



HOW CAN SHAREHOLDERS' AGREEMENTS SHAPE CORPORATE GOVERNANCE AND DIRECTORS' LIABILITY?

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Overview

- ▶ **I. Contract law or state corporate law- which one gave birth to modern companies?**
 - ▶ **II. Shareholders agreements vs. articles of association**
 - ▶ **III. Can shareholders' agreement affect corporate governance of the company?**
 - ▶ **IV. Can shareholders' agreement affect directors' liability?**
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I. Contract law or state corporate law- which one gave birth to modern companies?

CORPORATE LAW

- Company created by state legislator
- Legal personality + asset partitioning
- Automatic „upgrades”

CONTRACT LAW

- Company created by parties' will
- „nexus of contracts”
- articles of association as fundamental contract
- other contracts between shareholders



II. Shareholders agreements vs. articles of association

Can parties and content of shareholders' agreement and articles of association overlap?

Can shareholders' agreement modify the articles of association?



Can parties and content of shareholders' agreement and articles of association overlap?

ARTICLES OF ASSOCIATION

- articles of association includes all current and future shareholders, and obliges all shareholders

- Mandatory content

SHAREHOLDERS' AGREEMENT

- SA does not have to include all shareholders, and obliges only shareholders which are its contractual parties
- Third persons as contracting parties of the SA
- A manager/shareholder or a manager who is not a shareholder as contracting parties of the SA
- Company itself as a contracting party
- No or only a few limitation to the content

Total or partial overlapping of the parties!

Possible overlapping of the content! SA cannot replace the articles of association!

Can shareholders' agreement modify the articles of association?

FOR

- articles of association as a contract?
- consent of all shareholders?
- mandatory and facultative provisions of articles of association
- Facultative contractual clauses?

AGAINST

- Formal modification of the articles of association
- articles of association and its amendments are publicly available
- Prevailing opinion is that breach of SA, for example of the voting agreement, does not affect the validity of shareholders' actions in the general meeting of the company

III. Can shareholders' agreement affect corporate governance of the company?

- ▶ SA are mostly used in privately held companies, but possible for public companies as well
 - ▶ Most common goal from several studies:

I. Obtain **control** of certain shareholders over the election and composition of the board of directors.



III. Can shareholders' agreement affect corporate governance of the company?

Can shareholders modify default corporate rules equally by articles of association and by SA?

Can shareholders modify the mandatory corporate rules by SA that they could not by the articles of association?



Can shareholders modify default corporate rules equally by articles of association and by SA?

LIMITATIONS

- Mandatory corporate rules
 - shareholders can modify certain rights only via articles of association (in Croatian law: e.g. restriction of the transfer of the shares)

LEGAL EFFECTS

- SA - binding effect only on shareholders - contractual parties
 - legal actions of the shareholders on the general meetings contrary to the SA shall be valid

Shareholders can make almost all modifications of the default corporate law provisions by the SA, but with a binding effect only to shareholders – contractual parties!

Can shareholders modify the mandatory corporate rules by SA that they could not by the articles of association?

▶ **SEPARATION OF THE VOTING POWER AND CONTROL**

- ▶ minority shareholders can agree to vote as a block for election of a certain director and obtain voting control which they otherwise would not have
- ▶ the nomination of the exact person who shall act as a director in voting agreements between shareholders



the rise of the stealth governance

IV. Can shareholders' agreement affect directors' liability?

- ▶ managers can be a contracting party of the SA, regardless of whether they are also shareholders of the company
- ▶ SA - composition of the board of directors
- ▶ SA – right to appoint and remove director – ultimate power over directors?
- ▶ obligations to act in accordance with the SA – restrictions for managers (especially in joint-stock companies)



IV. Can shareholders' agreement affect directors' liability?

Is it possible to modify the directors' liability through the SA?

- ▶ Directors' liability as mandatory provisions of corporate law
- ▶ EU countries - Directors bear unlimited personal liability
 - ▶ German law – many scholars call for modification of liability framework, the most repeated proposition is to extend the labour law principle to corporate managers and limit the amount of damages in cases in which the harm was caused by simple negligence
- ▶ USA – Delaware
 - ▶ limitation of the DUTY OF CARE - a charter provision that limits or eliminates certain director liability for monetary damages in duty-of-care claims, BUT no limitation of FIDUCIARY DUTY
 - ▶ From 2000 explicitly waive *ex ante* the doctrine of opportunities and its consequences for the directors and shareholders (under certain conditions)



IV. Can shareholders' agreement affect directors' liability?

- ▶ Does mandatory framework of managers and directors' liability equals to conclusion that managers cannot avoid their duty to compensate for damages?
 - ▶ D&O insurance policies
 - ▶ indemnification clauses
 - ▶ usually covers the cases when the liability is invoked towards the third person
 - ▶ inserted in the SA where the manager/director is also a contracting party or to assure shareholders that directors which they elect will be indemnified under certain conditions
 - ▶ State corporate law:
 - ▶ Director's action is based on a lawful resolution adopted by the general meeting
 - ▶ settlement of the claim to compensation of managers/directors in relation to the company



CONCLUSION

- ▶ shareholders can obtain a significant level of control over the management of the company through the SA
- ▶ Altering corporate governance through SA:
 - ▶ unequal treatment of shareholders in the company?
 - ▶ sacrifices transparency of governance of the company towards third persons?
- ▶ further empirical studies should be conducted in order to reveal the actual position of shareholders and third parties in cases when SA exists parallel to articles of association.
- ▶ reassessing the scope of desirable influence of contract law instruments on corporate governance of the companies by both scholars and state legislators.

