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Redeemable shares: need for regulation?

Share redemption consists of the payment of the value of stocks upon their cancelation, with or without a capital reduction. It is a unilateral decision of the corporation, which may be regulated in the company by-laws or approved in a special general shareholders' meeting.

The redemption of stock may serve different purposes. It may facilitate the return of investment in stocks. It may be used to guarantee remuneration to certain groups of shareholders due to their respective contributions to corporate activities or as a means of attracting investments for a fixed term. It may also be considered as compensation for conditions to which preferred shares are subject. It can be implemented in simple governance structures and in complex financing of structured projects.

Brazilian Corporate Law presents two protective measures. First: drawing of lots, which shall be performed whenever the redemption doesn't involve all of the shares of the same type and class. Second: the redemption of shares of a certain class should be approved by shareholders representing at least half of the shares of that class, in a special shareholders' meeting.

Brazilian corporate legislation was silent concerning valuation of shares that are redeemed. The inexistence of pre-determined criteria may result in abuses on the determination of the redemption price, to the detriment of the company or of the affected shareholders.

The by-laws of the company may set forth in detail rules concerning the redemption price (there are several admissible criteria, such as discounted cash flow, book value and economic value). In this case, the shareholders consent in advance to the criteria for such valuation, and are therefore not entitled to questioning the value later. In case the by-laws contain no provisions on the matter, the redemption must follow a fair price. However, what would a fair price be?

In cases where no criteria are set in the by-laws, the Brazilian Securities Commission (*Comissão de Valores Mobiliários* - CVM) has pronounced that management shall propose criteria that result in a fair redemption price and shall justify the economic aspects that determined their choice. The Brazilian Superior Court of Justice (*Superior Tribunal de Justiça* - STJ) has determined that the price should consider the company's net worth, as calculated based on the market value of its assets and liabilities.

As a measure to avoid abuses and losses to shareholders and/or to the company itself, the adoption, in the company by-laws, of well defined and objective criteria for the determination of the redemption price is deemed good practice.

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