentives to manage checks of a purchaser or confront the risk to become an unprivileged minority compared to the new investor that will take control.[108] The selling majority is intending to sell in cases, where the buyer by no means is destroying the value of the firm and is intending to buy all the company units.[109] Both the above-mentioned differences of tag along rights allow the investor, who is a holder of such right, an easy exit before any further issues arise. Hence, tag along rights avoids "value-decreasing control transactions" in which the benefit of selling party and the purchasing party comes on the account of another investor.[110]

Additionally, tag along rights attract investments by the contracting parties.[111] Often time, the contractual agreements offer the parties specific rights, that are not granted by statutes or charters of the firms. Hence, they assure protection to the interests of the parties involved. However, as such, the rights cannot be extended to the third parties' obligations, unless the assignment of agreements appears, which is the transfer of the rights to the third party.[112] Accordingly, the third party might pull out more private benefits as opposed to the previous

[104] Ibid. 700.
[105] Ibid. 700.
[106] "Drag Along/Tag Along Rights", (*Financial Advisors Limited, EURO-PHOENIX,* 2020) <https://europhoenix.com> accessed 24 March 2020
[107] Suren Gomtsian (n 69) 700.
[108] Ibid. 701.
[109] Ibid. 701.
[110] Ibid. 701.
[111] Ibid. 701.
[112] Ibid. 701.

majority investor. This denotes that the controlling stockholder can be in a position to threaten selling to the third party, with the purpose of utilizing its own position.[113] Whereas, in spite of the lack of self-interest of the controlling stockholder, the unclearness caused due to the value-decreasing control may discourage the primary investment.[114] As a result, tag along rights proposes an exit possibility in case the third party refuses to engage in the agreement. This possibility is essential for the planning of the investment, for the reason that, without specific rights, the investment might not have value.

Tag along rights are an alternative for the protection of the rights of the investors.[115] In small companies, for instance, up to 19-15 people, minority co-sale rights are served as the fiduciary duties exemption of the directors and members and also grant essential decision-making rights to the majority stockholders.[116] Whereas in the event that the controlling stockholders lack fiduciary duties to minority stockholders in trading of the control transaction and minority stockholders are unable to stop the transaction, the tag along would be the only way to protect the minority stockholders in the deal.[117]

4.2.1.1 The Case Infosage v Mellon Ventures

This case illustrates that directors are to exercise a fiduciary duty to their investee firm. Infosage Inc., as a "software development company at the early stages of the business, received financing from its founders of about $5 million, and the second rounds were through PE funding, by investing $5 million, for the development of the services and products".[118] Mellon Ventures L.P., was the investor that offered to finance and Charles J. Billerbeck was the managing director, who then joined the Infosage BoD.[119] Infosage created a business strategy

[113] Ibid. 701.
[114] Ibid. 701.
[115] Ibid. 702.
[116] Ibid. 702.
[117] Ibid. 702.
[118] *Infosage INC v Mellon Ventures, 896 Superior Court of Pennsylvania (2006).*
[119] Ibid.

for the third-round financing, needed for its marketing phase, however, it was not successful and it filed a suit in the court of bankruptcy.[120] Infosage accused Billerbeck, claiming that it had interfered with the actions of Infosage when it contacted the other PE firms for third round financing but Mellon blocked them to invest in Infosage. Moreover, it claimed that Billerrbeck violated its fiduciary duties.

The court held that there is no breach of fiduciary duties and “directors are to devote themselves to the corporate affairs with a view to promoting the common interest and not self-interest, and they cannot either directly or indirectly, utilize their position to obtain any personal profit or advantage other than that enjoyed also by their fellow shareholders”.[121] Thus, the case pinpoints that based on the tag along right, the directors, Billerbeck acted based on the common interest with Infosage and not separately their personal interests.

4.2.2 Analysis of “Drag Along”

A drag along right permits the holder, the main seller of the company, often the majority stockholders, to condemn the other investors to exit/sell along with the drag along right holder under the same terms and conditions, to a third party.[122] The present right expands the level of control of the seller, assists “control transactions” via expanding the benefits of a purchaser, and prescribes “relationship-specific investments”.[123] The rationale of the right at stake is that “a business might possibly be sold in its entirety or at least to the extent that grants the purchaser sufficient stocks to acquire an essential control of it”.[124] In a case, when the majority stockholder decides to sell the business, they can fully take control and force the other investors

[120] Ibid.
[121] Ibid.
[122] Ibid. 705.
[123] Ibid. 705.
[124] Jelena Pajic, (n 89).

to join them in the transaction, thereby assure that the purchaser obtains 100% of the corporation.

With regards to private equity investors, "drag along rights are a sine qua non for any investment"[125]. Or in other words, drag along rights are an absolute necessity for any investment made by a private equity firm. A stipulation of drag along in the stockholder agreement is vital when selling a company because buyers normally seek total control of the company. Sometimes, the private equity firms consider these rights as "nuclear option", because it grants them complete control of the company, aids excluding minority stockholders, and sells all the outstanding stocks. Moreover, it helps to prevent the troublesome minority stockholders from postponing or stopping the business deals, for instance, mergers or sales of the assets of the company.[126]

From the point of view of the majority owner, or the seller, drag along permits to sell extra interest as opposed to what the seller in fact possesses, by including the interest of the other stockholders. In terms of the "activation threshold", determining, when can the majority use the interest of the minority, this may change the small holding into a "controlling package".[127] Hence, drag along right facilitates attaining the best value for the interest of the seller regardless of the desire of the minority.

With regard to the purchaser, the primary advantage is that the buyer does not have to engage in the high-priced negotiations with each minority stockholders when establishing control. The intent to obtain the company or fully control it entails a few privileges. One is that an investor by using its freedom of holding back from selling can use it as a strategic plan, in order to increase the value of the company in the future and demand a higher price.[128] However, drag along forbids such a self-interest attitude. Another is that the minority investor may cause

[125] *EURO – PHOENIX* (n 87).
[126] Jelena Pajic. (n 89).
[127] Suren Gomtsian (n 69) 705.
[128] Ibid. 706.

extra costs and risks to the purchaser.[129] Yet, realistically, these costs are higher in the listed firms, for the reasons that they confront additional costs while consenting to the regulatory and listing conditions.[130]

Additionally, when preventing the self-interest, of minority investors in obtaining the increased value, the drag along right condemns the parties to the contract, maintain the agreed stocks of the payoff.[131] When there does not exist a drag along right, the minority investors can demand an increased payoff. Thus, this holdup risk may not benefit the purchaser and in order to further continue with the deal, the majority seller will be obliged to share a portion of its initial payoff with the minority.[132] As a result, in order for such complexity not to become a problem during the exit of investors and attract investment opportunities, the holdups should be avoided.

4.2.2.1 Case Minn. Invco of RSA #7 Inc. v. Midwest Wireless Holdings LLC

This case is an illustration of the importance of exercising the drag along rights by the majority investors, which was decided by the Court of Chancery of Delaware, New Casttle. In this case, "the plaintiffs, the minority stockholders of the limited liability company (LLC) alleged that the right of refusal contracted in their LLC operating agreement, forbid selling the parent company to the third party, without first offering them a right to buy the interest of the parent company in the LLC".[133] The right of refusal is designed to ascertain that the majority, seller, will give a chance to the other party, the minority, to match the price that was proposed to the buyer. Consequently, the defendant responded that they had the drag along clause in their agreement, thus the right of refusal is in conflict with the drag along clause. As a result, the

[129] Ibid. 706.
[130] Ibid. 706.
[131] Chemla, Gilles; Ljungqvist, Alexander; Habib, Michel, 'An Analysis of Shareholder Agreements' (2007) 5(1) Journal of the European Economic Association 107.
[132] Ibid. 108.
[133] *Minn. Invco of RSA #7, Inc. v. Midwest Wireless Holdings, LLC, 903 Court of Chancery of Delaware (2006).*

Court held that "the minority interest holders did not have a right of first refusal with respect to the third-party transaction and the parent company could assert its drag along rights to complete the transaction".[134] Therefore, as it has been analyzed, the drag along rights will allow the investor to control the sale transactions with the purchaser, and thus, it ensures easy exit for the investor.

4.2.2.2 Case Haplin v. Riverstone Nat'l, Inc.

This case illustrates the importance of the notification by the majority stockholders in the event of exit though drag along rights. It has been denoted that the majority stockholders can enforce the minority to exit, however, they have to properly notify the minority stockholders.

This case was decided by the Court of Chancery of Delaware, where the court denied the implementation of drag along right, where the minority stockholders were not provided a proper notification after the approval of the majority stockholders.[135] The court emphasizes the significance of compliance with the stockholder agreement when exercising drag along rights.[136]

In this case, the majority stockholders of Riverstone accepted the acquisition of the company through a merger, by written consent.[137] In the stockholder's agreement, there was a stipulated drag along clause that obliged the minority stockholders to agree to change of control in the company if the majority approve the deal.[138] Consequently, shortly after the merger happened, the majority stockholders provided information to the minority stockholder and required them to consent to the deal, however, they brought a claim against Riverstone claiming

[134] Ibid.
[135] *Halpin v. Riverstone Nat'l, Inc., 49 Court of Chancery of Delaware (2014)*
[136] Ibid.
[137] Ibid.
[138] Ibid.

for appraisal rights of their common stock in Riverstone. The company asserted that the minority stockholders waived their appraisal rights on the basis of drag along clause contained in their stockholder agreement.[139]

The court rejected the claim of the company concerning the waiver of the rights of the minority stockholders, as a result of drag along clause. The court held that the drag along clauses would have waived the appraisal rights in an event when the minority stockholders would take an action.[140] However, in this case, the minority stockholders did not take any actions or give their consent, but the majority proceeded with the deal unilaterally.[141] Therefore, it is essential by the majority stockholders to make an informed decision about certain transactions, in order for the drag along right to be effective and implementing. It can be concluded that the majority of stockholders can defend themselves by the drag along right. They can command the minority, either demand their consent or vote, to exit from the transaction, but cannot proceed with the deal without properly informing the minority.

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[139] Ibid.
[140] Ibid.
[141] Ibid.

CONCLUSION

§ 4.1 Conclusion and recommendations

The United States has the leading market of PE investments. It is a location with one of the most successful PE firms that raised a great deal of capital. At a particular point in time, the US private equity development and expertise would become a lesson for the Central Asian countries, to realize dealing with the challenges of organizations and taking meaningful advantages of the opportunities, if provided by investment firms. The ideas and startups, that are in desperate need of capital to transfer the business into a reality, or the entrepreneurs that cannot manage the loss of value of a company and require financial assistance to bring the business to life again, will require a good knowledge and experience in the field of PE.

In contrast with the regular commercial companies, in the life of PE firms of key importance are the available exit strategies as PE as a rule invests for a limited number of years. This entails that, the outcome of the investment in the business, or in other words, the money that was generated from the business will determine, whether the goals of the investor were achieved or not. At this point, if a Central Asian country wants to attract foreign PE investors, the last should have clear and easily enforceable rules on these. From among the known strategies, tag along and drag along clauses stand out.

For Central Asian counties, a lesson to learn from the US PE industry is that tag along and drag along are deemed to be effortless way to exit the investment. These rights allow the minority and majority stockholders to balance their interest in the event of the sale transaction. In favor of the majority, the drag along will serve to compel the minority to sell their stake, and this way the majority will be able to sell the company 100 percent. Whereas, the minority can use the tag along right to ensure that its interest is being considered and it can sell its stake together with the majority stockholders at the same price and terms. In US practice, thee use of the mentioned clauses has become most favorable. Whereas, outside the US, because of having less information about the tag along and drag along rights, in practice, the clauses are not used by the investors. Nevertheless, this does not mean that there are do not exist issues using the above-mentioned rights by PE investors. As it has been discussed and seen from the case law, in the analysis part of tag along and drag along, problems may surface.

Sometimes, the minority stockholders may exercise the right of refusal while tagging along.[142] As it has been mentioned, tag along right limits the minority stockholders to oppose the sale or the transaction. Sometimes, this might cause a problem of the right of refusal. Based on this right, the minority stockholders can enter into the transaction before the majority has entered. Or in other words, the minority can offer the first opportunity of selling the stocks without considering another offer.

In these circumstances, it is essential for the majority stockholders to negotiate the interests and the ultimate benefit that both the minority and majority stockholder, will receive after the sale transaction. Notwithstanding, the tag along right can only benefit the minority stockholders because they will sell their stocks at the same terms and at the same conditions as the majority.

On the other hand, when exercising drag along right, the majority stockholders have to give proper notice to the minority stockholders about the sale. As has been discussed in the case of *Halpin v. Riverstone*, in the analysis part, the court held that the drag along right cannot be exercised, due to the fact that, the minority stockholders were not properly notified about the sale until it took place.

Thus, as important the drag along right is for the majority stockholders, the uncooperativeness of the minority stockholders may be a major problem. Therefore, the holder of a drag along right has to comply with the conditions and procedures, of drag along clauses,

[142] Chamber of Commerce, 'Comprehensive Guide to Tag Along' <https://www.chamberofcommerce.org/guide-to-tag-along-rights > accessed 27 May 2020.

such as providing proper notice to the minority stockholders about the next transaction, in order to ensure clear and quick exit from the investment.

Based on the above-mentioned implications and recommendations, if Central Asian countries desire to attract foreign PE investors, the law has to be clear and transparent. Because the investors favor understandable terms and laws as well as disclosure. When the investors will feel the confident about certain market, there is less doubt the investment process will take place.

Additionally, incorporating the type of exit strategies in the bylaws or stockholders' agreements can ensure protection to the investors and thus attract financing. Before providing capital to certain business, the investors demand security. When the stockholder's agreements include the protective measures, there is more possibility for them to take the risk and invest capital into a startup or other business to make revenue and develop the business.

Finally, effective control by the stockholders can lead to enforceability of the tag along and drag along exit strategies. Particularly, in case of drag along, the selling investor might take control over the stocks of the other stockholders and supply them to the buyer. One might think this action cause issues, but it guarantees easy exit to investors and might become a useful and effective tool to develop businesses and attract PE investors.

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